

Aeroflot Group

Aeroflot Group 6M 2018 IFRS Financial Results

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Edited Transcript

Speakers:

- Andrey Chikhanchin, Deputy CEO for Commerce and Finance
- Ivan Batanov, Head of Revenue Management
- Andrey Napolnov, Head of IR, Deputy Corporate Finance Director
- Artem Glaznev, Head of IFRS Reporting

Participants asking questions:

- Yulia Gerasimova, Goldman Sachs
- Michael Ganelin, Aton
- Alexander Kazbegi, Renaissance Capital
- Osman Memisoglu, Bank of America Merrill Lynch
- Olga Boltrukevich, VTB Capital

Operator: Good day, and welcome to the Aeroflot Group 6M 2018 IFRS Financial Results conference call. Today's conference is being recorded. At this time, I would like to turn the conference over to Andrey Napolnov, Head of IR. Please go ahead.

Andrey Napolnov: Good afternoon, ladies and gentlemen. Thank you for joining us on the call dedicated to Aeroflot Group 6M 2018 financial results. Here we have the following speakers: Andrey Chikhanchin, Deputy CEO for Commerce and Finance, Ivan Batanov, Head of Network Planning and Revenue Management, and myself. Let me remind you that the press release and IFRS statements are available on the website in the IR section. Before we start, I would like to draw your attention to the fact that the call may contain forward-looking statements regarding future events and performance, and actual results may differ materially from those expressed or implied in those statements. For further information, please refer to the disclaimer statement on the second slide of the presentation.

I would like to kick off the presentation with some highlights from our financial and operational performance in 6M 2018. In the discussed period, Aeroflot Group continued operational development by means of capacity expansion on the back of the opportunities provided by the positive market environment. Capacity growth of 8.5% allowed Aeroflot to increase the number of passengers transported by 8.2% as well as boost revenues by 13.2% on the back of growing yields, which showed positive dynamics in both domestic and international segments.

A few words on the market as usual. The market continued to grow in the first six months of 2018, even after the strong growth in the corresponding period of the previous year. Just to remind you, in 6M 2017, we posted a 22.6% growth. The recovery reflects an improved economic situation in Russia, an impact from the FIFA World Cup as well as the overall growth in capacity among Russian and foreign air carriers.

Aeroflot Group continues to consistently increase passenger numbers expanding in both international and domestic segments, but it grew below the market at the beginning of the year. The trend was reversed in May when Aeroflot Group matched the growth of the Russian airlines and in June when the Group's growth surpassed that of its Russian peers (11.4% vs. 10.4% for the market).

On the domestic side, the market saw a 10.4% PAX growth in 6M 2018, largely thanks to the increased demand in the local segment, with more than 25% of the domestic market growth contributed by Pobeda Airlines alone. In 6M 2018, Aeroflot Group's growth in the domestic market amounted to 8.5% in terms of PAX. We have been cautious with the growth in order to maximise efficiency at the beginning of the year but in Q2, as I have just mentioned, Aeroflot accelerated the growth on par with the market.

In the international segment, the market grew at 14.8% y-o-y, however, Aeroflot gained just 7.9%. The reason for the difference is that the market growth was driven by the leisure segment, while the Group has lower exposure to it. If we take out charter routes, the growth of the market will be just 11.6%, as international charter carriage expanded by almost 22% y-o-y.

If we look at absolute numbers, the growth was truly amazing with 1.9 million passengers added y-o-y bringing the Group's overall PAX to 24.9 million. Our competitors also developed their operations quite actively. For example, foreign carriers all together added over 1.6 million to their 6M PAX numbers, S7 and Ural Airlines – 0.6 million passengers each. We clearly see a continuing increase in competition in the market.

As a result, Aeroflot Group's market share adjusted to 40.9% in 6M 2018 compared to 42.5% in 6M 2017. In Q2 2018, this slight dilution slowed down only to 1 p.p. If we also look at other leading Russian airlines – S7 Group or Utair – they also faced some decline in the market share, as foreign carriers and smaller Russian airlines have been growing almost twice faster.

A few additional comments on the competition. On slide 6 you can see passenger dynamics in domestic and international segments as well as capacity developments. What is particularly interesting here is the huge growth in capacity in June that was attributed to the World Cup hosted by Russia, as I have already mentioned.

Our multi-brand offering continues to demonstrate the ability to capture passengers across all market segments and generate additional traffic. The two drivers for the Group's growth were Aeroflot and Pobeda, both increased traffic by approximately the same number of passengers – ca. 1 million passengers each. This translates into 6.4% growth for Aeroflot and almost 51% growth for Pobeda.

Aeroflot airline, our flagship carrier, grew on the back of higher demand. Pobeda continues to outperform due to an increase in capacity with eight aircraft added in the last twelve months. Rossiya posted a slight decline of 3.8% despite the 10.6% growth in international traffic. The decline is explained by some domestic network optimisations in Q1 that was offset by the growth resumed in Q2. In June, Rossiya resumed its y-o-y growth both in the international and domestic segments.

The next slide provides more details on Pobeda. The airline is accelerating its growth stimulating demand on the market. These are the two trends, which we see in the segment. The size of Pobeda in the contribution is going up. In 6M 2018, 13% of the Group's total passengers and 18% of the Group's domestic passengers were attributable to Pobeda. Pobeda remains predominantly a domestic player, with 80% of its passengers served on domestic routes. The international segment is also expanding because it helps us improve the airline efficiency and employ aircraft in a more efficient way.

In 6M 2018, passenger load factor (PLF) increased by 0.4 p.p. y-o-y to remarkable 93%, far outstripping typical load factors even for low-cost carriers. It is worth mentioning that the PLF growth happened on the back of a 60% increase in capacity that is a truly outstanding operational achievement. As of June, Pobeda had 20 aircraft, with eight aircraft added in the last 12 months as I have just mentioned. This fleet allows us to expand operations domestically and internationally with many new destinations for the winter season announced already.

Corporate strategy. A few words here. As you know, Aeroflot Group achieved a number of goals in its Strategy 2025 ahead of time, including becoming a Top 5 European carrier (excluding European low-costers) and ranking among the Global Top 20 airlines. If Aeroflot continues its growth at the current pace with slight deceleration, we will reach our volume targets by 2022, three years ahead of the 2025 plan. For this reason, the Group's management initiated a revision of the long-term strategic targets. It was deemed appropriate to set more ambitious strategic targets in terms of passenger numbers for the Group. The key drivers are defined as Europe-Asia transit traffic as well as low-cost flights. We will also develop regional bases to capitalise on untapped opportunities of the Russian aviation market. That concludes the Market and Strategy section. Now I would like to pass the floor to Ivan Batanov, Head of Network Planning and Revenue Management.

Ivan Batanov: Thank you. Let us move to slide 12. I will say a few words about the Aeroflot Group network. The overall approach to managing the Group's network remains unchanged. Our priorities lie in improving network quality by focusing on frequencies and connectivity, and expanding intelligently on profitable routes as well as adding destinations where we see high potential. The total number of Aeroflot Group's flights in 6M 2018 grew by 5.9% y-o-y, with North and Central America and the Middle East being two most actively expanding regions. In terms of the network quality improvement, in 6M 2018, Aeroflot Group increased flight frequency per route by 9.8% of scheduled flights, which was primarily driven by the domestic segment showing an 11.3% increase.

On the next slide, you will see an example of network expansion in the summer of 2018 and the coming winter. In the summer season of 2018, Aeroflot mainline added five international and one domestic destinations to its network. They are Naples, Verona, Burgas, Kyzylorda, Cairo and Saransk. Rossiya is also improving the quality of network by focusing on higher frequencies to selected international and domestic points, including Milan, Rimini and Berlin. The airline also launched a daily flight between St Petersburg and London Gatwick in March 2018, which is targeted primarily towards direct business travelling. Now the Group operates up to six flights per day between the Russian and UK cities. Notable frequency changes in the Aeroflot's mainline summer schedule 2018 include doubling the number of weekly frequencies to Dubai, Istanbul and Bucharest on the back of higher demand. On top of that, we are working on connectivity. Along with improving the quality of the network in the international segment, Aeroflot also doubled frequency to a number of domestic destinations, including Khanty-Mansiysk, Magnitogorsk and Novy Urengoy, The Group also expanded frequencies to other domestic destinations outlined on the slide.

In the coming winter season, Aeroflot plans to open six new domestic destinations in the South of Russia and several additional international destinations in Europe and Asia. Also, the Rossiya airline targets to start services to Bali, Indonesia. All these markets have high point-to-point demand as well as high transfer potential. For example, the route to Bali will be served by Rossiya from Sheremetyevo, which provides connectivity options with domestic and international destinations of the Aeroflot network.

As we move to the next slide, I will tell you a few words about the development of domestic and international transit. In 2018, we continued to grow transfer passenger volumes but due to the World Cup the growth significantly slowed down. High demand for point-to-point transportation affected all segments of the transfer operations, including domestic, domestic-international and international-international. Domestically

we recorded extremely high demand to Moscow, St Petersburg and Sochi as well as other legs to host cities. Internationally, very strong demand was recorded on most European destinations. Increased demand prevented price-sensitive transit passengers from booking carriage with Aeroflot. As far as international transfer is concerned, its share in Aeroflot airline operations was down to 12.8%. However, in absolute terms, the growth amounted to 5.8% in 6M 2018 and 1.2% in Q2 2018. We see this impact as temporary and plan to focus on our long-term vision of improving connectivity and growing the number of international-international passengers in order to further develop the important part of our transit business.

The next slide shows our revenue units. Yields in the scheduled segment continue to improve. The 5% decrease seen in 2017 was replaced by growth. Q1 2018 growth of 3.6% accelerated to 8.6% in Q2 resulting in the total H1 2018 growth of 6.5%. The fundamental reason is a gradual transfer of fuel costs into yields by companies in the market.

Let us look at the operating segments. First, the international segment shows 8% growth in terms of yield and 5% growth in terms of RASK. The tailwinds for the growth included rouble depreciation (15% vs. euro), adjustments in fares on selected routes and fuel surcharge increase, which happened at the end of March. The headwinds we faced were the following: pressure from increased competition, delayed currency effect on yields and also effect of USD-denominated fares. In the domestic segment, which showed 5% growth in terms of yield and 7% growth in terms of RASK, the tailwinds were an increase in fares in line with inflation, a fuel surcharge increase, no pressure on yields from Rossiya in the domestic segment for the most of H1, and effective capacity management, which helped us increase the load factor by 1.7 p.p., which in turn helped to increase RASK and supported yields. The headwinds included a dilution effect from Pobeda, (16% of Group's domestic RPK), and Rossiya's flat fares on the Far East, with a more sizable effect since May.

On the next slide, we will take a deeper look into monthly revenue dynamics of the Aeroflot airline standalone. In 6M 2018, the Aeroflot airline yields steadily increased in all segments, most notably, international yield was growing in excess of 20% in June 2018. That was supported by higher demand during the FIFA World Cup. Both economy and business class yields increased in 6M 2018, with the most significant improvement observed in the CIS, Europe and Middle East segments, while other geographical segments grew at a mid-single-digit pace. Now I will pass the floor to Andrey Chikhanchin.

Andrey Chikhanchin: Thank you, Ivan. Good morning, ladies and gentlemen. As I am a new person on the call, I would like to say a few words about myself. I am the newly appointed Deputy CEO for Commerce and Finance recently approved by the Board. I have been with the company since 2009, previously serving as Head of Aeroflot's Corporate Finance overseeing key financial functions of the company. More recently, I served as acting Deputy CEO for Commerce and Finance. In my new capacity, I will oversee all financial functions of the entire company as well as the network and revenue management, and loyalty programmes.

Let us start with our regular slides. Slide 18. As of 30 June 2018, the Group had 350 aircraft in the fleet deployed in operation by the airlines of the Group. The composition of the fleet has not changed materially from the recent results. The next slide is on the fleet expansion strategy. In 6M 2018, the Group expanded its capacity with 34 aircraft joining the fleet and nine aircraft being phased out resulting in the net increase of 25 aircraft. You can see the details in the table on the slide.

Financial highlights for Q2 and 6M 2018. In 6M 2018, we continued operational expansion, posting PAX growth of 8.2% and generating RUB 266 bn in revenue that represents a 13.2% growth. Expansion of revenue was supported by growing yields, which accelerated their growth pace in Q2 2018 helping us to accelerate traffic revenue growth to 19.2%. However, on the profitability side, notwithstanding the top line growth, in 6M 2018 the Group posted a negative result on the bottom line, despite RUB 6 bn generated in net income in Q2 2018 alone. Pressure on financial result of 6M and Q2 2018 was mostly affected by macro headwinds:

rapid growth in oil price as well as unfavourable movement of exchange rate (for the cost side). We will discuss revenues and costs in details on the following slides.

The next slide is on the revenue growth decomposition. The Group's revenue grew by 13.2% during 6M 2018 and amounted to RUB 266 bn, mainly driven by passenger traffic revenue, as I mentioned earlier. Expansion of scheduled operations (mainly due to the growth of Aeroflot and Pobeda) generated RUB 27.6 bn. The leisure segment had a modest contribution of RUB 4 bn as, after the rebound of the charter market on the back of Turkey reopening last year, the growth in the sector in general has been slowing down. Revenue growth in 6M 2018 shows clear signs of acceleration. For example, we had 7.5% growth y-o-y in 12M 2017, 8.6% growth y-o-y in Q1 2018 and 16.8% growth y-o-y in Q2 2018. We have seen positive contribution to revenue from all the factors: volume, currency and pricing. Expansion of our business generated RUB 16.4 bn. Depreciation of rouble vs euro (ca. 15%) and dollar (ca. 2%) had a positive impact on the currency factor of about RUB 11 bn. The yield growth that has resumed in Q4 2017 and continued in 6M 2018 supported the pricing factor and helped us to generate extra RUB 3.2 bn.

The next slide is on operating costs. In 6M 2018, we have seen OPEX growth driven by the following lines. First, fuel cost went up by 39%. The dynamics of the fuel cost was driven by the increase in rouble fuel price by 29% and growing scale of operations as our ASK went up by 8.5%. Fuel price growth was peaking at 42% in Q2 2018, which has come as a result of further increasing of oil price in 2018 and the change in correlation pattern between oil and rouble. Second, operating lease also showed growth of 30% y-o-y. The growth is primarily linked to growing fleet in operating lease as well as depreciation of rouble vs dollar as mentioned earlier. We have increased the fleet in operating lease by almost 60 aircraft. Third, maintenance grew by 29% y-o-y. Normalised change in maintenance expenses, including change in maintenance reserve, in 6M 2018 amounts to 26%. The increase is explained by growing size of the fleet, increase in light maintenance procedures and changes in types of maintenance in the reporting period due to the schedule. Additional increase came from the volume factor, as flight hours grew by 9.4% y-o-y, coupled with weaker rouble vs dollar (depreciation of ca. 2% as mentioned earlier).

Other lines have been supported by our savings initiatives, which we will discuss later. Staff costs in 1H were up by only 9%. Increasing headcount (up by 7% in the last twelve months) and indexation of pilots' salaries are the key factors for the growth. Notwithstanding the hike in pilots' salaries in Q2 2018, the Group managed to decrease the pace of staff costs expansion to 2.6%. Apart from stronger cost control, this also was possible due to the decrease of a reserve for long-term motivation programme. We have also seen savings in SG&A, mainly marketing, and D&A, as we have decided to use some of our equipment longer instead of replacing it, extending the life of our assets, mainly in IT infrastructure.

The next slide is on the Group unit costs. In 6M 2018, on a per unit basis, cost per ASK in rouble terms increased by 8% to RUB 3.33. Non-fuel CASK amounted to RUB 2.35 and increased by 1.5%, lower than blended RASK increase of 6.7%. In Q2, we managed to control CASK inflation by decreasing non-fuel costs by 1%. CASK dynamics once again illustrated execution of our cost cutting initiatives.

The next slide is on fuel cost management. The trend of increasing fuel price continued in 2018. In 6M 2018, the growth sped up to 29.4%, with a significant spike in jet fuel price recorded in Q2 as I mentioned earlier. The average fuel price in 6M amounted to RUB 42,300 – the highest in years. This trend is a result of Brent increase and absence of rouble response to the oil market dynamics. We continue to optimise fuel procurement and fuel consumption in order to further optimise fuel consumption. As you see from the slide, this approach starts to pay off – fuel consumption per ASK decreased by 1.4% y-o-y.

Let us discuss EBITDA evolution. In 6M 2018, we generated RUB 6.6 bn EBITDA. The pressure on EBITDA in the period is fully explained by an increase in the number of cost items, which we previously discussed: fuel,

operating lease and staff costs. The total fuel bill was up by RUB 21.7 bn: 19.9 bn increase driven by additional volume required for expanding operations and increases in prices, the latter being the key factor. This increase was exacerbated by rouble depreciation. The euro/dollar rate was quite favourable for Aeroflot – the 6M average rate reached 1.21 vs 1.08 in the respective period of the previous year – as it has resulted in euro strengthening vs rouble faster than dollar. This in turn resulted in positive FX effect on revenue in the amount of RUB 11 bn, which was partially offset by negative effect of FX on costs in the amount of RUB 4.9 bn.

Now, the traditional slide on Pobeda financial results. Pobeda has been very successful in 6M 2018. Notwithstanding significant additions of capacity (ca. 60% ASK growth in 6M 2018 y-o-y) Pobeda was able to increase load factor for the period by 0.4 percentage points y-o-y to a remarkable 93.4% and grow both yield and RASK, which is truly an outstanding operational achievement. The company expanded revenue by 66.1% in 6M 2018 y-o-y and grew passenger traffic by 50.8% on the back of active fleet expansion having added eight aircraft in the last twelve months. Active growth always requires additional OPEX which, coupled with a significant increase in jet fuel prices during 2018, pressured the margins. The company earned RUB 175 mn net income in 6M 2018 and almost RUB 1 bn in Q2.

The next slide is on leverage and liquidity. The total debt as of 30 June 2018 decreased by 7.3% on the back of decrease in finance lease liabilities. Finance lease liabilities decreased due to phase out of four aircraft from finance lease. There were no new borrowings. Aeroflot Group is currently left with one major loan outstanding in the amount of RUB 3.5 bn.

The next section of the presentation is Strategic Initiatives and Product. The first slide is on what we are doing right now. Now that we are done with our traditional slides on the financial analysis, let us look at the bigger picture of the factors that influence the Russian airline industry and Aeroflot Group's financial results and what we are doing to offset these macro headwinds.

As we all know, the oil price started to grow in 2017. The growth accelerated in 2018, as I have mentioned earlier. We have seen both economic and geopolitical factors that influenced the oil price on the global markets. As rouble has been under pressure as well, it resulted in a significant increase in jet fuel price. In the environment of rising fuel prices, the company has to respond with cost-cutting and revenue stimulation initiatives, including out-of-the-box ideas. I would like to highlight that our new initiatives complement Aeroflot's long-term commitment to efficiency: our approach to revenue management, existing ancillary revenue projects, efficiency-based strategy and so on. Net income and margins are already under significant pressure and without any action we risk to see significant decline in profit.

Next slide. What exactly we are doing and planning to do. On the cost side, we implemented even more strict cost control and launched cost optimisation projects. We started negotiations with key suppliers and service providers targeting to receive discounts. We conducted negotiations with fuel suppliers and received some discounts, as we are a very large consumer and an important partner. We decreased SG&A and marketing budgets, as well as postponed investments in product, which helps to avoid an untimely OPEX increase.

On the revenue side, Aeroflot has to come up with both conventional and creative solutions. We increased day-to-day control to improve PLF and profitability. We definitely try to adjust fares (where and if possible, mainly based on inflation) and increase fuel surcharge. We plan to increase ancillaries by introduction of paid upgrades and paid seat selection for lower booking classes. With improvements on the operational side (on-time performance and decrease in minimal connection time) supported by new routes (discussed on the previous slide by Ivan Batanov) we expect to further increase efficiency of our network and improve aircraft utilisation.

I want to pass the floor to Artem Glaznev, Head of IFRS, to give you some details on the new IFRS 16.

Artem Glaznev: Hello. Aeroflot will adopt IFRS 16 starting 1 January 2019. IFRS 16 will replace IAS 17 and become mandatory starting from January 2019. All operating lease contracts will be recognised on the balance sheet. Operating lease will be divided between depreciation and interest, implying increase in EBITDA. You can see the influence on the balance sheet and income statement on the slide. We are currently discussing the adoption methodology and implementation framework with our auditors. As soon as these discussions are finalised, we will inform the market regarding the implications of the new standard on our reporting and operations. Thanks.

Andrey Napolnov: Thank you for your attention. That concludes our presentation section. Now, let us move on to the Q&A session.

Yulia Gerasimova: Good morning, everyone. I have three questions. First, I just wanted to get some more colour about how August is shaping up in terms of operational stats. Could you give any comments about the PAX growth, for example, compared to July? Also, it would be interesting to hear what trends you have seen in July and August in yields. That is the first question.

Ivan Batanov: Let me take your question. In the first half of August, we saw positive traffic development trends. The growth has accelerated. Partially, it resulted from the FIFA substitution effect: leisure traffic, which we talked a lot about in the previous period, had to move from July to August. As for load factors, they are also in the positive territory so far for both international and domestic flights. With regard to yields, we can definitely see a positive trend compared to last year, but it would be possible to confirm with more precision by the end of the month when the monthly results are known. So far, I can see nothing negative.

Yulia Gerasimova: Just a small follow-up. Would it be fair to say that the growth in yields that you see in July and August is more comparable with April–May rather than June? Should we be focusing on April and May as a reference for the yields in July and August?

Ivan Batanov: I would say so. The June yields were exceptional. We made an analysis on this month and can definitely see the effect of FIFA, so I would agree with you – it is more like May.

Andrey Napolnov: One more clarification on the World Cup 2018 effect. We definitely see the FIFA effect in July, but the volumes in June and July are different, because June was the group stage of the World Cup with much more demand. In July, it is already the games between the national teams, so there is a little bit less traffic and less impact from the World Cup in July.

Yulia Gerasimova: OK, that is clear, thank you very much. My second question is about the fact you mentioned during the presentation that you are starting to pass through the increase in fuel into the tariffs and pricing. Do you see national carriers following you in that regard, or are they saving on the price and trying to get more market share in volumes? How are the international carriers responding to your action to pass through the fuel increase?

Ivan Batanov: The national carriers absolutely supported us in this step, they replied with the introduction of additional fuel surcharge on the following day after Aeroflot made this decision. Every Russian carrier has followed Aeroflot. As to international carriers, first, the increase that was made back in July was done for the domestic sector, so the fuel surcharge was not changed for the internationals. They did not follow us, but if we look at the increase that we made back in March, I would say that the first reaction of the international carriers was really careful, looking at the market. In the first month, the only airline that followed us was KLM. In the following months, a few carriers followed us, but I would not say that it was a common decision. Unfortunately, so far on the international market to Russia we have a situation when a lot of capacity is in place and every carrier is very careful with the pricing policy.

Yulia Gerasimova: That means that from the internationals, given that they are hedging their costs and they are not as easily following you as the national carriers, the competition is still high and the pressure on you in that part of the business persists?

Ivan Batanov: True. Another reason here is that with the devaluation of rouble that we can see on the market, carriers have to support the demand with, again very careful pricing policies. There is no room for us or any other international carrier to increase the fares in the current circumstances.

Yulia Gerasimova: OK, that is clear. Final question: can you give us any guidance in terms of this reversal of the reserves for the management bonuses, which you incurred in Q2 2018? Should we expect any such reversals in 2H 2018 and in Q3 2018 in particular? Thank you.

Andrey Napolnov: The estimate is made for the motivation programme, which is linked to market capitalisation. We have our own internal model, which is quite sophisticated. The revaluation reflects the current situation in the capital markets and with our shares. At this stage, it is complicated to say if we will reverse more or less, or whether we will reverse anything at all. You can see in Note 23 to our IFRS accounts the amount which is still reserved - maximum effect that we can have if we reverse anything. At this stage, I would recommend to leave everything as it is and just keep it in the models.

Yulia Gerasimova: OK, that is clear, thank you very much, Andrey. That is all for me.

Operator: We will now take our next question from Michael Ganelin from Aton. Please go ahead.

Michael Ganelin: Good day, gentlemen. Congratulations on good results and congratulations to Andrey on the new role in Aeroflot. I have two questions. First of all, regarding your plans to go outside Moscow and to develop regional hubs. Could you provide more details on that? What cities or city do you consider? What will it look like? When will you start? How many planes do you plan to allocate?

Andrey Chikhanchin: The strategy is still being discussed. The Board of Directors has approved only the main targets of the strategy. We will definitely launch several regional bases. We call these bases "hubs", but in fact they are not true hubs with wave connectivity like at Sheremetyevo airport. First of all, the development of intraregional operations is one of the targets of the strategy, and we need to implement it to stay competitive and not to lose the market share. That is all that we can say right now. Only one additional piece of information – the regional bases will be developed by Aeroflot and Pobeda. When the Board of Directors approves the new strategy, we will provide more details about our regional expansion.

Michael Ganelin: OK, thank you. My second question is about staff costs. I see that in Q2 2018, the increase was 2.6%, which is quite low. Could you specify the reason for that and how do you see it in 2H 2018? Thank you.

Andrey Napolnov: Michael, we have just answered this question for Yulia: one of the key reasons here is the reversal of provision for the long-term incentive programme.

Michael Ganelin: So the reversal is included, right? It is clear then, thank you.

Operator: We will now take our next question from Alexander Kazbegi from Renaissance Capital. Please go ahead.

Alexander Kazbegi: I had a question on the same subject. As far as I can see, and I'm trying to check this quickly, I think this reversal was a bit less than RUB 1 bn if I'm not mistaken. I think the fleet increased by about 45 planes in a year since the end of 1H 2017, so about 15–16% growth in the planes. And the growth in the overall staff costs was still significantly lower. Given that you said that the pilot costs had been indexed up, the staff costs and the personnel increased. Is the reversal of the provision really the only reason for the whole staff cost not to grow as much? The net effect if I'm not mistaken was about RUB 1 bn. So that was my first question.

My question number two. I have a similar question on your aircraft and traffic servicing. The RAS statements show quite a significant increase y-o-y. That is not the case in the IFRS statements. I wanted to know the reason why IFRS shows it differently, especially given again that the press was full of discussions about how much the landing and airport fees have increased in 1H 2018. Maybe you can give us a bit of colour on what happened then and what is the outlook for 2H 2018.

And the last two quick questions. Have you seen any return of international carriers more than there has been so far? Could you give us an outlook for that? And finally, an outlook for the PDP, prepayments for 2H 2018 – what do you plan on that one? Thank you.

Andrey Napolnov: Alex, thank you for the questions. Regarding the staff costs, yes, you are basically right in that we did see an increase in fixed pilot salaries, we are also recruiting personnel (headcount increasing 4% year-to-date and 7% y-o-y). But as a company, we have a very flexible approach to the compensation, we have a variable compensation component which is linked to the KPIs of the company. In the current environment, we are not doing better than the KPIs, which was the case in the previous periods, so here the compensation is adjusted based on the performance. Also, we need to look at the previous year, i.e. 2017. If you look at the results we reported last year, you can see a huge increase in staff costs for 6M 2017. The increase was linked to the fact that we made a decision to increase the compensation and this increase back in 2017 was linked to impressive results of 2016, and now we are talking about a very high base. Basically, we have three explanations for the staff costs – strict control and variable compensation linked to KPIs; reversal of the reserves related to the long-term incentive programme; and base effect of 1H 2017.

As for the aircraft, traffic and passenger servicing, the impact is explained by the fact that we had tax RI, which is netted in our IFRS accounts. It is an airport charge related to the terminal facilities. So it is netted from the end of 2017.

Alexander Kazbegi: So it is something that you showed before in revenues, right?

Andrey Napolnov: Yes, exactly. That is why this line's growth is at a slightly lower pace and the revenue also could have grown a little bit higher if it was shown in exactly the same way as in the previous periods.

Andrey Chikhanchin: About PDPs, we are not forecasting any big figures. In 1H 2018, it was less than RUB 1 bn and we are not expecting any bigger figures in 2H 2018. It will be on the same level.

Andrey Napolnov: And regarding your last question on foreign carriers coming back. We see different trends here. We showed on one slide at the beginning of the presentation that the number of passengers transported by foreign carriers has materially increased. In particular, we saw higher foreign carrier capacity in June but I would say it was to large extent charter capacity, or special, capacity dedicated to the FIFA World Cup.

Alexander Kazbegi: Yes, I was talking about the scheduled flights.

Andrey Napolnov: We also see an increase in scheduled segment by carriers from the Middle East and airlines based in Turkey because the Turkish market continues to grow fast. So yes, it is still in place. We have seen some milestone comebacks on the route from Moscow to Hong Kong, from Hong Kong Airlines. There is foreign capacity in place and it will be here in the upcoming season.

Alexander Kazbegi: OK. Just one thing to clarify on the first question about the reversal. On slide 26, you have a negative impact of RUB 1.3 bn in terms of NRE if you look at your EBITDA bridge. So if the reversal was effecting positively why is it shown here as a negative impact?

Andrey Napolnov: Do you mean the effect on staff costs?

Alexander Kazbegi: Well, I'm looking on slide 26 and there you have the EBITDA bridge, which shows staff costs at RUB 3.3 bn of net addition, I can see that, but also on the bottom of the right hand side there is negative impact from the recovery of the past provision by compensation and long-term motivation programme, which you said was a reversal which had a positive impact on the overall staff costs, but here it is shown as a negative one, if I read this correctly.

Andrey Napolnov: Yes, here we compared the changing staff costs line. If we have, let us say, FX effect or provisions, it is just taken to the NRE box on the right-hand side of the slide. That's the explanation. We may also take it offline as it's a technical question I believe.

Alexander Kazbegi: OK, maybe we can discuss it offline. That's fine. Thank you.

Operator: We will now take our next question from Fedor Kornachev, Sberbank. Please go ahead.

Fedor Kornachev: Thank you. Basically, my question has already been answered, sorry.

Operator: Thank you. We will take our next question from Osman Memisoglu from Bank of America Merrill Lynch. Please go ahead.

Osman Memisoglu: Hello, thank you very much for the presentation and your time. I have two questions. On the costs side and maintenance expense, there was quite a jump and you did elaborate on it a bit in your press release, but if you could give us any more colour particularly on the outlook for the rest of the year, that would be helpful. And then as an overall approach, you have quite a bit of moving parts. I guess maybe it is a question about the fuel costs as well: there is this cap of RUB 48,000. Is that also going to be enforced in Q2 2018 and Q3 2018? Putting all this together, do you have a new margin guidance for the EBITDA or EBITDAR to help us with 2018 estimates? Thank you.

Andrey Chikhanchin: About fuel subsidies. As far as we know, the Ministry of Transportation has offered the Ministry of Finance to provide Russian airlines with subsidies of RUB 22.5 bn, it will cover around 50% of the increase in fuel procured in Russia. I believe it is one of the effective approaches to solving the problem of rising fuel costs, not fully, just partly, but anyway. Let us wait until the decision is made and the mechanism of subsidy distribution is determined. At this stage, we are working on the areas that the management can keep under control. As I have mentioned earlier, we have negotiations with oil companies trying to make our best. Anything coming on top of that will be supportive. It is about oil and subsidy from the government.

About the EBITDA margin, we are targeting an EBITDA of 10% over the cycle under the current accounting methods but with the oil price trends in 2018 we will come in at a number below 10%. We have activated all

revenue management mechanisms as well as fuel surcharge starting from Q2 2018 in order to offset fuel headwinds.

Osman Memisoglu: Can I follow up on the fuel portion? Putting the potential spot aside, is there a cap? Maybe I am mistaken but I thought there was a cap of RUB 48,000 per tonne that is currently being applied. Is that the case? I just wanted to confirm.

Andrey Chikhanchin: We do not have more details about this initiative. Unfortunately, I do not know what the progress on the discussion is.

Osman Memisoglu: OK, this is fine. Any comment on the maintenance expenses?

Andrey Chikhanchin: Osman, can we take this question offline? I will explain what is happening with the maintenance expenses and clarify the question.

Osman Memisoglu: OK. No worries, thank you.

Operator: We will now take our next question from Olga Boltrukevich from VTB Capital. Please go ahead.

Olga Boltrukevich: Yes, good morning, thank you for the presentation. It is Olga Bolturkevich from VTB Capital. I have several questions. The first question is regarding yields, again just to clarify: you mentioned that we should see the performance in yields close to the trends of April and May, which means around 5–6%, if you look at slide 16 on the yield performance for Aeroflot Company. Basically, if we see a similar growth in yields for Q3 2018, it basically fully ignores your fuel surcharge which you made back in April and July. I am just trying to understand why we should see similar growth in yields when you actually increased the fuel surcharge in the tariffs. My understanding was that we should see at least high single-digit rather than mid single-digit growth for Q3 2018.

Ivan Batanov: First, with regard to the yields. The fuel surcharge was introduced taking into account the high season and the level of the surcharge was based on the current situation on the market. I do not think the market will be able to support even this additional increase when we see it going down after September, at the beginning of the low season. It means that in order to be competitive, we would need to decrease the fares, which means that we will not be able to get this additional effect on the yields.

Andrey Napolnov: Yes, that is one point, Olga. Also, I need to add a little bit on that. We see here various trends but we also mentioned that if we look at Q3 2018 and Q4 2018, we should not extrapolate the June trends, which showed extremely high growth.

Olga Boltrukevich: Yes, that's for sure.

Andrey Napolnov: It will be something in between. But for the models, you need to look at least at the run rates for 6M 2018, which take into account the low period at the beginning of the year and the beginning of the high season of the end of Q2 2018. It would be a good benchmark here, but also take into account what Ivan has just mentioned. Also please keep in mind that markets are always changing.

Olga Boltrukevich: OK, thank you very much. My second question is regarding your fuel prices. What should we expect considering your negotiations on the discount for fuel supplies? For example, if we apply your formula with a one or two month lag to international prices. My calculation is that we should see something

about RUB 45,000 in Q3 2018 and RUB 47,000 in Q4 2018. Do you think we will see lower prices? What are your expectations on that?

Andrey Chikhanchin: In our discussions with oil companies, we are trying to get as much discounts as we can but due to the rise in global oil prices we cannot receive a very significant discount. Based on forecasts of international banks and Bloomberg forecasts, we see that there can be a rise of the oil prices globally, maybe by around USD 70 per barrel. It is not our role to make forecasts. We are trying to use what we have in the open sources.

Olga Boltrukevich: OK, thank you. And my last question is regarding your other income, which you reported at RUB 1.2 bn in Q2 2018 compared with a loss of RUB 1.8 bn in Q2 2017. I am just trying to understand what was behind this gain. My understanding is that it is mostly driven by your fuel excise refund. So the question is what we should expect in Q3 2018 and 2H 2018: will we see similar gains?

Andrey Napolnov: Olga, yes, you are right in saying that it is linked to the fuel excise due to an increase in the volumes as one of the main drivers and it should not be negative in Q3 2018. But again there are a lot of different lines that can also come up with different results in 2H 2018. Maybe we can send you the breakdown of this line, and to anyone else who is interested, and you will understand what is behind the dynamics and make your own assumptions how the line should look like for the upcoming periods based on high-level assumptions in your model.

Olga Boltrukevich: Yes, for sure, thank you very much.

Operator: As there are no further questions, I will hand the call back to the host for any additional or closing remarks.

Andrey Napolnov: Thank you everyone for joining the call today. If you have any follow-up questions, please contact us, we will be happy to answer. Thank you and have a good day!

Operator: That will conclude today's conference call. Thank you for your participation, ladies and gentlemen. You may now disconnect.