

Analysis of operating results

Transportation and logistics

This business line focuses on transportation and infrastructure operation, including operation of rolling stock, creation of logistics chains with varying degrees of complexity (i.e. those involving several types of transport), contract logistics, warehousing, and transit freight shipments via international transport corridors.



Alexey Shilo

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Head of the Centre for Corporate Transport Services

Ensuring the availability and high quality of transportation and logistics services in the freight segment is one of the key priorities under Russian Railways Group's Development Strategy until 2030.

KEY ACHIEVEMENTS IN 2017

- ◉ 1,261.3 mt of freight (or an average of 3,455.7 kt per day) were handled in 2017, up 3.2% y-o-y. The strongest growth was in shipments of timber (up 1.1 mt, or 2.5%), hard coal (up 29.9 mt, or 9.1%) and fertilisers (up 3.6 mt, or 6.8%).
- ◉ The average haul for loaded freight cars increased by 36 km, or 2.0% y-o-y, to 1,800 km.
- ◉ Loaded freight turnover grew by 6.4% y-o-y to 2,491.9 bn tkm.
- ◉ As of 31 December 2017, the average length of guarantee sections ensuring safe passage of freight trains increased by 588 km to 1,825 km.
- ◉ The services launched by Russian Railways – Freight Express, RZD Express and Smart Logistics (container-based transportation of cargoes to end customers using low-capacity road vehicles) – received positive feedback from shippers.
- ◉ Launch of the Grain Express service enabling grain-loaded trains to proceed to their final destination with no yard operations in transit helped decrease railcar turnaround by an average of 4.5 days.
- ◉ On 1 April 2017, the Freight Transportation electronic trading platform was launched.
- ◉ In 2017, GEFCO launched the first container train service between Wuhan (China) and Dourges (France).
- ◉ UTLC launched a new transit container service along the China-Europe-China axis leveraging the capacities of the Kaliningrad Railway.
- ◉ Russian Railways Group and the Russian Export Centre joined forces with the Russian Government to provide logistics support to China-bound exports. Since the project's first shipment on 5 April 2017, a total of 155 containers have been dispatched, including 134 containers through Zabaykalsk and 21 containers through Naushki (Mongolia).

Freight transportation using Russian Railways' infrastructure

Key freight transportation results

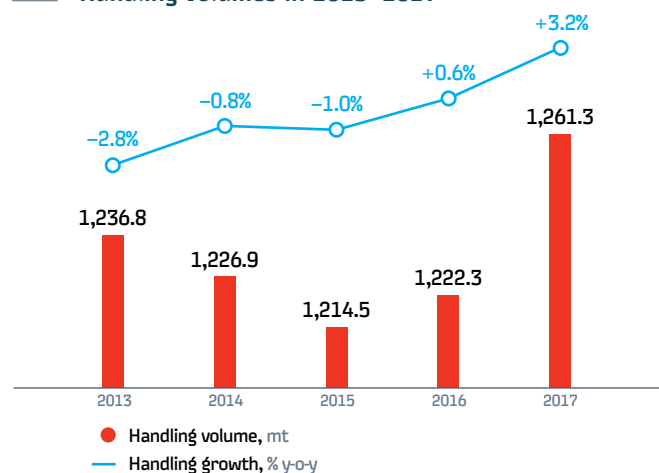
Items	Measurement unit	2013	2014	2015	2016	2017		
						Value	% vs 2016	% vs 2013
Handling	mt	1,236.8	1,226.9	1,214.5	1,222.3	1,261.3	+3.2%	+2.0%
daily average	kt	3,388.5	3,361.5	3,327.3	3,339.5	3,455.7	+3.5%	+2.0%
Total freight turnover, including:	bn tkm	2,813.1	2,954.5	2,954.9	2,997.8	3,176.7	+6.0%	+12.9%
loaded freight turnover	bn tkm	2,196.2	2,298.6	2,304.8	2,342.6	2,491.9	+6.4%	+13.5%
empty freight turnover	bn tkm	616.9	655.9	650.1	655.2	684.8	+4.5%	+11.0%
Share of shipments delivered within required (contractual) period	%	77.5	87.1	92.9	96.1	96.7	+0.6 pp	+19.2 pp
Average loaded freight car delivery speed	km/day	249	327	372	380.5	386.4	+1.6%	+55.2%

Handling

Given its close ties with major manufacturers, Russian Railways' performance reflects general situation in the Russian economy. According to the Russian Federal State Statistics Service, the Industrial Production Index closed the year at 1.0%. 1,261.3 mt of freight, or an average of 3,455.7 kt per day, were handled by Russian Railways (up 3.2% vs 2016). The growth came primarily from increases in shipments of hard coal, chemical and mineral fertilisers and grain.



Handling volumes in 2013–2017



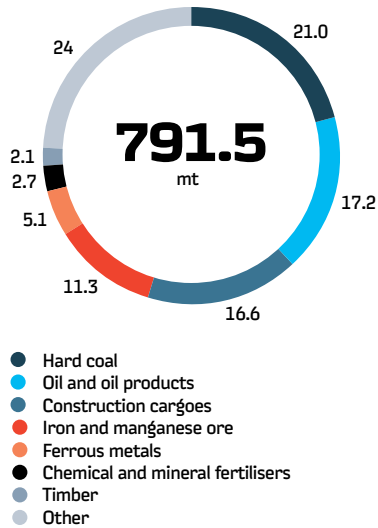
Handling by transportation type

Items	2016		2017		Change in volume, %
	mt	share, %	mt	share, %	
Handling	1,222.3	100.0	1,261.3	100.0	3.2
Domestic services	785.6	64.3	791.5	62.7	0.8
Export, including	428.3	35.0	460.0	36.5	7.4
via ports	273.3	22.4	291.2	23.1	6.6
via border crossings	155.0	12.7	168.8	13.4	8.9
Import and transit	8.4	0.7	9.8	0.8	16.2

In 2017, growth was recorded across transportation types, with domestic and export handling volumes having increased by 0.8% (to 791.5 mt) and 7.4% (to 460.0 mt), respectively. As a result of strong growth in export shipments, the share of domestic services in handling volumes decreased from 64.3% to 62.8%, while the

share of exports moved up from 35.0% to 36.5%. Shipments of hard coal, bulk oil, construction materials and ores made up the largest part of handling volumes, with their aggregate share amounting to 66.4%.

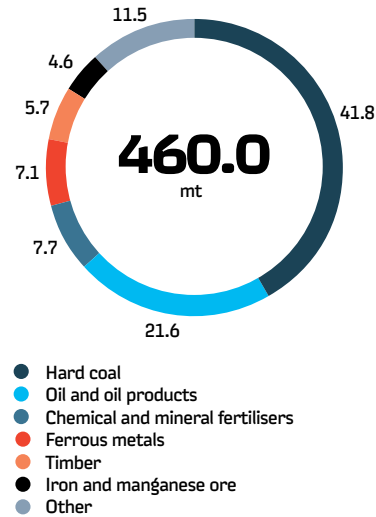
Domestic handling by cargo type in 2017, %



In 2017, handling volumes also showed growth across tariff classes. Class I, Class II and Class III freight shipments increased by 24.3 mt (3.3%), 11.0 mt (3.1%) and 3.8 mt (3.0%), respectively.

The best performing Class I cargo types were hard coal (up 9.1%, or 29.9 mt), industrial commodities (up 4.3%, or 1.5 mt) and timber (up 2.5%, or 1.1 mt), while handling of construction cargoes reduced by 5.7%, or 8.1 mt.

Export handling by cargo type in 2017, %



In Class II, significant increases were delivered by fertilisers (up 6.8%, or 3.6 mt), grain (up 16.4%, or 3.1 mt) and containerised cargoes (up 11.5%, or 2.9 mt).

Ferrous metals led the pack in Class III (up 2.8%, or 2.0 mt).

Low-margin cargoes dominated the freight shipment structure with a share of 60.2% in 2017, while mid- and high-margin cargoes accounted for 29.3% and 10.4%, respectively.

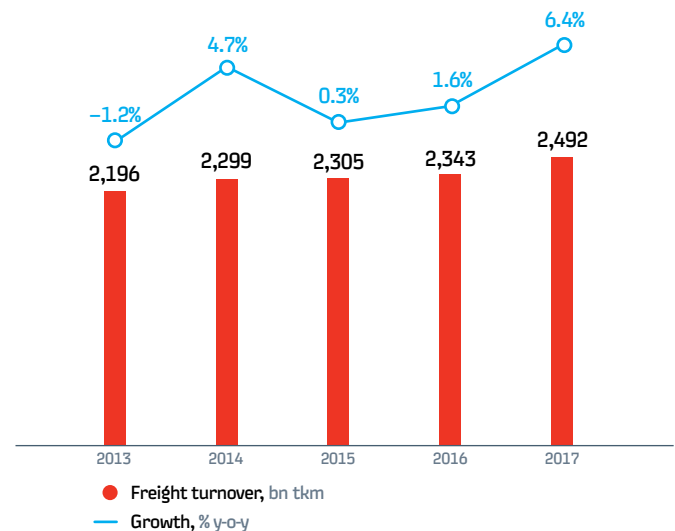
Freight turnover

In 2017, loaded freight turnover in the railway segment grew by 6.4% to 2,491.9 bn tkm.

Total freight turnover (including the empty run of third-party cars) within Russian Railways' infrastructure increased by 6.0% y-o-y to 3,176.7 bn tkm, with empty turnover gaining 4.5% y-o-y to reach 684.8 bn tkm.

Growing transportation volumes (primarily, coal shipments) were the main driver behind the rise in freight turnover. The 2.0% increase in the average haul also contributed to the positive result.

Loaded freight turnover in 2013–2017



In 2017, loaded freight turnover reached

2,491.9 bn tkm

the highest level in Russia's modern history

In 2017, average haul added 2.5% y-o-y, or 40 km, to reach 1,639 km, including 1,800 km (up 2.0%) for loaded shipments and 1,236 km (up 3.1%) for self-rolling cargoes.

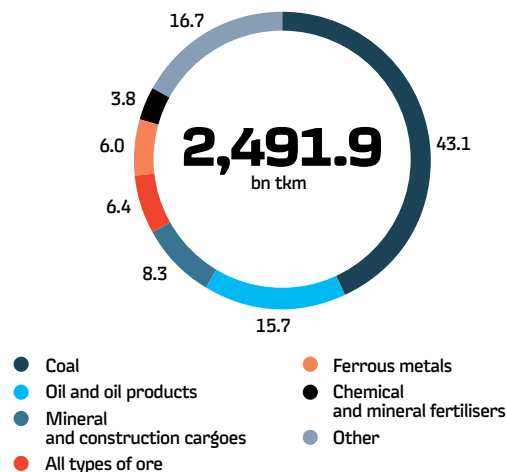
2017 saw the rise of loaded freight turnover across transportation types, with domestic, export, import and transit lines registering increases of 2.4% (to 999.7 bn tkm), 8.0% (to 1,334.4 bn tkm), 18.6% (to 99.4 bn tkm) and 26.8% (to 58.3 bn tkm), respectively.

These changes further reduced the share of domestic shipments and increased the share of exports in overall loaded freight turnover.

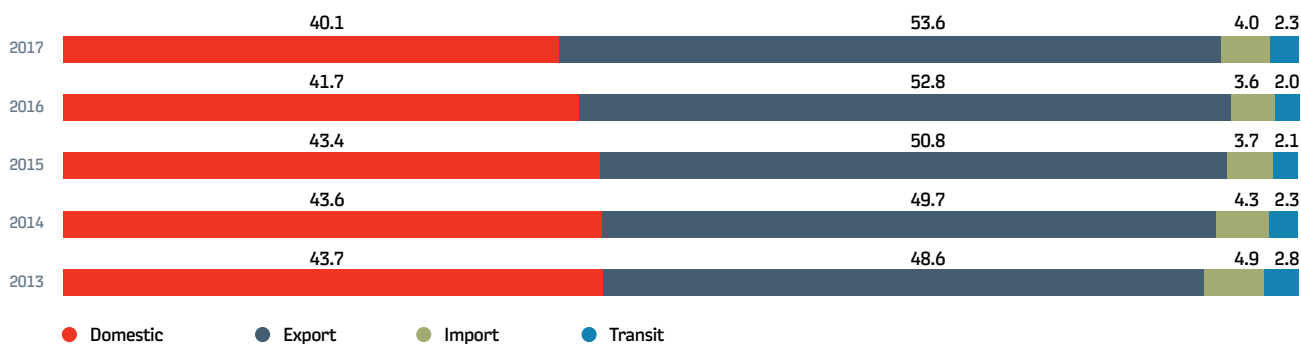
Over the past six years, the share of exports in freight turnover rose by 5.3 pp to come in at 53.6% in 2017, while the share of domestic shipments moved down to 40.1%.

In terms of cargo types, coal's share grew the most – up 2.3 pp to 43.1%, while the share of oil and oil products dropped by 1.3 pp to 15.7% and that of mineral and construction cargoes decreased by 0.5 pp to settle at 8.3%.

Loaded freight turnover breakdown, %



Loaded freight turnover breakdown, %



Transportation and logistics services

In the transportation and logistics segment, Russian Railways is shifting the focus from transportation services to comprehensive door-to-door solutions, expansion of its 2PL, 3PL and 4PL offering, and creation of global logistics chains. As business expansion and margin growth opportunities are limited in the government-

regulated sectors, the Group has been actively working to strengthen its presence in the deregulated transportation and logistics segments, bolster Russian Railways' position in the domestic and international logistics markets, and introduce advanced 3PL/4PL logistics technologies throughout its network.

Performance of Russian Railways' major transportation and logistics subsidiaries

Federal Freight Company

Federal Freight Company (FFC) is a network-wide operator of freight rolling stock. The company is a subsidiary of Russian Railways and one of the largest freight railway operators in Russia. FFC runs 15 branches and transport service agencies and has representative offices in Moscow and Kazakhstan.

In 2017, FFC maintained its leadership by:

- the share in freight turnover (16.5%);
- the average annual size of fleet under management (153,700 units);
- the share in the Russian railcar fleet (14.2%).

United Transport and Logistics Company

United Transport and Logistics Company (UTLC) provides transit railway container services on the China / Southeast Asia – EU route operating within the 1,520 mm track gauge network.

In 2017, transit container volumes amounted to 175,750 TEU, up 74% y-o-y. By the end of 2017, UTLC operated on 51 regular routes as compared to 19 routes at the beginning of 2016. Overall, UTLC accounted for 64% of container volumes transported via the East–West transport corridor along the China–Europe–China axis.

GEFCO

GEFCO (France), Russian Railways Group's logistics subsidiary, is a global provider of logistics solutions and services. Its operations cover over 150 countries making GEFCO one of the top 10 logistics operators in Europe.

In partnership with Russian Railways, GEFCO is implementing several projects to improve efficiency of the Group's supply chains and use assets for joint activities. For example, in 2017, it transported polyester granulate from China to Gazprom khimvolokno through Novorossiysk and delivered rails from Nizhny Tagil Metallurgical Plant (part of the EVRAZ Group) to Mongolia under a contract signed by RZD Trading Company and Ulaanbaatar

For the first time in the company's history, its revenue exceeded RUB 100 bn (up 38% vs 2016), while its net profit increased 2.8 times to over RUB 16 bn.



For more details see the company's website at <http://ru.railfck.ru>

In 2017, the company's revenue totalled RUB 13,902 bn (up 67% y-o-y), while its net profit from core operations grew by 108% to RUB 1,082 bn.



For more details see the company's website at <http://utlc.com/en/>

Railways. In the same year, GEFCO launched the first container train service between Wuhan (China) and Dourges (France).

In 2017, the company's revenue rose to EUR 4,442 bn (up 5.1% y-o-y), while its income from core operations totalled EUR 139 m (up 15.4% y-o-y).



For more details see the company's website at <https://ru.gefco.net/en>

Improving the quality of transportation services

The Group's key priority in the freight transportation segment is to attract additional cargo volumes and expand the range of logistics products available to the customers. In order to deliver on these objectives, the Group launched three new services: Scheduled Freight Traffic, Freight Express and Grain Express.

In 2017, the EAEU member states made further amendments to the effective customs laws, including those regulating customs administration and controls and railway freight transportation

procedures. The Group's involvement in this legislative work will help protect Russian Railways' interests while also making its services more attractive for the forwarders, shippers and consignees.

Creation of the Freight Transportation electronic trading platform (FT ETP) came as a landmark event of 2017, as it helped integrate transportation, rolling stock supply, terminal, warehousing and logistics services of Russian Railways' subsidiaries into a single marketplace and increase the number of SME customers.



All initiatives and projects seeking to improve the quality of transportation services rely on regular comprehensive service quality assessment surveys conducted by the Russian Public Opinion Research Centre (VCIOM). The latest survey revealed a positive trend in assessment of the freight transportation service quality. In August 2017, 61% respondents were satisfied with the service quality as compared to 59% a year earlier.

FT ETP progress in 2017

Key achievements of 2017:

- FT ETP Service Terms approved;
- 1,851 users registered;
- nine operators added (FFC, NefteTransService, RusaGrotrans, E.S.A.Trans, LitKol, UTC UniTrans, TEQ-SV, Gazpromtrans and RefService);
- 9,938 orders registered;
- RUB 2.86 bn received in order payments.

In 2018, the FT ETP will see further improvements as regards approval of orders for exports through sea ports, registration and payment of orders for transit or export services by the largest freight forwarders of the bordering countries, and trading in bids to supply rolling stock for certain routes.

Terminal, warehousing and freight forwarding services

In 2017, the Central Directorate for Management of the Terminal & Warehouse Complex (Russian Railways' subsidiary) handled 107.2 mt of cargoes (vs 102.3 mt in 2016, up 4.8%) as part of its core operations.

At Kantemirovka and Rossosh stations, 329.7 kt of freight (construction materials) were handled in 2017 – fully in line with the targets under the federal project to construct a two-track electrified Zhuravka-Millerovo line.

At Dzerzhinskaya-Novaya, a project was rolled out to build a Kaliningrad terminal and logistics centre (with a satellite facility at Chernyakhovsk station). In 2017, the first container train running on a new transit route launched by UTLC along the China-Europe-China axis was serviced at the Chernyakhovsk freight yard. At Dzerzhinskaya-Novaya station, transshipment of coal products from

1,520 to 1,435 gauge railcars was introduced. Since May 2017, 192 kt of coal have been handled at the station.

In 2017, Russian Railways sought to arrange the delivery of fish products from the Far East to the European part of Russia and develop the infrastructure required for refrigerator trains to run between Vladivostok and Moscow. Container sites were upgraded at Artyom-Primorsky I (Primorye Territory) and Kuntsevo II (Moscow) stations.

The Company was also running a programme to create a network of prefabricated warehouses and develop unit load handling competencies within the Group. In 2017, prefabricated warehouses with a total floor area of 14.46 thousand m² were installed at freight yards in St Petersburg, Volgoda, Rostov-on-Don, Barnaul, Tambov, Tomsk and Belgorod.

¹ Tariffs for intercontinental ocean shipments between base ports.

Expert view



Alyona Zyabkina,

President of the Non-profit Partnership for Protection of Freight Owner Interests in the Domain of Railway Transportation

RUSSIAN RAILWAYS – SHIPPERS' PERSPECTIVE

In 2017, Russian Railways became more transparent, open and accessible, while its customer focus grew sharper and was easier to grasp.

New hi-tech export products, such as shipments with fixed departure and arrival times, gained particular traction as they help shippers optimise their transportation expenses by cutting costs, avoiding fines and demurrage¹ charges, reducing inventories at ports and production facilities, and boosting sales in external markets.

Focus areas for the Company's cooperation with shippers in 2018 could include:

- a new technology to optimise empty runs and improve railcar performance;
- an updated methodology to estimate railcar turnarounds for non-public routes;
- planning horizon improvements for long-term contracts;
- upgrades of shippers' industrial rail transport;
- enhanced dialogue between Russian Railways' clients and service support personnel;
- attractive conditions for shippers to encourage private investments in public railway infrastructure;
- shorter delivery times;
- a stable mutually beneficial long-term cooperation framework.



Pavel Ivankin,

Chairman of the Expert Council at the Institute for Railway Transport Studies

EFFORTS AIMED AT BOOSTERING THE COMPANY'S MARKET POSITION

Russian Railways currently focuses on infrastructure development to access major ports and extension of the throughput and carrying capacities of the Eastern Operating Domain.

Oleg Belozеров, the CEO of Russian Railways, has been pursuing a policy of openness and customer-oriented approach. In 2017, the monopoly launched a public discussion of its new pricing policy.

The newly adopted Risk Management Policy will also have a positive impact on the operating results.

In 2017, subsidiaries' dividend transfers to the parent Company hit a record high of RUB 21.2 bn. Revenue increased by 6.7% y-o-y. Russian Railways has also been actively offering instruments in both local and foreign

currencies, meeting all the capital market requirements and consistently improving credit ratings from the international rating agencies.

The Company's active involvement in international railway infrastructure projects is also set to have a positive impact on its results.

Approval of the Group's financial plan and investment programme for 2018 by the Consumer Council on Operations of Russian Railways and its Subsidiaries and Affiliates helped the management convince the Russian Government to accept the well-informed decisions made by the Company. In addition, the Government issued an order establishing a long-term tariff regulation system – a win-win solution for the monopoly and its clients.

¹ Demurrage is a charge paid to the carrier or charterer for a delay in operations of loading/unloading.