Analysis of financial results[1]

Vadim Mikhailov
First Deputy CEO of Russian Railways

The strong commitment and impressive performance of many thousands of the Company's employees helped us make 2017 a year of success. We have outperformed all our financial and volume targets for 2017. The Company's RAS net profit increased 2.7 times (vs RUB 6.5 bn in 2016) and amounted to RUB 17.5 bn.

RUSSIAN RAILWAYS' PERFORMANCE IN 2017

Handling
+3.2% y-o-y
+0.6% vs target
1,261.3 mt

Income from freight transportation
+7.8% y-o-y
+ RUB 15.6 bn vs target
RUB 1,352.8 bn

Overhaul
+16.7% y-o-y
– RUB 3.6 bn vs target
RUB 84.3 bn

Total freight turnover
+6% y-o-y
+0.7% vs target
3,176.7 bn tkm

Cost of transportation
+0.9% y-o-y
–1.4% vs target

EBITDA
+12.1% y-o-y
+ RUB 0.9 bn vs target
RUB 353.9 bn

Transportation expenses
+6.6% y-o-y
–0.7% vs target
RUB 1,381.8 bn

Labour productivity
+9.2% y-o-y
+1.5 pp vs target

Net debt / EBITDA
–0.2x vs target
2.8x (RAS)

Sales profit
RUB 140 bn
(+19.5% y-o-y)
+ RUB 27.6 bn vs target

Net profit
RUB 17.5 bn
+ RUB 11.0 bn y-o-y
+ RUB 14.5 bn vs target

RUB 23.1 bn
(excl. FX effects)
+ RUB 31.6 bn y-o-y
+ RUB 9.6 bn vs target

1 Based on the audited RAS financial statements for 2016 and 2017; the statements and the auditor report are available on Russian Railways' website at: http://ir.rzd.ru/static/public/ru?STRUCTURE_ID=32#3

Russian Railways' performance in 2017

In 2017, the Company delivered a strong performance in terms of volumes, quality and financial metrics, with cost reduction and cost management posited as key priorities of the reporting year. Operating growth was achieved on the back of both the country's economic recovery and higher quality of railway transport operation.

Thanks to the stronger customer focus, effects of prior infrastructure and rolling stock investments, and closer cooperation between the operating and financial functions, the Company's volume growth outpaced the national average.

In 2017, Russian Railways met its volume and financial targets. The increase in freight shipments came as a sign of improvements in Russia's economic situation.

While Russia's GDP grew by 1.5% and industrial production was up by 1.0%, the Company increased its freight shipment volumes by 3.2% having transported a total of 1,261.3 mt. Loaded freight turnover rose by 6.4% reaching the highest level in Russia's modern history (26.7% growth compared to 1992). Transit and container-based transportation also grew considerably: by 16.1% and 17.4%, respectively.

With the new quality of services on offer, the Company managed to greatly improve its passenger transportation. Having served some 1,117.9 million passengers, Russian Railways surpassed its 2016 results by 7.8% and hit a record-high over the last eight years.

The multiplier effect Russian Railways' operations had on the generation of added value in the economy was over RUB 2.5 per RUB 1 of costs.

The income from core operations totalled RUB 1,697.6 bn, up 7.6% y-o-y.

Freight transportation yielded 7.8% more income compared to 2016.

Amid changes in the freight transportation structure, the revenue rate growth stood at 1.8%.

Income from passenger transportation increased by 28.6% y-o-y.

With ongoing cost controls and targeted increases in repairs, payroll and fixed asset revaluation budgets, the Company improved its cost structure and curbed cost growth.

As consumer prices grew by 3.7% and producer prices by 7.6% per annum, transportation costs increased by 0.9%.

In 2017, the Company indexed its staff salaries twice, with workers enjoying a higher-than-average indexation. To enhance the impact of its social policies on workforce and manage growing transportation volumes, the Company transferred some of its part-time employees to full-time schedules while also increasing their minimum wages. As a result, employees' real salaries increased by 3.9%. The growth of salaries in 2017 was accompanied by a 9.2% rise in labour productivity.

Income from other operations amounted to RUB 28.2 bn (up RUB 1.8 bn y-o-y).

Sales profit for the year increased by 19.5% and amounted to RUB 140 bn.

Dividends from subsidiaries and affiliates stood at RUB 21.2 bn (up RUB 17.3 bn y-o-y), while sales of their shares amounted to RUB 1.8 bn with a profit of RUB 0.8 bn.

The amount of interest payable went down by RUB 8.7 bn compared to 2016.

As a result of the Company's push to improve service quality, streamline profitability management and optimise costs, RAS net profit increased to RUB 17.5 bn compared to RUB 6.5 bn in 2016 (target – RUB 3 bn).

Outstanding loan debt at the end of 2017 stood at RUB 1,075.5 bn. Net debt / EBITDA (under RAS) was 2.8x.

Analysis of income from transportation operations

In 2017, income from transportation operations increased by 7.7% to RUB 1,493.6 bn, exceeding the target by RUB 16.1 bn (up 1.1%).

Income from freight transportation

In 2017, income from freight transportation grew 7.8% and reached RUB 1,352.8 bn.

An additional RUB 74.9 bn came from a 6% increase in freight turnover, while 6% freight tariff indexation yielded another RUB 73.9 bn.

The following trends in freight shipment structure persisted in 2017:

- increased share of low-margin cargoes;
- increased share of export volumes;
- higher share of gondola cars (with a low revenue rate) and lower share of tanks (with a high revenue rate) on the empty runs.

These freight shipment structure changes triggered a slowdown in the growth of the average revenue rate, with Russian Railways' 2017 revenue rate increasing by 1.8% y-o-y. Weak revenue rate growth led to a decline in the tariff revenue of Russian Railways and reduced the general economic impact of the tariff burden.

In 2017, income from freight transportation was 1.2% (or RUB 15.6 bn) ahead of the target.

Income from long-haul passenger transportation

Income from long-haul passenger transportation in the high-speed and ultra high-speed segment (Sapsan, Lastochka and Allegro) increased by 15.5% to RUB 17.2 bn in the reporting year. Additional trains on the St Petersburg – Moscow route brought about a passenger turnover increase of 3.3%, helping the Company to exceed its income target by 5.8%. Other income drivers in the long-haul passenger transportation segment included the Company's successful marketing and tariff strategy for Sapsan trains and higher ticket accessibility. By the end of 2017, eight in ten Sapsan tickets were being bought online, while the overall number of Sapsan passengers had grown by 6.1% y-o-y.

Income from suburban passenger transportation

In 2017, income from transportation services provided by Russian Railways within the Moscow Central Circle amounted to RUB 4.6 bn.

Income from infrastructure operation

Income from infrastructure operation grew by 3% to RUB 107.8 bn. The infrastructure operation target for 2017 was exceeded by 0.2%, or by RUB 0.2 bn.

Income from infrastructure operation in the freight transportation segment went down by RUB 0.1 bn y-o-y due to a decrease in servicing of idle cars coming on the back of a 0.5% y-o-y reduction (50,600 cars) in the working railcar fleet.

Income from infrastructure operation in the passenger transportation segment increased by RUB 3.3 bn y-o-y.

Income from provision of locomotive traction

Income from provision of locomotive traction grew by 2.3% to RUB 11.2 bn, missing the target by RUB 0.4 bn (-3.1%) due to a reduced volume of provided services.

Transportation expenses

In 2017, transportation expenses amounted to RUB 1,381.8 bn, 0.7% (or RUB 9.7 bn) below the target and 6.6% above the 2016 level.

Breakdown of transportation expenses

Items	2016	2017	Change, 2017A/2016A	
	Actual	Actual	RUB bn	%
Transportation expenses	1,296.2	1,381.8	85.5	106.6
Payroll expenses	400.7	425.0	24.3	106.1
Social expenses	110.8	119.5	8.7	107.9
Material expenses	452.3	496.9	44.5	109.8
materials	61.7	65.6	3.9	106.3
fuel	78.7	88.4	9.6	112.2
including for train traction	68.5	76.9	8.4	112.3
electricity	138.0	156.2	18.2	113.2
including for train traction	121.4	138.6	17.2	114.2
other material expenses	173.9	186.8	12.8	107.4
Depreciation	190.3	220.2	29.9	115.7
Other expenses	142.1	120.1	–21.9	84.6

Cost optimisation

To ensure a balanced financial performance, Russian Railways strives to enhance its internal efficiency.

In 2017, the Company implemented a number of important optimisation initiatives that brought about cost savings of RUB 67 bn, including RUB 36 bn in the Company's branches.

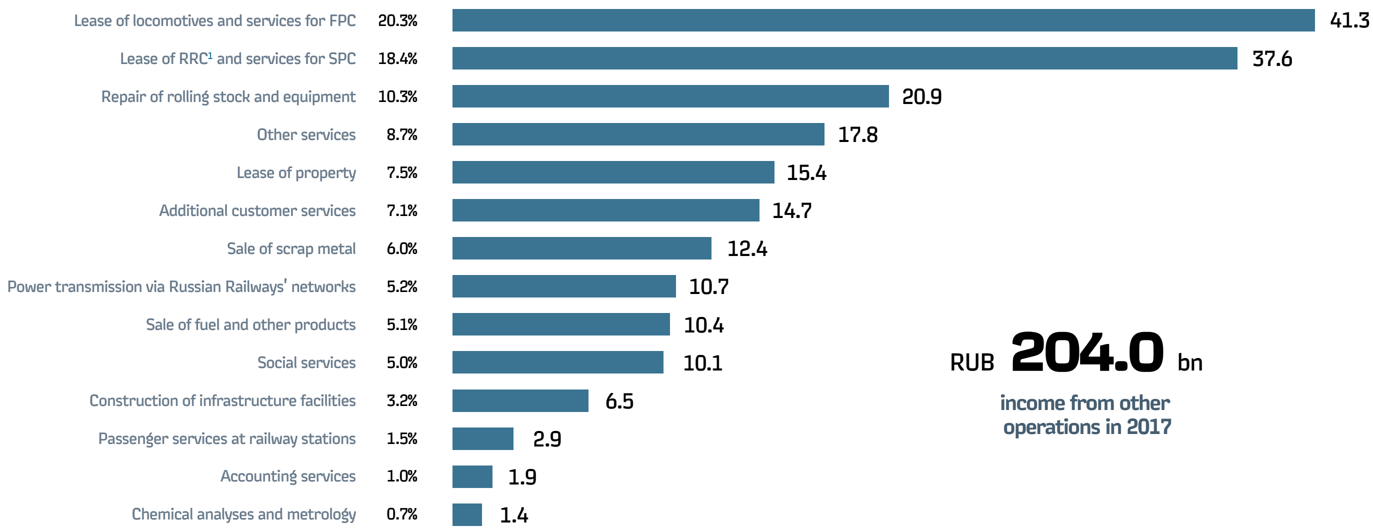
Savings from the use of tender procedures in the reporting year amounted to RUB 7.3 bn.

In addition, in 2017, the Company achieved success in its negotiations with the federal authorities and reduced its property tax costs by approximately RUB 12.8 bn by agreeing an unchanged 1% property tax rate on the railway infrastructure as opposed to the previously planned rate of 1.6%. On top of that, lease payments for maintenance vehicles were reduced as a result of their early buyout in the amount of RUB 18.6 bn.

Income from other operations

In 2017, profit from other operations increased by 6.7% to RUB 28.2 bn, while income from other operations rose by 7.1% to RUB 204.0 bn.

Breakdown of income from other operations, RUB bn



RUB **204.0** bn

income from other operations in 2017

1 RRC – railcar rolling stock.

Other income and expenses

In 2017, other income totalled RUB 163.2 bn, while other expenses amounted to RUB 250.8 bn, with the financial result coming in at – RUB 87.6 bn.

Changes in other income and expenses in 2016–2017, RUB bn

Indicators	2016	2017	Change, 2017/2016, %	
			+/–	%
Result from other income and expenses	–73.6	–87.6	–14.0	19
including for the key items:				
• sale of assets	0.6	2.1	1.3	217
including sale of shares	0.0	0.8	0.8	–
• dividends	4.0	21.2	17.2	430
• property contributions to charter capital	0.0	0.1	0.1	100
• interest receivable	9.2	2.7	–6.5	–71
• FX effect	18.8	–6.9	–25.7	–137
• change in provisions	–7.0	–11.3	–4.3	61
• government support and compensations pertaining to state regulation of prices and tariffs	2.1	3.2	1.1	52
• interest payable, excluding capitalised interest	–64.2	–55.2	9.0	–14
• guarantees under the Collective Bargaining Agreement for the Company's employees, their families and retirees	–26.9	–23.6	3.3	–12

Taxes and insurance fees

The total amount of taxes and insurance fees accrued for 2017 stood at RUB 311.3 bn.

Vadim Mikhailov
First Deputy CEO of Russian Railways

> The Group's income in 2017 grew by 5.6% y-o-y to RUB 2,252 bn, while our operating expenses decreased by 2.2% y-o-y to RUB 2,049 bn. The key driver behind that drop was the 2017 reduction in losses from fixed assets impairment. This was made possible by the Russian Government's decision to introduce a long-term tariff policy until 2025, enabling Russian Railways to stabilise its long-term outlook and drive down losses from the impairment of fixed assets.

Consolidated IFRS financial statements of the Russian Railways Group for 2017[1]

In 2017, the Company for the first time introduced a mid-term IFRS financial plan for 2018–2020 within the consolidation perimeter of the financial statements (ca. 190 companies, including international) applying transformation methodology to the target numbers produced under Russian standards.

In 2017, the aggregate income of Russian Railways grew by 5.6% y-o-y to RUB 2,252 bn (RUB 2,133 bn in 2016). Operating expenses dropped by 2.2% driving a net profit of RUB 139.7 bn (RUB 10.3 bn in 2016).

The Group's revenue was mainly attributable to income from freight transportation and infrastructure going up by 9.5% y-o-y to RUB 1,449 bn. Income from logistics services amounted to RUB 345 bn, including on the back of growing currency proceeds of logistics company GEFCO. This segment's income accounts for ca. 15.3% of the Group's aggregate revenue.

In 2017, EBITDA went up by 11.8% to RUB 496 bn. EBITDA margin increased to 24.7% against 23.6% in 2016 on the back of growing income coupled with lower operating expenses resulting from efficiency improvement efforts.

Net debt / EBITDA stood at 1.97x.

Net profit	EBITDA	Net debt / EBITDA	EBITDA margin
RUB **139.7** bn	RUB **496** bn	**1.97x**	**24.7%**
13.6x higher y-o-y	+11.8% y-o-y	vs 1.94x in 2016	+1 pp y-o-y

1 The consolidated IFRS financial statements of Russian Railways and its subsidiaries for 2017 and the auditor report are available on Russian Railways' website at: http://eng.rzd.ru/statice/public/en?STRUCTURE_ID=4224

Debt policy

Russian Railways uses borrowings to ensure financing of the Company's investment and operating activities. The Company uses long-term loans to fund strategically important and commercially viable investment projects, while short-term loans provide flexibility in managing the current liquidity.

Loan portfolio performance in 2017

In 2017, the Company's medium and long-term debt totalled RUB 244.8 bn. The loans were largely raised through unsecured public debt instruments held by Russian and foreign investors.

Russian Railways repaid a total of RUB 129.2 bn of medium- and long-term debt in the reporting year. The Company's loan portfolio was significantly impacted by the appreciation of the rouble causing revaluation of the FX-denominated debt and reduction in its rouble equivalent at year-end.

In addition, the Company drew down bilateral short-term (from several days to 1 year) bank loans throughout the reporting year for the day-to-day management of liquidity and refinancing of liabilities. As at the end of 2017, short-term liabilities stood at RUB 58.5 bn.

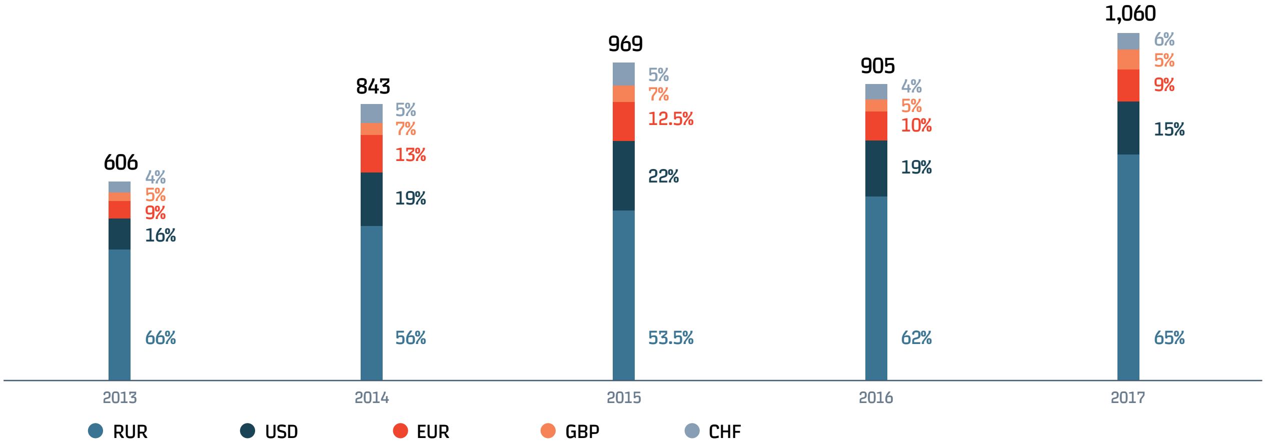
In the reporting year, the Company's total debt grew by 16.8% to RUB 1,075.5 bn, including a 17.1% increase in the principal debt to RUB 1,060.2 bn.

Loan portfolio structure and debt policy

As at 31 December 2017, the loan portfolio of Russian Railways was as follows:

Indicator	2017 value	Threshold	Comments
Share of FX-denominated debt	35%	Below 40%	FX-denominated debt in the Company's loan portfolio creates risks associated with FX fluctuations. However, the interest rate on FX-denominated loans is much lower than on rouble loans. It is, therefore, the debt policy's primary objective to find balance between the FX and rouble-denominated loans.
Short-term debt	12%	Below 15%	Short-term obligations in the loan portfolio offer greater flexibility in managing the portfolio.
Average maturity	8 years	7–10 years	The Company works to increase and maintain the average maturity of the loan portfolio that would be consistent with the long payback period of the investment projects financed by such loans.

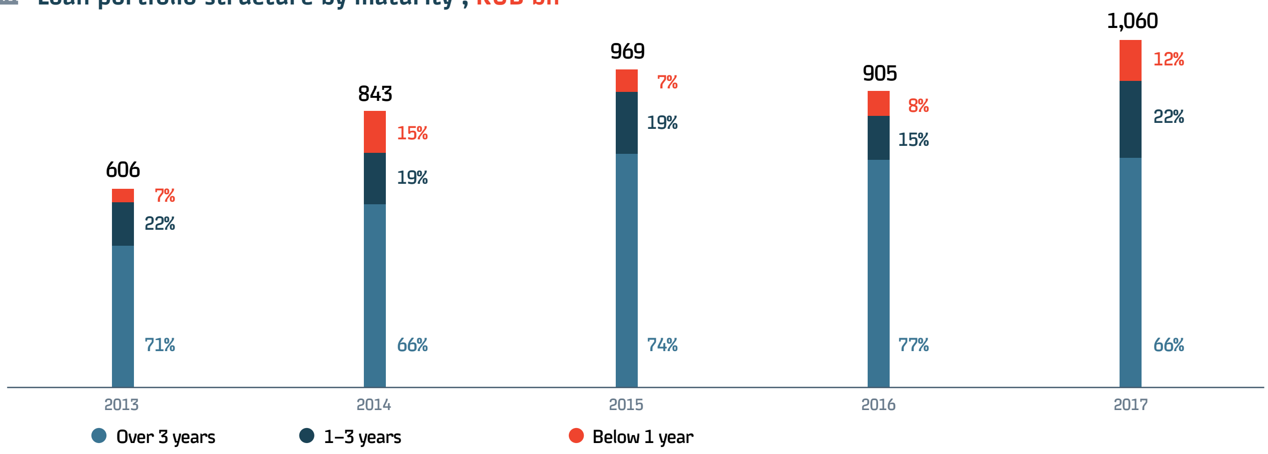
Loan portfolio structure by currency[1], RUB bn



The share of FX loans in 2017 did not exceed the threshold set by the debt policy. With a view to cutting the weighted average cost of the loans and reducing the share of FX loans, Russian Railways completed a number of successful deals in the domestic and global capital markets. These measures coupled with the gradual appreciation of the rouble over the year resulted in the reduction of the share of FX-denominated loans to 35% by year-end.
The weighted average interest rate across the portfolio decreased from 7.7% to 6.2% (a 1.5 pp decline).

1 Principal debt. As at 31 December of the relevant year.
2 Principal debt. As at 31 December of the relevant year.
3 Principal debt. Debt obligations as at 31 December 2017. FX payments calculated on the basis of the FX rates as at 31 December 2017.

Loan portfolio structure by maturity[2], RUB bn



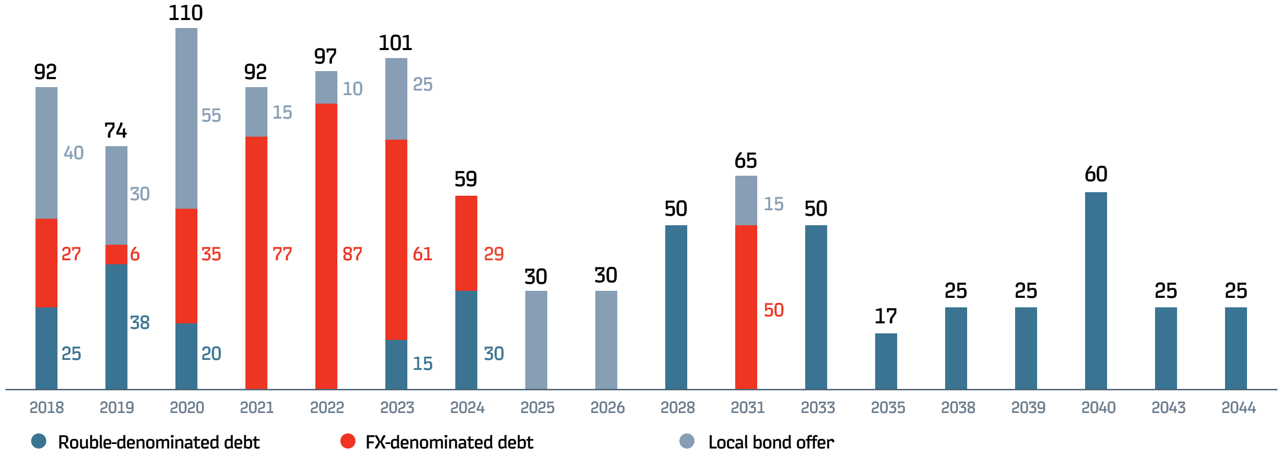
The major part of the loan portfolio is comprised of local bonds (49.8%). Some bond issues maturing in 3–20 years (23.7%) are held by market investors. Other bonds (26.1%) are sold to the state funds (the Pension Fund of the Russian Federation and the National Wealth Fund) in the form of long-term infrastructure bonds issued in 2013–2015 for a period of 15 to 30 years.

A substantial part (40.6%) is represented by 4–20 year Eurobonds in different currencies (RUB, USD, EUR, CHF).

As the maturity dates of the respective obligations approach, the Company replaces them with new long-term borrowings and determines their optimal maturity subject to the existing repayment schedule to keep the share of short-term liabilities below 15%.

As at the end of the reporting year, the average maturity across the Russian Railways' loan portfolio was approximately 8 years with payments evenly distributed over the long-term horizon, thus mitigating the refinancing risks.

Maturity schedule of the Russian Railways' loan portfolio[3], RUB bn



Debt and share capital

Bonds

Global capital markets

In 2017, Russian Railways made a number of significant transactions in global capital markets.

In late February, the Company successfully placed 7-year US dollar-denominated 4,375% Eurobonds worth USD 500 m.

In the same month, it placed rouble-denominated 7-year 8.99% Eurobonds worth RUB 15 bn. Global investment funds acquired almost 70% of the placement.

In March 2017, Russian Railways accessed the syndicated loan market for the first time in nine years, raising USD 420 m under a 5-year unsecured syndicated loan agreement. The record-low rates offered to the Company as compared to similar recent-year transactions testify to the Company's status of a first-class borrower.

With a number of international transactions in Q1, the Company completed the refinancing of its debut US dollar-denominated Eurobond issue (2010).

More activities in global capital markets followed in autumn 2017. In October, Russian Railways placed franc-denominated 6-year 2.1% Eurobonds for CHF 450 m. The rate was the lowest ever secured by a Russian borrower for CHF instruments. The proceeds were raised to proportionally repay the foreign currency part of the Company's loan portfolio as scheduled for Q1 2018. Having expanded the liquidity position, the placement did not have a negative impact on net debt.

In October, Russian Railways again tapped into global markets placing 7-year 7.9% bonds for RUB 15 bn. The rate was the lowest among Russian rouble-denominated global placements since January 2013. International investors, mostly from the UK, acquired 40% of the securities. This fourth placement of rouble-denominated Eurobonds pushed the Company's rouble obligations in global capital markets up to RUB 82.5 bn.

As a result, it became Russia's largest corporate borrower in global markets attracting a significant number of international investors in rouble-denominated bonds.

In 2017, an equivalent of ca. RUB 110 bn was raised using global instruments.

Local capital market

In 2017, the Company placed six successful rouble bond issues raising capital in the local market, with each placement consecutively achieving a lower rate. The weighted average rate for the new issues stood at 8.4%. The latest public transaction (Series 30 secondary placement) was made last November at 7.65%. In 2017, the Company placed a 9-year 8.5% issue for RUB 15 bn with one of the longest maturities.

The aggregate proceeds were partly used to replace costlier 11%+ bonds. The plans to replace the expensive securities issued amid the peak yields of 2015 prompted Russian Railways to exercise its right to buy back Series BO04 11.65% bonds for RUB 15 bn, Series BO08 11.44% bonds for RUB 20 bn and Series BO03 11.75% bonds for RUB 15 bn.

In 2017, the Company raised a total of ca. RUB 90 bn in the local capital market.

Full information on outstanding Eurobond and rouble bond issues is available in the Investor Relations section of Russian Railways' website at http://eng.rzd.ru/bondse_euro/public/en?STRUCTURE_ID=4160 (Eurobonds),

http://eng.rzd.ru/bondse/public/en?STRUCTURE_ID=298 (rouble bonds)

Share capital

Russian Railways has been included in the list of strategically important companies approved by the Decree of the President of the Russian Federation No. 1009 dated 4 August 2004[1].

As at the end of 2017, the Company's charter capital amounted to RUB 2,212,238,725,000.

It is comprised of 2,162,238,725 ordinary registered shares with a nominal value of RUB 1,000 each and 50,000,000 preference registered shares with a nominal value of RUB 1,000 each.

In 2017, Russian Railways' charter capital was increased by a total of RUB 67,923,584,000, including RUB 24,981,693,000 contributed in December 2016 and RUB 42,941,891,000 contributed in 2017.

In 2017, a total of RUB 60,628,311,000 was contributed by the federal government, with an issue worth of RUB 42,941,891,000 registered in the same year. An issue for the remaining RUB 17,686,420,000, which were contributed in December 2017, was registered in 2018.

Dividend policy

Russian Railways' dividend policy is based on the balance of interests of the Company and its shareholders and seeks to:

- improve the Company's investment appeal,
- protect shareholder rights as prescribed by applicable Russian laws.

Distribution of the 2016 net profit

In 2016, Russian Railways earned RUB 6.5 bn in net profit.

Pursuant to Clause 42, Section 6 of the Company's Charter, RUB 325 m, or 5% of net profit for the reporting period, were allocated to reserve capital.

The following amounts were allocated to dividend payments for 2016:

- RUB 5 m, or 0.01% of the nominal value (RUB 50,000 m) of preference shares, payable to preference shareholders;
- RUB 5,142 m, or 50% of the IFRS net profit, payable to ordinary shareholders.

1 List of joint-stock companies owned and partially managed by the Russian Government to serve the strategic interests and the needs of state defence and security of Russia and the protection of morals, health and legitimate interests of Russian citizens.

Net profit distribution in 2012–2016, RUB bn

Indicator	2012	2013	2014	2015	2016
Net profit	14.110	0.740	–44.078	0.318	6.500
Reserve capital	0.706	0.037	0.000	0.016	0.325
Dividends accrued on:	0.000	0.185	0.045	0.302	5.147
ordinary shares	0.000	0.185	0.045	0.297	5.142
preference shares	–	–	–	0.005	0.005

Distribution guidance for the 2017 net profit

In 2017, Russian Railways earned RUB 17.5 bn in net profit. Pursuant to Clause 42, Section 6 of the Company's Charter, RUB 875 m, or 5% of net profit for the reporting period, are to be allocated to reserve capital.

The ordinary shareholders will be paid dividends for 2017 in accordance with the Russian Government's directive. The preference shareholders will be paid RUB 5 m, or 0.01% of the nominal value (RUB 50,000 m) of preference shares, in dividends for 2017.

Rating agencies and investors

In 2017, global rating agencies improved their outlook on Russia's sovereign ratings on the back of stronger macroeconomic data and growing international investor confidence in its economy. Standard & Poor's and Fitch revised their outlooks from "stable" to "positive", while Moody's improved its outlook from "negative" to "stable". In line with their policies, the agencies continued the sequence of positive rating actions reviewing the ratings of some quasi-sovereign issuers, including Russian Railways.

In the reporting year, the Company's ratings were in line with Russia's sovereign ratings at "BB+" (Standard & Poor's, outlook positive), "Ba1" (Moody's, outlook stable) and "BBB-" (Fitch, outlook positive).

Aside from global agencies, in Q4 2017, ACRA and RAEX assigned Russian Railways the highest "AAA(RU)" and "ruAAA" ratings, respectively, both outlooks stable.

Russia's and Russian Railways' credit ratings[1] as at the end of 2017

Issuer	Agency	Rating	Outlook
Russia	Standard & Poor's	BB+	Positive
	Moody's	Ba1	Stable
	Fitch	BBB-	Positive
Russian Railways	Standard & Poor's	BB+	Positive
	Moody's	Ba1	Stable
	Fitch	BBB-	Positive
	ACRA	AAA(RU)	Stable
	RAEX	ruAAA	Stable

In early 2018, Moody's and Standard & Poor's upgraded Russian Railways' ratings on the back of previous year's improvements in macroeconomic conditions and investment climate in Russia.

In 2017, the Company continued its dialogue with Russian and global financial investors at bilateral meetings and industry conferences.

The landmark events of 2017 included the road shows arranged in February, September and October to promote four Eurobond placements (in dollars, roubles and francs). In addition, a traditional annual Investor Day was held in London in December 2017.