

## Aeroflot Group IFRS Financial Results 6M 2014

### August 28, 2014, 18:00 Moscow

Operator: Good day, and welcome to the Aeroflot Group IFRS Financial Results 6M 2014 Conference Call. Today's conference is being recorded. At this time, I would like to turn the conference over to Adilya Fokeeva. Please go ahead.

Adilya Fokeeva: Good evening, ladies and gentlemen. This is Adilya Fokeeva, Head of IR at Aeroflot. Thank you very much for joining Aeroflot's conference call on the consolidated IFRS financial results of Aeroflot Group for the six months ending 30 June. Today we have two speakers: Aeroflot Deputy CEO for Finance and Network and Revenue Management Shamil Kurmashov, and Deputy CEO for Strategy and Alliances, Giorgio Callegari. Our conference call will last for an hour, and I suggest we pursue the following agenda: 25 minutes for our presentation, and then a Q&A session.

Before going forward with the presentation, I would like to address you with a disclaimer. The presentation contains forward-looking statements and all the comments and announcements to be made in the course of the conference call do contain forward-looking statements which relate to Aeroflot Group's business and its results. Any statements other than statements of historical fact are or may be deemed to be forward-looking statements. Forward-looking statements are statements of future expectations that are based on management's current expectations and assumptions, and include known and unknown risks and uncertainties that could cause actual results, performance, or events to differ materially from those expressed or implied in the statements made during this conference call.

With that, I would like to hand over to Shamil Kurmashov.

Shamil Kurmashov: Good day, ladies and gentlemen. Let me begin with a few general inputs which might be of interest to you. So, Aeroflot Group continues to outperform the Russian market in passenger traffic, solidifying its leading position across domestic and international routes. We continue to grow faster than the market in terms of not only passenger traffic but also revenue, especially in the domestic segment.

At the same time, we saw a material impact in our performance related to the more challenging macroeconomic environment and strong movements in exchange rates. So, revenue growth of approximately -- almost 10% year-on-year supported primarily by stronger traffic was supported by also a positive effect in the foreign exchange rates, but which was negatively offset by lower fares in the weaker economic environment, I mean, the lowering of yields.

So, weaker consumer confidence, combined with a double-digit capacity growth in the market, required an adjustment of fares. It was illogical, because we couldn't go on growing in physical terms, or like competitive passenger terms, in passenger turnover terms, the companies with strong load factor and also stabilizing our yields. And that was the case. That has been the case for a period of three and four years.

Aeroflot's cost base was also materially impacted by ruble devaluation as some of the expenses are USD-denominated. We are also going to speak about one-off events which had a significant impact on operational expenditures, in particular we build substantial provisions for impairment of accounts receivable and made provisions on early return of

MD-11. We had three freighters in our fleet, but also we retired Tupelov 204 aircraft. Thus, the systematic step on the way of renewal of fleet, and we get rid of the -- all those aircraft, which continued to negative cash flow generation. Adjusted for one-off effects, the Group's profitability is positive at both operating and the bottom line level, which differs from the nominal figures which you might see in the press release and in the presentation.

Looking ahead, the environment remains very uncertain. Despite these challenging conditions, the Group's overall strategy remains intact as the medium-to long-term potential for growth in the Russian market remains very strong. At the same time, fares and yields began to stabilize in May because we have some recent data about the yields in May, and also June. We don't have any significant capacity growth planned for the second half of 2014. Therefore, we are not going to grow extensively. We are going to more efficiently use our capacity.

In response to a tougher pricing environment, we are further increasing our focus on cost controls and efficiency. We have several new initiatives underway both on the subsidiaries and parent company levels that are expected to reduce cost of aircraft servicing and -- administration and general expenses and other costs. All of these inputs are going to be duly addressed just over the course of the presentation.

And now, I would like to pass the role to Deputy CEO for Strategy and Alliances, Giorgio Callegari, who will speak about strategy and market conditions, market solution and also the competitive environment.

Giorgio Callegari:

Thank you, Shamil. Good afternoon and good morning to everybody. I'll be happy to walk you through the part of the presentation that deals with the market conditions and the commercial performance of the Aeroflot Group and those conditions, and about the outlook that we have in terms of commercial performance for the immediate future, as well as the impact that that might have on our strategy.

Let me start with the market performance in itself. And as we have said already, I would say several times: we can confirm that the Russian market continues to grow at a very fast pace. The first half of 2014 has seen the market as a whole grow 9%. That's much higher than all the neighboring markets, Europe to our west and Asia to our east, and is the result of a very high growth in the domestic section of the market -- plus 17% year-on-year -- and a lower growth on the international market.

Now, as far as the domestic market is concerned, part of that growth is extraordinary in the sense that it has the result of the Sochi Winter Olympics, as well as the fact that there has been a significant growth of air traffic to Crimea for the well-known reasons. That has resulted in a slightly lower growth of international traffic, as I said 5% versus the traditional 8%. All in all, all the fundamentals are still there. The market is growing faster than the others, and is growing faster because of sound drivers. So, penetration of air transportation is still low, and there is still a significant move from other means of transportation, in particular rail, to aviation.

What's the position of Aeroflot in these markets? It is one of increasing market share, so we ended the -- basically last year with a 30% market share, and the first six months of 2014 see Aeroflot at a 31% market share. And that comes as a result of successful implementation of our strategy in a market which continues to be affected by fragmentation.

What is interesting is that the other four major players in Russia, so notably TransAero, S7, UTair and Ural, still have more or less the same market share that they had last year. And therefore, there has been no growth in competitive position of the other Russian

players. The market has been consolidating, so the first -- the top five players have gone from having 53% of the market share to 65%, but we believe that it will continue to grow towards consolidation in the next few years.

Now, what is our performance in that market? Well, as you heard me say several times, we believe that we have the right answers to address a growing environment as well as to address a somewhat less encouraging environment. And those features are based on our focus on limited expansion in terms of destinations. As you might see in the presentation, we still increase destinations but with a very limited pace. So, only Novy Urengoy in Russia and Karaganda in CIS so far, and some seasonal destinations in order to take advantage of our effective cost base that enables us to serve successfully also leisure markets.

Therefore, the focus of our development remains on increasing frequencies, which is further consolidating the quality of our network. As you see in the chart, the number of frequencies per destination has grown 12%, from eight frequencies scheduled to nine frequencies scheduled, while at the same time we're reducing the number of charter per destinations because we've become more and more selective in the destinations that we serve. The increasing frequencies are applied both on medium-haul destinations as well as in long-haul destinations. So, once again, the focus of our network is to improve the quality of the schedule for business passengers to domestic, international, and intercontinental destinations.

Sheremetyevo remains the focus of our operations, the main hub, and, as you see, connecting traffic is growing, shown an appreciation of Sheremetyevo by our customers. It remains still well below some of the other operators, both in Europe and in the Middle East, and has reached a percentage with which we feel comfortable. We don't have plans to grow the percentage of connecting traffic beyond that level because it would expose, we believe, Aeroflot too much to fluctuations in the market and would make us too dependent on connecting traffic. And what is happening in these days, in these weeks, with the effect of the Ebola virus spread in Africa I think is leading to a number of carriers rethinking their expansion in a number of markets where point-to-point flows are very small.

In terms of growth, therefore consistently, we have put, and continue to put, most of our attention on the booming Russian market, and we have been able to increase capacity, but we have outpaced the growth in capacity in terms of passengers carried, and therefore we have seen an increase in load factors. The same has not happened as far as Europe is concerned and as far as Asia is concerned. As far as Europe is concerned, that is also the result of a restructuring of our network, in particular of Rossiya, where we have terminated a number of flights which are no longer justified in the newly integrated network of the Group.

As far as Asia is concerned, we have grown capacity significantly as a result of the addition of the B777s that came into the fleet in 2013 and the beginning of 2014. And therefore, even though we've seen a decrease in load factor, we are comfortable with the kind of strategy deployed there because, once again, it's not aggressively depending on connecting traffic. The decrease on passengers that we show to Asia is not the decrease on scheduled operations of Aeroflot, but is the result of a revision of Orenair operations in that area. As far as CIS is concerned, you might see a decrease there, but is the result of mostly the Ukrainian crisis, and therefore the termination of services to that destination. And as far as the rest is concerned, is mostly Northern Africa and the Middle East uprisings.

As far as operating indicators are concerned, we have seen a positive trend in terms of passenger traffic over last year throughout -- not only the six months for which we are

reporting the results, but the trend is continuing in July and onwards. There has been a less higher growth in terms of RPKs, but that's the result of a different fleet mix. More narrow bodies in percentage than wide bodies, even though, as I said, we have increased the number of B-777s has resulted in average shorter stage length, and therefore in a comparatively lower growth in RPKs. It's an arithmetic effect. It's not concerning development.

In terms of load factors, we had low load factor compared to last year due to an aggressive growth in capacity in the first three months. We have recovered in terms of performance in the following months, and the trend shows that we are continuing on a positive side. And therefore, year-on-year, the seat load factor, has increased 2.5 percentage points.

In terms of revenue breakdown, we continue to remain a scheduled airline focused group, with 91% of the revenue coming from schedule operations, and about 6% coming from charter operations. As far as cargo is concerned, now we have a significant capacity in our bellies, and that's therefore an opportunity to have an interesting portion of our revenue coming from cargo, but it's a tactical approach and consistent with the decision to phase out the full freighter airplanes about which Shamil will talk later on.

All regions are showing significant growth, Russia plus-15% year-on-year change. Europe, notwithstanding the fact that, as I said, the load factor was somewhat less than targeted, still showed about 9% increase in revenue. And Asia, as well, is about 8.5% growth in revenue. North and Central America, 16.5% as a result of our increasing capacity to some North American destinations.

In terms of yields and RASK, which has been a topic of great interest for the analysts, and obviously for the market at large. Yields for the Group have performed well in rubles, plus 4.3% compared to last year and negatively in US dollars, minus 7.5%. That is the result of a decrease of yields in Russia, minus 2.1% in rubles and minus 13.2% in dollars, as a result of a pricing policy aimed at dealing with softening of consumers' purchasing power. On the other hand, we've had an increase in yields on international routes, plus 2.4% in rubles, and minus 9.1% in dollars. All in all, this means an increase in RASK of 3.3% in ruble terms.

Let me spend a couple of additional words on this. It means that, yes, we have adopted a policy which is reflective of changed market conditions. In adopting that policy, we have been able to protect yields in ruble terms in international markets where we have more competition, and we have accepted a slight decrease in yields in the domestic market also as a result of decisions taken to broaden the customer base, and in particular with respect to the Olympics.

In terms of efficiency, commercial efficiency, the parameter is RASK -- Revenue per Available Unit of Capacity -- which is a reflection of the way that we fill our aircraft and we price the passengers that we carry. And that has increased. So, even in this difficult market environment, commercially we have delivered better than last year. That is what leads us in terms of operating guidance to state the following: Our long-term strategy of growth is intact. We see the market as still showing a significant potential because, as we said on several occasions, notwithstanding the fact that other, let me say, discretionary spending might see a reduction, demand for transportation still shows healthy growth rates -- not only on the main line but also the response that we've had from the market on the launch of Dobrolet is showing that the project of launching a low-cost company within the Group is a successful launch.

Obviously as the market outlook is characterized by some political instability, we believe that most of the growth will come from the domestic market, and there will be slower

growth on the international market. That combined with a conservative approach to capacity growth, because we have shown that we've been able to grow market share even with capacity growth which is below that of some of our competitors, enables us to not only target improving RASK, but to target stabilizing yields. All in all, in terms of metrics, we see an updated RPKs guidance of higher single digit growth, a load factor which will be stable or potentially marginally better, and a year-on-year performance for the year which will see, again, a high single digit target percentage growth compared to last year.

Thank you for the attention. I'm happy to turn back to floor to Shamil.

Shamil Kurmashov:

Thank you, Giorgio. Two words about our fleet: as of the end of 2013 we had 235 aircraft in our fleet. By the end of the first half of 2014, the amount of aircraft works out at a level of 251, plus 16 aircraft over this period. We continue renewing our fleet, substituting old aircraft with modern, fuel-efficient aircraft, and unifying the fleet of subsidiary airlines. Ultimately get rid of six old-fashioned Tupolev 204, which was in our subsidiary company, Vladavia. These aircraft were very inefficient and had contributed \$100 million of loss in our network. Therefore, we retired these type of aircraft, and we also agreed with the Boeing Company to phase out three freighters, MD-11. These two positive steps allowed us to reach the targeted level of our fleet age of four years. It's lower than it used to be some time ago, which makes our fleet one of the youngest in the industry, and the youngest in Europe.

We were moderately growing our capacities and demonstrated only 5% interest growth in ASK compared to 7.4% growth in the overall sector. So, we are increasing our capacity less than the industry, because we are going to more efficiently use these aircraft. The majority of our aircraft is represented by operating lease. We have flexibility in terms of aircraft additions, and our order program is regularly adjusted on the basis of demand. As of today, we expect 99 new aircraft to join the Aeroflot Group fleet in 2015-2017. These will include Boeing 777, Boeing Dreamliners 787, B737NG, Airbus 320 family aircraft, and SSJ. At the same time, we are planning to further phase out six remaining -- not six remaining -- Ilyushin-96, that we have only two machines of this type in our fleet, and we are going to accomplish the phasing out in a couple of weeks. We reduced to zero the amount of Boeing 767, and therefore our fleet is -- would be represented by only new machines.

Let me talk about financial performance on the key financial results represented on slide 18. There is 9% increasing growth in our revenue and we have sort of nominal negative margin, and I am going to explain it, and we're going to speak about it in more detail. But, we have very positive movement above the shift in operating free cash flow. I mean, 20% growth compared to the respective periods of the previous year. Our EBITDAR margin is 13% if we exclude non-recurring expenses, and I'm going to explain why we exclude them. Our cost base was impacted mostly by ruble depreciation and non-recurring spending. So, we generated significant amount of free cash flow due to higher working capital inflows, driven by growth of unrealized transportation revenue, because we have sales which were so-called unearned revenues because we got the cash for the sales but we didn't carry the passengers in this period. And this operating cash flow offsets lower operating results for the first half of 2014.

If we go line-by-line analyzing these key fundamentals, first of all, I would like to speak about revenue on slide 19. Our revenue growth of 9% was a result of traffic volume growth, plus more than RUB10 billion, decreasing use on the back of like consumer -- weak consumer sentiment, slow economic growth, intensified competition. This was also offset by foreign currency movements. So, the positive foreign currency difference is plus RUB10 billion, which was almost to the full extent offset by softening of pricing.

Combined pricing and currency implication was positive and accounted for RUB700 million, as you can see from this chart. If we go to the cost side of the economy of the company, almost all cost items were negatively impacted by foreign currency exchange rate fluctuations. Overall cost increase, excluding currency effect, was mostly driven by change in operating lease, staff cost, and other expenses. Operating, as you know, in the aviation industry, the majority of expenses and -- operating less, expenses are denominated in rubles, in dollars, and we had great amount of aircraft which were delivered to our fleet.

And the second factor on the cost side is personal expenses, which grew as a result of wages growth. There was indexation in October 2013, which resulted in the increase of the line of cost in the first half of 2014. And also, there was introduction of share-based payments. They were not part of staff costs in the first half of 2014. That's why these two bases are not comparable. Other expenses growth was mostly driven by one-off provisions for bankruptcies of tour operators, as you know, that our subsidiary charter company, Orenburg Airlines. We dealt with Ideal-tur and Pegasus. These first of these companies became bankrupt in this year, which resulted in RUB1.6 billion of write-offs, but they haven't been written off yet because they were reflected as reserves in our P&L. And RUB200 million, which is like debatable amount, with Pegasus. It is not bankrupt, but, nevertheless, we have issues relating to this amount. Therefore, RUB1.6 billion plus RUB0.2 billion and RUB1.8 billion reserves were created by their owner.

But, at the same time, we had enhanced fuel efficiency and lower fuel consumption ratio as a result of replacement of older aircraft with new, fuel-efficient fleet. Our traffic and passenger service costs are directly linked to passengers and RPK, and we're growing largely in line with our passenger traffic. We also managed to decrease sales, general and administrative expenses as a result of continuous cost optimization. We have plans to further reduce these amounts by more than RUB2 billion. We have put a program in place, and it was approved by the Management Board last week.

Now, I'd like to switch to CASK, I mean Group cost analysis. On a per-unit basis, cost per ASK increased by 4.2%, excluding currency impact and non-recurring items. Increasing in staff costs on a per-unit basis in ruble terms was driven by wage increases, which I've already mentioned in the last slide, which happened in October. The decision was taken in October 2013. Impact from stock-based compensation is a non-cash item, and it's an accrual-like adjustment, which was recommended by auditors, and its full-year impact will depend on the share price performance in the end of the year. Continued focus on fleet modernization and fuel efficiency led to almost stable cost per unit on ex-currency basis plus .01 in ruble terms. We're continuously optimizing maintenance and repair costs and saved also in CASK terms 0.01. Overall CASK performance was mainly driven by favorable currency fluctuations and non-recurring items as a result of provisions for doubtful accounts receivable for two apparatus, which I already mentioned in the previous slides.

So, if we -- just clear as a result from one-off expenses and nonrecurring items, it would be 4.2% decrease in CASK. If we look at nominal figures, that would be a 9.7% increase, so therefore we should analyze line-by-line items that will stand behind -- that's the aim of the following slides.

Managing fuel costs. As you know, the majority of fuel purchased in Russia, and this amount stands for 83% of our total annual consumption. And almost all fuel in international airports and international destinations are supplied as formula linked to that price. That means that it's linked to Northwest Europe FOB Rotterdam price plus multiplied by discount and multiplied by the foreign exchange rate, multiplied by value-added tax, and all the components of the formula which you see on slide 23.

As you understand, the formal pricing is very transparent, and we achieved these efficiency gains in fuel costs because of that. A long-term supply agreement of transparent pricing mechanism largely protects us from fuel price spikes. We expect approximately 2% growth of fuel prices in September versus August, but see this as normal seasonal factor as a result of decreasing supply from refineries reallocating capacities to fuel oil in autumn and winter, because the balance of the finished products which are delivered to the market by refineries differs from season to season, and in this case we have certain deviation and this reflects perhaps 2% of growth in fuel price, but it is not negative trend. Our average fuel purchase price of \$900 per tonne in first half 2014 versus \$915 per tonne last year.

So, going forward with headcount overview and labor productivity on slide 24, we increased our headcount number in the first half 2014 by 7.7% for RFO, standalone, and by almost 5% for the Group, managed capacity expansion. We are very focused on cost discipline, and we have three metrics which we historically demonstrated during our conference calls and during our presentations: traffic revenue per average headcount, RPK and the PAX traffic divided by average headcount. In all these three metrics, you see that, in -- so we have 6% increase in PAX turnover, while RPK average headcount was flat due to lagging growth of RPK versus traffic due to fleet structure change. Aeroflot's staff costs in first quarter 2014 were also impacted by share options-based payment of approximately RUB600 million, which were not part of staff costs in the previous year. So, the overall message of this slide is, like, we effectively managed our headcount.

Now, I will -- I would like just to draw your attention to the analysis of operating income and net income and the reconciliation between the nominal figures which you see in our statement and the adjusted figures, which reflect the changes in our economy and all the hidden factors which might justify the performance of the Company.

When adjusted for nonrecurring provisions base, Aeroflot remains profitable. We have created a provision for 100% of doubtful accounts receivable from Pegasus and Touristik and Ideal-tur, as we had already explained. And we don't expect any impact on Aeroflot P&L from this for the remaining part of the year. Moreover, the sum amount of RUB1.8 billion, which were reflected as reserves, and adversely affected our bottom line, would be offset by proceeds from the owners of these companies because we have certain surety agreements with the shareholders of these two operators, and we will use all measures available to Aeroflot to recover these accounts receivable. That's why the figures which you see in the financial statement is usually the most conservative ones, and that's the approach of the auditors.

Compare of pre-term returns of Aeroflot's cargo aircraft MD-11 and, yes, Aurora, that's the second subsidiary company, Tupolev 204, if we just take these two as an -- the combined sector will be neutral on a net basis. So, if we count from RUB1.3 billion of operating income, having in mind the adjustments I explained to you, our adjusted operating income would be RUB715 million. If we make the same adjustment on the bottom line level, so instead of RUB1.9 billion net negative effect, we would have plus-RUB375 million. All the reconciliation has been stated on slide 25.

If we make this structure, and we analyze the structure of the Group operating income, we see that the earning growth was driven by higher passenger volumes and currency effect, and this was offset by decreasing overall use on the back of [INAUDIBLE] macroeconomic environment. And certain effects on our cost side due to foreign exchange movements and nonrecurring expenses are also shown here. The overall effect of nonrecurring expenses and are huge, as shown on this chart, is more than RUB2 billion, which contributes to our income becoming lower than zero.

This structure of Group net income on slide 27, Rossiya Airlines, Vladivostok Air, Donavia, Orenair, Aurora these our aviation daughter companies. The most significant effect comes from Orenair. We understand that it was a really tough year for this company because the tourist market doesn't go up, and we see clear signs that the purchasing power of population and the propensity to spend for leisure segment goes down. Therefore, we see the compression of demand in the segment of charter flights, which translates to RUB3.2 billion loss in Orenair case. So, Aeroflot stands for RUB1.8 net income. Rossiya Airlines -- we have significant negative adjustments for finance lease liabilities. It's a paper adjustment. This is not a cash out of the Company. It translated to more than RUB700 million net loss for the Company. But, once again, adjusting net income for one-off expenses will bring net income to positive and also better than the loss demonstrated in the first half 2013.

Capital structure and liquidity on slide 29, three key messages from this slide. We have manageable debt levels. We have 12% increase in net debt, and the majority as always comes from financing liabilities because we have 16 aircraft coming to our fleet, and they automatically are reflected in our balance sheet like liabilities. Our total debt to EBITDA level is 4.3. We are well capitalized. We have no near-term funding needs. We don't expect any shortfalls in liquidity because [we have] over RUB56 billion available liquidity via cash on balance sheet and undrawn credit line. So, we have a supported cash position.

Borrowing structure by currency: 91% by rubles and only 9% by dollars. So, I think this is a reasonable structure in the current conditions. And out of finance lease structure by currency, 3% are other currencies, and 97% are denominated by dollars. So, we have manageable debt levels. We are well capitalized and we don't expect any shortfalls. And we have consolidated cash position, which is supported by the figures on the next slide, operating free cash flow.

As you see, plus 20% increase in our free cash flow position for the six months 2014 compared with the previous year. We generated substantial cash flow ahead of summer season. This was primarily driven by inflow from sales of tickets ahead of vacation season, increasing our unearned transportation revenue, which was reflected in our cash flow, but it's not affecting our bottom line. Therefore, some items from our cash flow statement will compensate the not very good performance in terms of our net income terms.

Financial guidance, we declared previously that our revenue would be double-digit growth, about 11%. Now, we would like to do some correction on this previous statement, and we think that it will be in line with first half of the year growth, approximately 7% to 8% growth on the revenue level. In operating margin forecast, we declared it would be stable, approximately 7%, margin operating income level, and we stand slightly behind this forecast at a level of 5% to 6%. On EBITDA margin level, the previous forecast was 11%. I think it will be like maybe high single digits, 7%, 8%, 9%. So that's our vision for the whole year.

That's what I wanted to explain and that's all I wanted to show, and thank you for your attention. I think that it's reasonable to switch to our Q&A session now. Thank you.

Operator:

If you would like to ask a question at this time, please press the star or asterisk key followed by the digit one on your telephone. Please ensure that the mute function on your telephone is switched off to allow your signal to reach our equipment. Again, please press star-one to ask a question. We will pause for just a moment to allow everyone to signal. We will now take our first question from Irina Stupachenko from Otkritie Capital. Please go ahead. Your line is open.



Irina Stupachenko: Good afternoon, gentlemen. Thank you very much for your presentation. I have several questions. My first question is about this positive contribution from the working capital. Apart from a substantial reduction in accounts -- substantial growth in accounts payable that actually reflects the still unearned revenues and actually cash coming from ticket bookings, you also showed quite very low growth in accounts receivable, especially as compared with the first half of 2015. We saw some RUB8 billion or RUB9 billion there, minus RUB9 billion, and the only RUB300 million in the first half 2014. Could you please explain what's happened with accounts receivables, so why the change is so low? It's seasonal? Is it sustainable?

Shamil Kurmashov: I would like just to -- I don't have the figures which you used, just because you quoted for the previous year. But, we don't see any extraordinary in the dynamics of accounts receivable, and certain positive changes, like sustainable -- and I think that we will see this trajectory in the future. I think that the dynamics now accounts receivable, if you take first half of 2013 and first half of the current year, more than RUB55 billion was for the previous year, and RUB51 billion for the current year. I don't think this is a positive dynamics, but it's not a very significant one. And I think that's, like, a slight improvement in working with our debtors and our account suppliers, but it doesn't--.

Irina Stupachenko: --I hear you -- yes, you are looking at the balance sheet, and I am looking at the cash flow statement. If you look at the cash flow statement, there is a breakdown of categories in the changes in working capital. And there, if you look at just -- it's a receivable -- it's cash flow statement -- in Russian it's called (foreign language), and there we see just a cost of RUB400 million in the first half 2014 versus RUB8.7 billion in the six months 2013. And I am interested in the reasons, because I expected higher accounts receivables because of this Ideal-tur and Pegasus. I saw that you had some costs, or you buried some costs, and you have not been compensated for them, and that's why you are doing provisions, but I cannot see it in your cash flow statement.

Shamil Kurmashov: Maybe we didn't get the logic of what you are asking us. So, we see on slide 30 other adjustments that are before capital changes, 1.7, and working capital changes and net income tax you see here, yes? So, you reconcile the balance sheet item with the cash flow statement. So, what contradiction do you see? We didn't get your idea. Would you please just say it again?

Irina Stupachenko: Actually, in your slides, you tried to address the difference between this year and last year, and you showed quite substantial positive contributions from the changes in working capital. It was the case in 2013 as well, but at that time it was exclusively driven by increase in accounts payables, which is seasonal as far as I understand, and would revert in third quarter. But, this year we see not only increase in accounts payable, but also a very low reduction in accounts receivable, which is also positive for you because it means that you did not pay someone. Probably somehow it is related to the optimization of your agency network that you use, just low commissions and so you work with fewer agencies or something like this, and that --.

Shamil Kurmashov: --So, maybe we'll take it offline. We'll call you because we'll need a clarification in order to make the relevant answer. We will get in contact with you.

Irina Stupachenko: Okay. Okay. And my second question is about -- just first I wanted to clarify, you expect 2% growth in fuel price. It's for what period? It's for full year '14 or from the levels reached in the first half?

Shamil Kurmashov: If you're talking about -- it's September to August.

Irina Stupachenko: --In the current month, just -- yes, and then -- okay, yes. And the next question just related to this, what are you thinking about fuel price dynamics in 2015 given the tax

maneuver recently approved in the oil industry? I mean, the intent to increase domestic oil prices, this should result in higher fuel and jet care prices, but there may be some subsidies which are currently being discussed. So, what are you thinking of this, and have you negotiated 2015 prices with your suppliers?

Shamil Kurmashov: Yes, sure, we have long-term contracts for 2015, sure. But we have the pricing formula which cannot be changed by any counterparty, any fuel supplier. If certain -- there will be certain amendments to the, like, regulation of the fuel market, and there will be some certain expenses on top of that, it doesn't fit into our pricing, and it doesn't mean that it would be passed through to the airline company by the fuel companies. We have certain protection when we speak about the fuel pricing, and I think that these rumors are something which might be translated into realistic steps. But Aeroflot, given the formal pricing contracts, is well protected again in that. And 70% and 80% of fuel is also hedged. I forgot to say about that. And it gives positive effects in this year already. Did I answer your questions?

Irina Stupachenko: Yes, thank you.

Operator: And the next question is from Anton Farlenkov from Goldman Sachs. Please go ahead, your line is open.

Anton Farlenkov: Hi, good day, everyone. I have questions about -- question about yields. What I don't understand is why don't you increase prices much more in ruble terms, given that your load factor started recovering nicely? Because, based on my estimates, and based on my experience, one percentage point increase -- decrease in yield, it takes 20% of load factor to recover lost net income. So, effectively for you, which is better to keep load factor flat and increase yields. How do you look at the yield environment, as second question, in the last two months? And what is your expectation for September-October, given that you see -- you should see already forward booking? And how is forward booking look like?

Giorgio Callegari: Anton, I think it's actually three questions, so I'll try and answer that--.

Anton Farlenkov: --Three questions, yes.

Giorgio Callegari: I'll try and answer all of those. As far as price increases, that can be applied farther. I think it's a bit difficult to judge in detail our pricing strategy looking only at the Group results. Because as I said, the percentage of narrow bodies versus wide bodies has changed, the RPKs have changed, the proportion of revenue from Rossiya over the Group has changed, the proportion of revenue over the Far East companies over the Group has changed, the proportion of revenues from Orenair, which has seen a significant decrease over the Group, has changed.

And therefore, we believe that we are delivering the best possible pricing policy in the current conditions, and that's why I underline RASK as a metric, because that is a measurement of efficiency across the Group, which is obviously made of different approaches on Aeroflot versus the daughter companies, which operate scheduled flights versus other daughter companies that are operating charter flights.

As far as yield environment is concerned, I think that I mentioned that we see a challenging environment, and therefore we see a revenue expectation in terms of growth, and that was said both by me and Shamil, is lower than the previous guidance, but still higher than last year.

Finally, as far as advanced booking is concerned: as I think it was mentioned in the previous call, not this one but let me repeat it in this one, we are seeing a shortened booking cycle, average booking time earlier on was -- I mean, booking lead was three

months, now is down to 1.5 months, which is still significantly higher than the average booking cycle in more mature markets where customers are used to delay their purchase in order to take advantage of promotions available closer to the date of departure.

That means that we are in an environment that is changing behaviors, and therefore, to give more guidance compared to what we have already said in terms of traffic, we said that we see growth in the low double-digit, high single-digit performance, and therefore that -- considering that we don't have aggressive capacity growth planned for the rest of the year will enable us to defend yields and RASK even in a slowing environment. Thank you.

Anton Farlenkov: Bookings, do you see for September-October, or you should have the data for the Group--

Giorgio Callegari: --We do have the data, Anton, and those data are consistent with the outlook that I just described.

Anton Farlenkov: Okay, thanks.

Giorgio Callegari: Thank you.

Operator: And the next question is from Ivan Belyaev from Sberbank. Please go ahead.

Ivan Belyaev: Hi, gentlemen, thank you for the call. Just one question. Can you elaborate a bit on what effect the Olympic Games had for the yields, for domestic yields? And what could your yield be without that, or something like that? Thank you.

Giorgio Callegari: Thanks for your question, Ivan. It's very difficult to make a comparison to a scenario that didn't materialize, because Olympics were there, and so we cannot say what would have been if the world would have been different. What I can tell you, though, is that if you compare our performance with what LatAm, so the combination of LAN Chile and TAM Brazil, has announced with respect to the impact on the accounts for the Soccer World Cup, we did much better. They lost money out of it. And we said always very clearly that, as much as we had very competitive fares, in particular from Moscow to Sochi for a period of time in order to stimulate the traffic, we were more than paid back in terms of load factor. Therefore, the net result of our fare policy and pricing policy during the Olympics was positive result and significant growth in volumes. Unfortunately, we cannot tell you what would have been if there were not the Olympics. We can tell you that numbers -- and we announce the statistics month by month, so I'm sure that our IR department can give you the -- in case you need them -- the performance in terms of traffic, both domestic and international, in February and March so you can see how much the traffic grew in that period.

And that will obviously have affected Aeroflot, partially Rossiya and significantly Donavia, as the carrier operating there, but not the rest of the Group. So, all in all, it was a positive effect, especially if we consider that, in similar situations, other carriers have performed negative. Thank you.

Ivan Belyaev: Okay. Yes, thank you.

Operator: And the next question is from Mikhail Ganelin from Gazprombank. Please go ahead. Your line is open.

Mikhail Ganelin: Good evening, gentlemen. Thank you for presentation. I would like to ask a few questions, if I may. Would you be so kind to repeat your financial guidance for this year? Did you say 7% EBIT margin and 8-9% EBITDA margin for this year, right?

Giorgio Callegari: Yes, yes.

Shamil Kurmashov: 8% EBITDA margin. I would say high single digit margin, 8-9% on EBITDA.

Mikhail Ganelin: Okay, thank you. And my next question is do you see opportunities for further operating cost reduction? And if yes, in what items?

Shamil Kurmashov: Yes, we approved the cost reduction plan on our Management Board last week. The overall plan comprises RUB2.2 billion cost reduction, beginning with maintenance repair, RUB500 million, soft expenses RUB500 million also, marketing expenses RUB0.7 billion, and also headcount reduction. So, the overall program is more than RUB2.2 billion, the first wave. But we also expect to launch additional waves as long as we elaborate them, and we also hired A.T. Kearney company who is responsible for elaborating the initiatives in the field of cost reduction. But the first wave is RUB2.2 billion.

Mikhail Ganelin: And during what time? It's this year, next year?

Shamil Kurmashov: Here, several months, or the second half of the year.

Mikhail Ganelin: Second half?

Shamil Kurmashov: Yes, these are quick wins. They can be realized very quickly, and that's why we elaborated on them very quickly, and we created a project management office, which would be in charge of these initiatives comprised of all the managers who are responsible for these cost centers. And by the middle of the second half, or delivery of the second wave, which would comprise not only quick win initiatives but also mid-term result.

Mikhail Ganelin: Okay, thank you. And my last question is about your capacity expansion. If market growth slows down, could you specify what kind of aircraft deliveries might be suspended, if any? I mean, if you decide to reduce capacity?

Giorgio Callegari: Well, while we were on the call, I received the official statistics of the Russian Aviation Civil Authority, and the market in the month of July has grown 17%. So, once again, in our belief, the situation is not a situation of a shrinking market, which is what has happened in other parts of the world when there has been a slowdown in the economy, but is of slower growth. As our planning has always been targeted on an average growth rate of 6% and not beyond that, we still have significant room for adjusting to lower growth rates. So, at this stage, we're not looking at relinquishing or changing any of our planned phase-in of additional aircraft.

Still, as the CEO of the Company has publicly stated, we will have a further moment of in-depth analysis after the release of nine-month results. At this stage, the Russian market is a healthy market, and the way that we are developing is based more off frequencies than not on adding thin markets gives us the kind of flexibility and protection to our margins that enables us to confirm the growth plans that we have.

Mikhail Ganelin: Okay, thank you very much. No more questions from my side.

Giorgio Callegari: Thank you.

Operator: Thank you. The next question is from Georgy Ivanin from Deutsche Bank. Please go ahead. Your line is open.

Georgy Ivanin: Hey, good afternoon, gentlemen. I have a question regarding the profitability of your routes. Given current changes in yields, what are the most profitable destinations for this year -- or at least in first half -- and what are the destination at which you are losing money...I mean, in terms of regions or in terms of specific cities, if possible?

Shamil Kurmashov: In terms of the question, our key, we call them contributors of the margin, like I would call deliveries of the margin really don't change from time to time, and first place is -- the first place is Europe, second place is Russia. So, we expect 15% our revenue from Russia and 8.6% from Europe, and 8.5% from Asia. But, if you speak about the margins not revenue -- the most significant margins are got on European destinations, like Paris, France, Italy, Germany and others.

And we also remain profitable in most of the Russian destinations, because our relative market share, which allows us to apply more favorable tariffs and control the market, and gives us a certain market power in the Russian -- in the domestic regions. So, therefore, the less profitable are Asian destinations because are not on the break-even point yet because we're increasing our frequencies, and we are getting the favorable slots in order to realize all the benefits from multi-wave schedule, when the inactivity time reduces to minimum levels within each wave. But not always we can manage to get favorable slots in, for example, China or Japan, and other destinations.

And also, less profitable are North and Central America destinations. North American destinations on third place, and others on fourth place. I think I answered your question.

Georgy Ivanin: Yes, quite clear. And another question regarding your financial report, in particular FX gain that you reported. My understanding was that given that most of your debt and finance lease are in dollar terms, and given depreciation of ruble, you should report FX loss, but instead you reported a sum FX gain of -- if I'm not mistaken, of \$40 million, something like that. Could you explain in two words how FX gain-loss that you report are working, why is FX gaining first half?

Shamil Kurmashov: On our earnings side, you have positive currency effect because 55% of revenue is denominated in euros. Taking into account the significant solidifying of euro position versus ruble will have positive effect of more than RUB10 billion on our revenue side. If you were speaking about the cost side. So, the majority of our aviation expenses, I mean, operating lease contracts, are denominated in dollars. In these aspects it played a negative role in our -- and of course negative currency exchange differences.

But, nevertheless, on the revenue side, this positive currency effect was compensated by the lowering of the tariffs, because according to our assessment, especially purchasing power of the market lowered, and therefore we couldn't increase tariffs although we had the ambition to do that, because if we sell tickets, for example, from points in Russia to Europe, it's denominated also in euros. But, if we made, like, the increase of our tariffs in line with the increase of the euro to ruble exchange rate, that would negatively affect demand.

But, to make a long story short: on our revenue side, significant, more than RUB10 billion effect of positive dynamics of core currency, I mean euro. And on the dollar side, we have certain negative impacts for operating lease expenses.

Artem Glaznev (Aeroflot): It's also about liability for the balance sheet date. We have the better exchange rate, closing rate then for the year-end. Therefore, we have positive effect on the balance sheet for this exchange rate in finance these liabilities, positive.

Shamil Kurmashov: You speak about the balance sheet if you speak about the figure, that for six months -- the current six months, we have positive effect, RUB1.3 billion in comparison with the previous year. It could be explained by the closing rate of the period.

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

Operator: And the next question is from Denis Vorchik from Uralsib Capital. Please go ahead. Your line is open.

Denis Vorchik: Good afternoon. My question is regarding contribution of regional airlines to P&L. We see that Rossiya, Vladavia, as well as the special case Orenair, remained loss-making. So, could you provide any guidance when do you expect to turn them to profit-making?

Shamil Kurmashov: You see that the contribution of each subsidiary company to the overall financial result was shown on slide number 27, so you see the net income contribution of each of these subsidiary companies. Speaking about the strategic view on subsidiaries, we look at them like the business units which are responsible for operations, cabin crews and pilots, and all the strategic and commercial functions at the Aeroflot level. That's why, internally, we don't always look at them as companies which would be profitable as legal entities. They should deliver our -- they are also used like feeders for our whole network.

For example, if you look at the leg between Arkhangelsk and Moscow, it's loss-making, but if you take -- not this leg but the O&D, the origin and destination economic from Arkhangelsk to Tokyo via Moscow, it's very profitable. If we didn't have our Arkhangelsk leg in this O&D, we wouldn't have profitable Japan -- Tokyo destination. Therefore, our subsidiary companies, they provide feeder passenger flow from the regions where they're -- where they are, and they provide feeder passenger flow to our overall network.

Therefore, if we look on a standalone basis, on each legal entity, we're not aimed at driving them technically to the break-even level. Because you know the business model between Aeroflot, for example, and Rossiya Airlines or Donavia is that we purchase 100% of their capacity and then make centralized selling to the market. Therefore, they get always cash for 100% of their capacity. They are -- have stable operations where they don't care about sales. All the market adjustments and market policy initiatives are elaborated on the Aeroflot level.

Therefore, if we are -- look, if Rossiya Airlines is loss-making, it doesn't mean there's something wrong in the operations. It means that it's providing the passenger flow, and we're paying it at the rate which was calculated at the beginning of the period. And if the expense of this company is more than the amount which was translated to the company, it means that arithmetically they are loss-making. But, in case of the majority of our Company, except for Orenair, the net loss stands for arithmetical adjustment for finance lease, for instance, because finance lease is denominated in dollars, they can take out the dollar appreciation over the course the first half of the current year. There is a negative adjustment in finance lease liabilities. If we make this adjustment the result is closer to zero.

Denis Vorchik: Okay, thank you.

Operator: As a reminder, to ask a question at this time, please press star-one. We will now take our next question from Maxim Kondratiev from Sberbank. Please go ahead. Your line is open.

Maxim Kondratiev: Good evening. Could you describe the impact to your financial reports from the new regulations that give you an opportunity to sell non-refundable tickets, food, baggage? And what could you save on the cost side due to you can take pilots from abroad?

Shamil Kurmashov: All these initiatives -- sorry?

Maxim Kondratiev: And how can we calculate it right? What is the main approach to calculate it right in our models? Thanks.

Shamil Kurmashov: Of course, it's not a straightforward effect. But if we speak line by line, and first of all, if we take the effect of non-refundable tickets, on a yearly basis, we -- our losses were more than \$100 million on the refundable tickets, so we had to refund \$100 million to settle the tariff. I worry if our competitors didn't do the same, even our Russian ones. So, the effect of this only, this sole factor is more than \$100 million. The easier speak about foreign pilots, so we have the first tranche of these clearings for 200 pilots, and we have - - we just hired first portion of them, and we didn't assess -- or we didn't feel the effect yet. So, we think that by the end of 2014 we will have the certain economies on that. But, I think that the effect would be in that we are not going to make the price adjustment, I mean, inflation-driven adjustment on the salary of the pilots. The trade unions have always required adjustments for their salaries. I think that our negotiating power with the pilots increases significantly. And what would be the outcome, like, the effect of that, quarterly business effect? We will just make the report by the end of 2014, because we don't feel it now ourselves.

In terms of our non-refundable tickets and the tariffs, almost more than 50% of our budget segment tariff line is now non-refundable. We can lower the prices, but at the same time, we have restrictions on the usage of these tariffs. They could not be refunded, or there may be some tough rules on the way of refunding those tickets. Free meals on board is one of the key initiatives which will make viable low-cost project, because before that according to the federal aviation rules, we were obliged to provide free meals on board even if it was not required but by our passengers, and we should implement in that the cost of such meal into the ticket. I think that the positive effect in the model would be the way that it would be increase in passengers, budget passengers who were not our clients before that. So, this effect is indirect. It's not like direct effect on our financials. That's all I can comment.

Maxim Kondratiev: Thanks a lot, and just one more clarification. What about luggage bags? Now for many tickets, as I know, you should pay to have one place or two place. So, what will be the revenue from this side?

Shamil Kurmashov: You mean, the luggage rules? I think that at least we will get \$50 million to \$60 million benefit in this year by this innovation, by this -- incorporating euros.

Maxim Kondratiev: It's in dollars, yes, \$50 million?

Shamil Kurmashov: Yes. Yes, in dollars.

Maxim Kondratiev: Thanks a lot. That's all for me, thanks.

Shamil Kurmashov: Thanks.

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

Giorgio Callegari: Thank you.

**END**