

## **Aeroflot Group IFRS Financial Results Nine Months of 2014**

**Monday 1<sup>st</sup> December 2014**

Operator: Good day and welcome to the Aeroflot Group IFRS Financial Results for the first Nine Months of 2014 Conference Call. Today's conference is being recorded. At this time I would like to turn the conference over to Mr. Andrey Napolnov, Head of Investor Relations. Please go ahead sir.

Andrey Napolnov: Good day ladies and gentlemen, this is Andrey Napolnov, Head of Investor Relations at Aeroflot. Thank you for joining today's conference call on Consolidated Financial Results of Aeroflot Group for Nine Months of 2014. Today we have two speakers, Aeroflot Deputy CEO for Finance, Network and Revenue Management, Shamil Kurmashov; and Deputy CEO for Strategy and Alliances, Giorgio Callegari. We will start with a 30 minute presentation followed by a question and answer session.

Before we begin I would like to refer to the disclaimer statement in the financial results presentation regarding forward-looking statements. During this call we may make reference to forward-looking statements by using words such as 'plans', 'objectives', 'goals', 'strategies' and other similar words which are other than statements of historical facts. Any statement other than a statement of historical fact is or may be deemed to be a forward-looking statement. Actual results may differ materially from those implied by such forward-looking statements due to known and unknown risks and uncertainties and reflect our views as of the date of this call. We undertake no obligation to revise or publicly release the results of any revisions to these forward-looking statements.

I will now turn the call over to Giorgio Callegari, Deputy CEO for Strategy and Alliances of Aeroflot. Giorgio.

Giorgio Callegari: Thank you so much. Good day to everybody and thanks for being on the call with us. Let me start by sharing with you all what we believe are the key highlights of our call today. The main message is that Aeroflot, the passenger traffic of the Group continued its remarkable growth, in this case by 10.5% in the nine months of 2014 year over year – that's

above the market average as the growth of the market was 9.6%. That means that the Group consolidated its leading position. It's also a growth which is impressively higher than that of our peers both to the West (European and American carriers) as well as to the East (Asian carriers) in terms of passengers, capacity and RPK. Obviously the growth was most significant in terms of domestic traffic, with a 25% growth in that market, which again led to increased market share. That came at the expense of a reduction of yields, so the revenue growth was 6.5% in the nine months of 2014, with a combination of strong traffic growth, a positive foreign exchange effect offset by lower sales obviously in a weakening economic environment. We believe that this set of results justifies the confidence that we have in the validity of the strategy, which is also based on strict cost control and improved efficiency. A proof of the efficiency of the Group is, we believe, the effective multi-brand strategy underpinned by the restart of Pobeda, our low-cost subsidiary, which today has performed its first flight. We will have a chart on that later on.

If we can move ahead with the presentation I would like to draw your attention to the Russian market, because we continue to believe in its strength as highlighted on slide number 6, and in particular on the increased market share of Aeroflot. As you see the dynamics are slightly changed, with a higher growth in domestic traffic compared to a slower growth in international traffic. Some of those figures are obviously affected by specific phenomena that took place in 2014, in particular the Sochi Winter Olympics in the early part of the year, but also the significant increase in traffic to Crimea and the fact that Crimea is now classified as domestic traffic rather than international traffic as it was earlier on. We believe that the growth of the Russian market is the result of still significant under-penetration of air transportation in the market and this is a resilient phenomenon.

As we see on the following slide it is also still a somewhat fragmented market, as we as the leading group in Russia still have slightly more than a 30% market share. The 30% market share is more than the combined market shares of the following three competitors which are companies that are also facing some significant challenges. We therefore believe that the continuing trend in consolidation of the leading players will possibly accelerate in the next few months.

If we look at our multi-brand strategy as described on page 8, Aeroflot accounts for 67% of the passenger contribution of the Group. The daughter companies with a strong geographic feature Rossiya, Donavia and Aurora are, respectively, 15%, 5% and 3% of the total traffic; while Orenair with 9% of the passenger traffic is our leisure-oriented company. Let me say very clearly that Orenair as you heard, as discussed in the call about the six month results, has faced some significant challenges due to the turmoil in the tour operating market. We have aggressively addressed the issue so that a significant part of the capacity of the carrier has been moved to the third airport in Moscow, Vnukovo in particular, effective November 1<sup>st</sup>, to fly scheduled flights in order to capture what we believe is the more resilient part of the market. Those flights will come under full commercial management of Aeroflot effective January 15<sup>th</sup> and therefore, again, an issue clearly identified, with clear answers to address that issue and to reduce the exposure of the Group to the less profitable leisure segment.

As far as Pobeda is concerned, if I can draw you to the following page you will see that the company has started sales on November 11<sup>th</sup> a very, very short time after the company was grounded. The company started flying in June, was grounded at the end of July after 55 days of operation with a very, very significant response from the market and in the space of four months we were able to restart it from scratch – a new company, a new name, new contracts have been negotiated with lessors and providers and a new operating base. That removes, as it was in the original plan, the most significant risk of cannibalisation between the different operators of the Group and gives room for expansion in an entirely new airport. At the beginning the company will fly to seven destinations by year end 2014. The average number of frequencies will be one flight per day, so seven flights per week and we plan to end the year with four B737-800 next generation with a cabin configuration of 189 seats for Pobeda.

The growth plan remains as it was, so the idea is to expand the company to 37 aircraft by 2018, with 47 routes and 10 million passengers, so once again an important component of the Group strategy is focused at the price sensitive segments of the market. As far as the Group network is concerned, on slide 11 you see that we continue our focused development strategy with the increased quality of the network as a result of adding frequencies to the destinations that we already serve, adjusting capacity in the most efficient way to those destinations and with limited additional points added to the network, in particular two domestic destinations, Murmansk and

Arkhangelsk and two CIS destinations, Chisinau and Tbilisi in the Caucasus. We're also adjusting capacity in the Far East, so Aurora has stopped serving a number of markets that were unprofitable and also in the case of Rossiya we have adjusted their network.

The transit traffic, which I believe is an important component of our strategy has grown from 35.5% to 39%, but remains well below the percentage of our peers, giving us the opportunity again to leverage the geographic position of Moscow and, if it gains a profit, to pursue a higher proportion of connecting traffic.

On the following slide you see the evolution of growth and load factors. You see that our growth throughout the year has been always close to or above double-digit figures in terms of passengers, matching or better performing than the growth in ASK. That's why the load factors, overcoming the slight decrease in the initial part of the year, has been consistently higher than last year, has been basically in line with last year as far as the month of September is concerned.

We come now to the dynamics, evolution of our traffic and as you see that on slide 13 our performance remains very balanced, with critical performance only in two areas: one being CIS and that's understandable only because it includes Ukraine, where we had to stop services to Odessa, Donetsk, Kharkov and Dnepropetrovsk, and reduce services to Kiev. In October we restarted services to Odessa. We have readjusted capacity to Kiev and until a few days ago we were in possession of authority to restart services to Dnepropetrovsk and Kharkov. There's now a debate between the two civil aviation authorities and that has been put on hold. Still the other area is Asia where we have deployed B777s at the beginning of the year with a resulting reduction in load factor, which we see easily addressable in the next few months when capacity will stabilise. All in all, even if you don't have this information, I would like to underline the fact that in terms of growth in the nine months of 2014 the Aeroflot Group has grown 10.5%. If you look at our peers, traffic has grown at a median of around 14% mainly driven by the growth of IAG and Turkish. On the other hand if we look at the capacity growth, ASKs for us have grown 5.7% while capacity for our peers has been 6.3%. So we have been more efficient, by comparison, than our peers in the growth that we have had – that results in a load factor which is in line with our peers, 80.7, the median 79 for us as a result of an RPK that again is in line with that of our peers.

In terms of revenue breakdown we remain very balanced in terms of geographic exposure with Russia 42% of our revenue, Europe 27%, Asia 13%, North and Central America 7%. Again the Ukrainian situation has affected these figures.

When we move to yields, let's be very clear on this: certainly there has been a decline in yields in the nine months of 2014, with a decreasing RASK, which is lower than the decrease in yield. So yes, we have adopted a commercially aggressive policy also in response to aggressive capacity increases of our competitors, mostly in the first part of the year and in the summer months. That trend shows an inversion, with our competitors reducing capacity additions in the future months. We also have effects coming from Dobrolet. Obviously the launch of Dobrolet in June and July resulted in a decrease of yields at Group level, as well as the increase, as I mentioned earlier on, of capacity to Asia with the substitution of the new B777 with 400 seats compared to the previously operated B767s that had obviously a lower capacity. The discounting policy that we introduced at the beginning of the year to cope with the Euro-nominated fares increase remains one of the actions that we take from time to time again to address currency devaluation effects and to remain competitive in terms of offers on the market. That means that in terms of guidance compared to what we said earlier on in the call, we see capacity stabilising in terms of ASK growth for the full year compared to last year between 5-7%, a load factor that remains in line with what we have delivered so far, so between 78% and 79%; and a revenue evolution that sees an increase between 5% and 8% compared to last year.

Thank you so much. I will hand over now the floor to Shamil Kurmashov.

Shamil Kurmashov: Thank you Giorgio. I will begin on the slide that discusses our fleet and our strategy in this direction. Aeroflot still operates the youngest fleet in the industry. The average age of our fleet is four years. It's even lower than our competitors in the Middle East and in other young and developing countries. We are younger than Turkish Airlines, for example, and Qatar Airways and Etihad. Our fleet management strategy is based on the renewing of the fleet and the substitution of old aircraft with modern, fuel efficient aircraft. We described the increase of our efficiency.

On the next slide you will see the structure of our fleet, so we get rid of old, Soviet-made aircraft the Ilyushin 96. We also made a pre-term termination of the contract for freighters – the MD-11. In the nine months 2014 our fleet increased by 13 aircraft on a net basis if you take into account those that were retired and those that were introduced. The Group capacity went up moderately, we demonstrated 5.7% growth of available seat kilometres, in line with the median of our major European peers. So the majority of our fleet is under operating lease. The moderate phase-out schedule is demonstrated on slide 20, there is nothing special about it. In 2015 we will have additional Boeing 777 and two single-aisle aircraft and 14 Sukhoi Superjets, but we have flexibility in terms of aircraft additions and we consider market conditions when making decisions on fleet expansion. As of today we expect 49 new aircraft to join Aeroflot Group in the period of 2015-2017, on a net basis. These will include Boeing 777, Dreamliners, B737s, Airbus A320 and SSJs. The number of aircraft on finance lease in 2015 is 85 and the proportion is 32%, so the remainder is in operating lease, so this corresponds to our policy, which we declared before.

On slide 22 we show revenue growth of 6.5%, which was driven by growing traffic volume and ruble depreciation. There are two contradicting factors was +RUB 14.5 billion, the growth, the positive influence of currency exchange; and the downward influence produced by pricing of RUB 15.2 billion. We saw a very tough environment in the market and a lot of capacity issues by those companies, which operated in the charter market, for example VIMAvia and Transaero, and they are obliged to really key the capacity from one segment of the market to another one. We don't pursue them like our competitors because they abandoned those destinations that they operate now, but nevertheless the short term influence is in our figures.

So in the forthcoming slides I will describe factor-by-factor. Cost analysis on slide 23. Here we make the composition of the nominal effect year on year analysis and the pro forma metrics net of foreign exchange effect and non-recurring expenses. For example there are two for each expense items. For operating expenses, for example, there is 15% growth if we deduct from this figure one-off effects the growth will be 11%. Briefly about the structure of our costs: fuel cost growth in nine month 2014 hasn't changed materially from what we had reported for last year for the first half of the year and our aircraft capacity service costs are directly linked to passengers and RPK growth and we demonstrated from 6% to 10% growth in these metrics, so

grew very intensively, so the absolute amount grew correspondingly in compliance with our business growth pace. Staff costs grew mainly as a result of salary indexation, which remained in 2015 and the increase in the number of leases by 6% as a result of capacity growth. In all the items of expenses we can just feel the effect of currency devaluation of rubles as the majority of our cost base...not the majority but a great amount of our cost base is represented by dollars, which is a common practice in aviation, for example maintenance costs and operating lease expenses are denominated in dollars. Maintenance expenses increased also mainly from foreign exchange, while the residual increase is attributed to growth of the scale operations and growth in tariffs. Operating lease expenses have been mostly affected also by ruble depreciation but we also want to draw your attention to the fact that there was a change in the structure, there would be a greater amount in the low-cost lease in our portfolio, there would be an addition of three B777s, which will come to our fleet in the next year and we received more than six wide-body aircraft in 2013 and you know that the operating lease rates for the wide bodies are more than for a single-aisle aircraft.

I forgot to tell you about the difference in CASK due to the increase in staff costs. There was an option programme during this year, payments to the management according to the option programme which was not the case in the last year because the last year results of the option programme were moderate and the payment was nominal. For this year the capitalisation at the end of the previous year was \$3 billion and the option programme parameters were linked to this capitalisation. The pay-outs were more significant than in the last year. This contributed to the growth of CASK. Also there was a payment, from net income payment, like a bonus to management, and lease expenses also.

Slide number 24, Group unit costs. On a per unit basis costs per ASK increased by 8% and from a nominal point of view from 2.37 to 2.55 as a result of the negative impact of operating expenses, aircraft servicing and maintenance, but if we deduct the foreign exchange difference the growth wouldn't be so significant. It would be lower than 8% and if we also deduct non-recurring expenses, so the CASK would be 2.48 which would be 4.7% lower than the in comparison with the corresponding period of the previous year. Key drivers of Group and unit costs are the same as I just explained in the previous slide.

Managing fuel costs. Due to the fact that we operate the youngest fleet in the world, this translates into a very strong operational performance. Fuel expenses per ASK and per ATK demonstrate gradual consecutive shortfall, almost a 6% decrease from the level of nine months 2013 and 17% for cost per ATK, fuel cost per ATK. The average monthly price per tonne for September 2014 is \$842 in comparison with \$943 for last year. I would remind you that we have long term direct contracts with oil companies, vertically integrated companies like Rosneft and Gazpromneft and we have five year supply contracts at Sheremetyevo and in regional airports. We have formal pricing in place which links...despite the fact it links our cost expenses to dollars, to special index, but nevertheless the margin of these companies is limited to a percentage that is incorporated into this formula, that's why the pricing is transparent and the marginality is limited. Therefore we have a certain manageability of the fuel costs. So fuel consumption per ASK decreased by 6% also thanks to continued fleet optimisation, headcount and labour productivity. We usually set as an example three metrics which are used in the region: traffic revenue per average headcount, RPK per average headcount and PAX traffic per average headcount – all these three metrics demonstrate either flat dynamics for a downward trend, clearly described on this slide.

Operating income evolution, there are two contradictory tendencies: the positive contribution of fixed benefits and the negative contribution of fixed drag, so due to the fact that 70% of our revenues are denominated in hard currency, currencies like the euro and the dollar, also approximately 50% of our cost base is already denominated in euros and dollars, therefore the positive contribution was 14.5 billion and the negative was 7 billion, whilst the net effect was plus almost RUB 7 billion. Softer fares contributed RUB 15.2 billion reduction in our revenues and total recurring expenses change was RUB 27.5 billion and non-recurring expenses was RUB 1.6 billion which is represented by doubtful accounts receivable as well as reserves for Ideal Tour clients, Pegas and other tour operators. There was also the provision for the pre-term return of the MD-11s and again for the pre-term return of the TU-204, which were in the fleet of our daughter company VladAvia.

If we look at slide number 28 we'd like to demonstrate here that if we didn't have such kind of one-off effects our operating income would be more than RUB 15 billion, coming to 13.6 taking into account all the aforementioned factors like reserves, like provisions for pre-term return and



certain gains on return of the TU-204. On the net income level, bottom line level, we have gained 13.5 to RUB 12.9 billion and if you go from the right part of this chart to the left part we gradually demonstrate which factors contributed negatively to our bottom line result, from RUB +13 billion which we think was the implied income which was earned by the company to the actual audited financials of RUB 3.5 billion. As you can see here all these effects are not like cost plans which would appear in our future financials but they are one-off expenses.

Group net income. The composition of the consolidated net income between the company and the Aeroflot daughter companies, which are in the red dotted area. Group net income was mainly impacted by net loss of Orenair due to the current situation in the tourist market. As you all know approximately 12 operators became bankrupt, that's why we reoriented our business from the charter market to the regular market, Orenair would go 100% commercial management, like Rossiya airlines and Donavia, which just contributes additional market power according to our estimation because we would coordinate our tariffs and there would be single electronic tickets for all the three companies and they would not compete each other. We shift operations to the airport where we were not present before that Vnukovo, because before that this airport was orientated with the airlines Transaero and Utair because they wanted to counterbalance Aeroflot operations from Sheremetyevo. Vnukovo airport believed in that alliance despite significant constraints in the activities of our competitors. We signed a special agreement with Vnukovo that we would migrate to our two companies in the low cost charter segment, Orenair and Pobeda, that would give us two competitive advantages. First of all Pobeda would no longer cannibalise passenger turnover of Aeroflot when it was the case before that, when it was located in Sheremetyevo. The second thing that Orenair has the same capacity, the same configuration of aircraft like Pobeda, 189 seats in each aircraft. Therefore we have a homogenous fleet which would allow us to economise on costs on the one hand and on the other hand it apply low cost pricing in competition with Transaero and Utair and they would operate on their markets. Therefore we think that when entering these airports, we think that our holding company with all the daughter companies would be correctly placed in all the airports of interest of Moscow "knot". Those of us who want to compete with the low cost segment would operate from Vnukovo and the remainder of the Group as has been the case before that from Sheremetyevo Airport. We think that the segmentation on this geographical distribution of our operations would contribute to the effectiveness of the result.

Financial highlights, slide 31. Revenue growth of 6.5% was a result of expanding passenger traffic. We think that any crisis, any constraint of the market gives us not only problems or increased competitiveness but also gives us a lot of opportunities. We think that our market share of the majority of our internal flights is lower than a fair market value according to the estimation of independent consulting companies, therefore we think there's good headroom for growth, not diluting our tariffs at the same time. The cost base was mostly impacted by expanding operations; additional pressure on cost as a result of a number of non-recurring expenses you also see here. I already explained what was the dynamic of net income margin, net income also. So adjusted net income including foreign exchange losses and non-recurring expenses amounted to RUB 13 billion. We of course draw your attention to this figure, not to the actual net income or net loss because that implies the internal health of the company, internal earnings which is generated – so the company is in a position to generate a good, well, produce good performance even in such, like I would say, not very favourable market conditions.

Very good slide 32, that's for the first time we demonstrate the comparison. So unfortunately we didn't incorporate this into this presentation so I wanted to disclose these figures. We took the public financials of different companies, I mean not from aviation but from different industries – oil and gas industry, telecoms, metals and mining – and tried to... One moment. So we tried to find a slide which we didn't insert into the presentation which compares us with the industrial peers in terms of sales growth, EBITDA growth and EBITDA margin. So the median for such kind of net sales growth is 5.2% and the sales growth of Aeroflot is lower than the median. In EBITDA growth terms, so the median was 3.5%. So in all the three metrics, I wouldn't just read this like because you don't have any deliverables. In all the three metrics, we are – out of the three metrics, in two of them we are better than the market having compared ourselves with, for example European companies like Turkish Airlines, Lufthansa Group and IAG in the United States and Asia, Singapore Airlines. So like most peers with the exception of IAG and American Airlines also had a slight increase in load factor. Okay, let's go further.

Capital structure. Debt profile, so our total debt increased by 42%. The majority is represented by finance lease liabilities, and net debt works out at a level of RUB 91 billion – almost RUB 92 billion – which demonstrates a 36% increase from the last period. Net debt to EBITDA is 4.7x

better from the nine months figures. Then break it down by currencies, like finance lease is represented by dollar and total borrowings like short-term cash lines or like money, the money markets 90% rouble-denominated. Finance lease repayment schedule is on the right lower corner of the slide.

Next slide, operating free cash flow. Net cash flow from operations is almost RUB 35 billion but net capital expenditure 4.7 and that's drawing our free cash flow to a level of RUB 29 billion, which is almost 5% higher than the corresponding level of the previous year.

I think that's all about the presentation. Now we can switch to the Q&A session.

Operator: Thank you. If you would like to ask a question at this point, please press the star or asterisk key followed by the digit 1 on your telephone. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. If you find that your question has already been answered, you may remove yourself from the queue by pressing \*2. Again, please press \*1 to ask a question. We will now take our first question from Denis Vorchik from Uralsib. Please go ahead; your line is open.

Denis Vorchik: Well, good afternoon, gentlemen, thank you for the presentation. My question is regarding the yields. So you disclosed that the yields on domestic lines dropped faster than that on international lines, and you mentioned actually that competitors increased capacity. So how do you see the yields going forward on domestic and on international lines and which routes do you see getting more competitive going forward?

Shamil Kurmashov: Thanks for the question. Yes, we did say that the yields decreased on domestic routes faster than international as a result of a number of actions. The first one is the launch of Pobeda, as I mentioned. The second is – we mentioned it in the previous call, I didn't repeat it this time but it's important – the launch of non-refundable fares which obviously come at the lower end of the pricing range and therefore affect the yield evolution.

As far as the outlook, obviously we're not expecting to be talking about outlook as it was said at the beginning of the call, but it is reasonable to assume that yields will remain stable for the remaining part of the year. Thank you.

Denis Vorchik: Okay, thank you.

Operator: We will now take our next question from Mikhail Ganelin from Gazprombank. Please go ahead; your line is open.

Mikhail Ganelin: Good evening, thank you for the presentation. I have one question, why staff costs increased so strongly in the third quarter?

Shamil Kurmashov: Due to three main factors: 1) the option programme, the payments under the option programme this year, 2) payments for the net income for bonus for management, I mean not top management but for 15,000 staff which represents the core personnel of the company, and 3) reserves for holidays which was created by us. All these three elements were not present in the last year.

Mikhail Ganelin: And payrolls are denominated in roubles; they are not in dollars? For pilots for example.

Shamil Kurmashov: Yes, all the salaries for the top management are denominated in roubles.

Mikhail Ganelin: Okay, thank you. So, and you don't provide any guidance on 2015 in terms of passenger growth, turnover, yields?

Giorgio Callegari: Let me say we don't give any guidance but what we can say is that, as I believe I clearly explained, our strategy has proven to be successful, we believe in our strategy and we believe in the opportunities, also as Shamil said, that critical situations present us with. We have the capital structure and the network and the multi-brand approach that will enable us to take advantage of market opportunities; therefore we will continue to grow in line with what we believe is the potential of the market.

Shamil Kurmashov: And we would like to say it will be the Board of Directors, and therefore we are going to present our consolidated budget to the Board, and before that we cannot comment on it because it might not be approved by the Board or it might be significantly corrected by the Board members.

Mikhail Ganelin: I'm just curious that for example next year, you will increase your fleet – well, your net addition will be around 19 planes – and let's assume that there will be no growth next year, so is it a risk that your load factor will decline or yields will decline further? This is what I think markets have said.

Giorgio Callegari: Again, without disclosing sensitive information, we are – as we clearly said – 30 point something, 30.2% of the total market of Russia. So the fact that the market decreases, the market decreases doesn't mean that Aeroflot should decrease or that the load factor of Aeroflot should be affected. As I believe that both Shamil and I clearly explained, we have a strategy which is leveraging our Group structure. So penetrating Vnukovo with Pobeda and Orenair will represent a major opportunity for growth in the face of weakening competition. We are capping the growth both in the South and the North, in St. Petersburg, by improving the efficiency of those two subsidiaries, and we are reshaping the growth of Aurora in order to better serve local communities. So all in all, we believe once again that we have the right answers to face both a growing market as well as a shrinking market because we believe that we have opportunities to gain significant market share from other competitors.

Shamil Kurmashov: I would add something. You know that the risk of overcapacity exists from time to time on the market and it's a permanent risk. For example if the market is growing, so all the competitors try to increase their volumes and there is a certain additional, maybe exorbitant additional capacity into the market. But let's look at the results of nine months. The domestic market demonstrated growth of almost 19 point – 20%. So therefore all these signs of crisis were in place from the beginning of the second quarter and then despite this fact, the market has substantially grown. We are trying to allocate capacity to the market when we have certain market problems, our market share is below a fair market value. That means that we can increase our market share not diluting our rouble-denominated tariffs. Of course it can be

reduced to zero by the rouble depreciation or devaluation but this is a totally different story. I am talking now about the business.

So in the international markets, European destinations, we clearly see the decrease of frequencies by our competitors – by British Airways, Lufthansa – they decrease their capacities from cities in Europe to Russian destinations and we don't know why the policy is so, but we are trying to get advantage of these steps and also to grow in Europe by 6% at least.

In Russia we are going to grow by 18–19% in some destinations. For example, I mean if you take the CIS, we would commence our flights to Tbilisi, so we launched our flights in 2014 but it wasn't for the full year. Therefore arithmetically, we have the operations to new destinations like Kishinev and Tbilisi for the full year. Then we're also expecting re-launching of operations from Ukraine, from Dnipropetrovsk and Kharkiv, that would also be accountable for the full year. Internally, we reopened too destinations like Murmansk and Arkhangelsk. These destinations were not operated by us because we had the understanding of our format of the company – not that we didn't have the right to – we had the right but there were agreements not to fly to these destinations for the period which ends in 2014, therefore we reopened these destinations. And to the remainder of those destinations we are going to fly, we increased the frequencies per day and per week thus leveraging the benefits of our six ways hub in Sheremetyevo. Because we increased the number of connectivity, the quality of our products which makes us more comfortable for our passengers. In this case it's not by tariffs but by the quality of connectivity by our network.

And again, we are lower than the fair market value on a lot of destinations in Russia and we would like to take advantage of the problems which are present in activities of our competitors – and increase our market share internally. Therefore we think that the arriving capacity of +11% as we assess it rather fits in the market, fits in the conditions where we are operating our business. Thank you.

Mikhail Ganelin: Okay, thank you very much for such a detailed answer. Very clear.

Operator: We will take our next question from Daniil Fedorov from Goldman Sachs. Please go ahead; your line is now open.

Daniil Fedorov: Good evening, Giorgio and Shamil. Thank you for your presentation. I have a couple of questions if I can. First on dividends, maybe a bit early to speak on this but given that you have a lot of non-cash items in your P&L and your cash flow looks good, how are you going to distribute dividends? Do you see a possibility that dividends will be paid from adjusted net income?

Shamil Kurmashov: We expect the approach of our main shareholder like Ministry for Property of the Russian Federation wouldn't have changed and the level of dividends is at the level of 25% of the consolidated IFRS income. So if we are going to produce consolidated loss so we are not going to pay anything. We don't take Russian accounting standards income. We take the consolidated IFRS statements for those purposes.

Daniil Fedorov: Okay, that's clear. Another question if I can on fuel expense. Could you please say what percentage of your budgeted fuel expense is already hedged for 2015 and if you can also provide the level at which you hedged this expense?

Shamil Kurmashov: So the current hedging ratio is 70% and the sliding window is that we are going to increase the share but also taking the attractiveness of this very volatile market. You know that fuel expenses correlate in a direct manner with the cost of crude oil. So currently our hedging ratio is 70%; we are going to increase it up to 80%. That's our hedging standards and we would be in line with that.

Daniil Fedorov: Thank you very much; that's clear.

Operator: We will now take our next question from Andrey Rozhkov from Metropol. Please go ahead; your line is now open.

Andrey Rozhkov: Gentlemen, good evening and thank you for your presentation. My question is about a possible buyback. Just to remind you that Aeroflot already bought shares from National Reserve Corporation in the first quarter 2010 at a price level very close to the current price level.

And my question is will you propose to the Board a possible share buyback from the market to support the share price and maybe to use these shares for privatisation in 2015 or later?

Shamil Kurmashov: We now assess the conditions of our markets and they are favourable for buyback operations. Of course with the confidence of the Board, and surely we are going to present our proposals for the actions in the market, but everything will be decided by the Board.

Andrey Rozhkov: Okay, thank you.

Operator: We will now take our next question from Georgy Ivanin from Deutsche Bank. Please go ahead; your line is now open.

Georgy Ivanin: Good afternoon, everybody. I have a question regarding ... actually a follow-up question on your fleet expansion for next year. Could you elaborate a little bit whether you have enough flexibility to cancel some plane bookings or maybe sublease them in case of substantial market deterioration in the next year?

Giorgio Callegari: Okay, thanks, Georgy. Well, first of all, I think we have said very clearly that we believe in effect that we will not need to resort to those actions because again we have a 30% market share on a market which is, we estimate will end 2014 at over 110 million passengers total. So we have significant room for growth. If the market will be so critical that all the growth plans will need to be revised then we'll start discussions with the counterparts and we'll assess what the options are. Already at this stage, as we said very clearly, we believe in our growth strategy and we therefore align the most efficient approach to that.

Georgy Ivanin: Okay, and maybe could you give some colour what typical penalties or fees are if an airline cancels a plane booking, plane order, if you can?

Giorgio Callegari: No, we cannot disclose that. Those are the confidential terms of contracts that we have with lessors and manufacturers. And again, if the situation comes to a point where a renegotiating of phasing is necessary, then we will entertain those negotiations and will disclose accordingly what the results of those negotiations are.



Shamil Kurmashov: Yes, I'd like to tell you that very seldom in the past we paid what were called penalties, direct payments, like penalties to our lessors. In the case we don't need this or that aircraft, we transfer it within the Group; if we don't need it at all within the Group, so we negotiated for further business. We can shift deliveries of new aircraft maybe, or freeze out one aircraft in exchange for growth of business for this lessor in the future. So the majority of the transactions and/or the negotiations with them are based upon this principle. So we've never paid direct penalties in the past although we knew that there was a crisis in 2009 for example and that there was a crisis RUB devaluation in Russia. At that moment, we didn't pay any penalties; we just changed the rates of delivery of this or that aircraft in the future.

Georgy Ivanin: Okay, thank you for that. If I may, one more question on operating lease expenses in Q3: they were flat year-on-year in rouble terms and in dollar terms they decreased. If I'm not mistaken, your operating leases are mostly in dollars and you had some kind of a fleet expansion in the first half of this year. What's the reason for the decrease in operating lease expenses in Q3?

Shamil Kurmashov: So in real terms, we expect 8.7% growth in operating lease expenses. So if you take a net effect of business drivers, excluding from the analysis the FX factor, the fleet would be more expensive for us in absolute figures because we expect the delivery of 3 Boeing 777s out of maybe 18-19 aircraft which are going to come to our fleet. The price for them is significantly higher than for Airbus 320 or Boeing 737NG. Therefore we don't see any contradiction in what we are demonstrating.

Giorgio Callegari: Page 24.

Georgy Ivanin: So it's basically change in types for fleet of planes, right?

Shamil Kurmashov: Yes, the change in the structure of the fleet.

Georgy Ivanin: Okay. Okay, clear, thank you.

Shamil Kurmashov: Thank you.

Operator: We will now take our next question from Irina Stupachenko from Otkritie Capital. Please go ahead; your line is now open.

Irina Stupachenko: Good evening, gentlemen, thank you very much for your presentation. I have a follow-up question on fuel. Actually we have not seen any material effects from your hedging strategy so far as there was just no significant drop or increase in oil price. But in the fourth quarter we have seen some 20% quarter-on-quarter drop in crude oil prices and I expect that we should see some more substantial gains or losses, extra losses from hedging. So could you please just give us an indication of what scale of losses should we expect in the fourth quarter and in 2015 as well, if taking into account that you are going to actually increase the size of your hedge?

Shamil Kurmashov: Thank you for your question, but if you can answer the question what will the oil price be in two months or maybe in two weeks, in this manner, we would have asked you this question. Our auditors constantly make the valuation of the current mark-up value of the derivatives which are on our balance sheet. So they are reflected in our P&L for part of the contracts and in the capital change in our balance sheet. So therefore the current amount of the losses, which I refer to as a reserve, for nine months is RUB 500 million. That's a valuation. There's no cash out of the company because up to now, we have payments in two Aeroflot-owned banks. But according to our auditors' approach, like creating the reserves on our balance sheet for nine months, this is the figure which I've already mentioned. And for just end of the year, any forecast would be misleading because we don't know the price of oil even for tomorrow because even the current level is very, very surprising and is not driven by fundamentals as the majority of experts say. Therefore we cannot disclose you the figures besides those ones which are audited by our current auditor Pricewaterhouse, and which is embedded in our nine month financials.

Irina Stupachenko: Okay, but am I right at least that you are hedging, that your strikes are actually above the current levels, right?

Shamil Kurmashov: Yes.

Irina Stupachenko: Okay. And my second question is regarding the big deferred tax gain that you showed for the third quarter: could you please elaborate more on your income tax policies and whether we should expect such big gains going forward if you post some big forex losses due to revaluation of financial leasing liabilities in the P&L?

Andrey Napolnov: It would be explained in a very long and detailed answer and I would propose that we could send you a short letter admitting the detailed information of our policy, our methodology, which is now officially approved by the Board, and the corresponding figures. So we'll send you shortly after the meeting; I think it would be more reasonable.

Irina Stupachenko: Okay, thank you very much.

Operator: We will now take our next question from Alexandra Serova from Renaissance Capital. Please go ahead; your line is open.

Alexandra Serova: Good evening, gentlemen. Two questions from my side. First on fuel surcharges: can you give us a rough estimate of the share of fuel surcharges in your ticket prices? And my second question is about this dynamic price system introduced by FAS that requires prices to be cut closer to the flight date. So it seems that some of your competitors have decided to follow this initiative. So what's your view? Do you plan to make, to execute this system and how can it affect your pricing? Thank you.

Shamil Kurmashov: Thank you for your questions. For the surcharge in the fuel prices, you know this is something virtual which was invented by the airline companies. So there is a certain surcharge which we place on the shoulders of our clients. If there is increase in the oil price, we can pass it through to our passengers. If there is decrease, so vice versa. But no, I would like to say to you that that's like a virtual explanation of our pricing policy because not always, it's not always the case that this charge would follow the oil price because we cannot, we understand there's a disposable income of our passengers which cannot afford a certain level of pricing when we quote the prices for tickets. Therefore surcharge is something which doesn't exist. It's an

element of the marketing policy. We can just take over the increase of oil price and don't pass it through to our passenger. However, we make the corresponding increase in our tariff. Therefore we don't use such a term inside the company. It's like the marketing policy and the revenue management policy.

As for the Federal Antimonopoly Service, surely we know about this initiative and although competitors declared or announced that they follow the recommendations of FAS, we are now looking very attentively at their pricing policy because you know that what they are proposing contradicts the best international practices and methodology of air ticket pricing. Because the more you go to the time of the flight, the more the price is. That's the principle based on which a lot of companies – all companies all over the world, they follow this principle and I don't think that we should reinvent the bicycle and propose something which would differ radically from the policy of the remainder of the airline industry. Just in this way, of course we would create two test areas, for example two test destinations, we would try to demonstrate to FAS the results of implementing their policy. For example, we would make the sale of tickets on one high destination, one for the high season, and one for implementation in the low season, and we will get the results and discuss with them, with FAS, whether it would be reasonable to implement their proposal. Because the theoretical experiment which is derived from nowhere and we're trying to get the figures from the practice to demonstrate or present them to – our methodologies from FAS and then decide what to do further. So up to now we haven't implemented this and we know that our competitors also didn't do anything in that direction.

Alexandra Serova: Okay, thank you very much.

Operator: If participants would still like to ask a question, please press \*1 on your telephone handset, \*1. We will now take our next question from Dmitry Sorokin from VTB Capital. Please go ahead; your line is now open.

Dmitry Sorokin: Good evening, everyone. Thank you for your presentation. My question is actually regarding your leasing costs. Do you expect operating and financing lease rates could increase in the new contracts? If you do, are you going to consider some options such as altering the duration of contracts or maybe postponing some aircraft deliveries? Thank you.

Shamil Kurmashov: Thank you. You know that's only the small part, a not very big portion of our lease contracts are represented by finance leases which are linked to LIBOR or other indicators which dip from time to time. Before that, we hedged our finance lease liability body having converted the floating rate into the fixed rate. So we don't expect any leases to be more expensive in the forthcoming days.

If we take the operating lease market, the prices for this market demonstrate the downward trend, not the increase in prices because there are a lot of aircraft in the backlog and not always – a significant amount of airlines, they renounced the contracts, they exit from them. Therefore there are a lot of new aircraft which are on the secondary market which are placed there by the lower price due to the fact that they should be remarketed by the lessors because they don't have any other way to find homes for them. Therefore, answering your question, we don't expect any increase in operating lease – I mean in leases at all.

Dmitry Sorokin: Okay, thank you.

Operator: We will now take our next question from Daniil Fedorov from Goldman Sachs. Please go ahead; your line is open.

Daniil Fedorov: Yes, sorry, just wanted to follow up on yields. You said that yields probably will be flat going forward till the end of the year so just wanted to clarify, are we speaking in terms of roubles or US dollars and is that versus third quarter or fourth quarter? Thank you.

Giorgio Callegari: Roubles, versus third quarter.

Daniil Fedorov: Thank you very much.

Andrey Napolnov: Sorry, we are running out of time so I guess that was the last question. Thank you for the call. If you have any follow-up questions, you can send them to [ir@aeroflot.ru](mailto:ir@aeroflot.ru).

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