CEO's Review

A YEAR OF ACCOMPLISHMENTS, DESPITE A MIXED INDUSTRY ENVIRONMENT

Globaltrans has come far by basing everything it does on innovation and value creation. We take our responsibilities extremely seriously and believe that many opportunities remain ahead. One of our true strengths is our ability to capitalise on changing market conditions. We are stronger and more competitive today than even a couple of years ago, and I am confident in our ability to create value for clients and investors.

Valery Shpakov
Chief Executive Officer

Dear shareholders,

I am pleased to say that in 2016 we remained competitive and outperformed the market once more. While the wider economic pressures continued, thanks to our large and modern fleet, long-term contracts and advanced route management, we were well positioned and able to really capitalise on the recovery in the gondola segment during the year. This helped us to deliver decent results, despite the soft market for oil products and oil transportation. In 2016, we increased Adjusted EBITDA by 10% year-on-year and pushed the Adjusted EBITDA Margin up to 40%*, real accomplishments given the market conditions.

Among other achievements was the renewal of the multi-year contracts with both Metalloinvest (until the end of 2019) and Rosneft (until the end of March 2021). These have now been renewed several times since they were first concluded and I am proud of the trust that both companies have in our team and services. We have worked with Metalloinvest for almost a decade, while Rosneft has also been a longstanding client. In both cases, we deliver significant volumes of cargo across a vast geographical area, requiring careful management of complex logistics. Our ability to dispatch gondola cars from a single logistics centre means that we can move freight efficiently across the largest country in the world. This is something at which we excel and is the reason why they and others choose us as their transportation partner. At present, 62% of our Net Revenue from Operation of Rolling Stock comes from long-term contracts with blue-chip clients, while the next contract is due to be extended in 2019.

I believe that this accomplishment is based on the commitment from the Globaltrans team at every level and a genuine focus on placing clients at the heart of our business. We have come far by basing everything we do on innovation and value creation for all our stakeholders, from logistics to new investment opportunities to ways to improve our corporate structure. We take our responsibilities towards our customers, shareholders and employees extremely seriously. We feel that many opportunities remain ahead and we are committed to taking advantage of them and doing so well.

+8%

Year-on-year increase in Freight Rail Turnover

7.8%

Market share of Russia's overall freight rail turnover (2015: 7.3%)

48%

Total Empty Run Ratio (2015: 51%)

Shift in supply and demand

I often tell investors that one of our real strengths is our ability to capitalise on changing market conditions. This is exactly what we demonstrated in 2016, when performance in the freight rail transportation sector was varied. With our diversified fleet of gondola and rail tank cars, we were able to tackle the challenges in one area, while maximising the opportunity in the other.

The market context highlights Globaltrans' successful performance. Russia's total freight rail turnover rose by 2% year-on-year, while the Group's Freight Rail Turnover increased by 8%, well ahead of the market. This was largely due to the performance of the bulk cargo segment, which remained relatively strong throughout 2016, with overall Russian volumes up 3% year-on-year, supported by greater shipments of coal and construction materials. However, overall Russian volumes of oil products and oil declined by 6% year-on-year, reflecting the negative effect of both new pipeline capacity and lower output of refined products.

The industry-wide, regulation-driven retirement of railcars that have reached the end of their useful life continued in 2016 and was beneficial overall, although oversupply remained an issue in oil products and oil. The largest decline in railcars was in the gondola segment, where Russia's gondola fleet has decreased by 16% over the last two years, even as demand has increased. While Russia's rail tank car fleet has declined as well, falling by 11% over the last two years, the oil products and oil segment as a whole has continued to suffer from weak demand. These differing supply/demand balances in the two segments have meant that while prices in the gondola car segment have gradually recovered, pricing for tank cars has continued to be negatively affected. Clearly, the picture for the industry was mixed overall in 2016 and we expect little change during 2017.

CEO's Review continued

Rapid and effective response

Our successful performance reflected our ability to respond quickly and take advantage of the increased demand in the bulk cargo segment. We expanded our fleet by leasing in more gondola cars, knowing that our logistical capabilities could easily and quickly manage the additional rolling stock. As a result, the average number of gondola cars operated increased by 4% year-on-year. With non-oil cargoes representing 87% of the Group's Freight Rail Turnover in 2016, our ability to successfully capitalise on this shift in the market was crucial. Freight Rail Turnover for metallurgical cargoes, coal and construction materials all rose, driving an 11% year-on-year increase in the Group's non-oil cargo turnover.

At the same time, we needed to act decisively given the deteriorating demand for freight rail transportation of oil products and oil, as Globaltrans was clearly not immune to this trend. Our team immediately started to relocate rail tank cars and change logistics to maximise deployment, achieving the Group's Transportation Volumes decline broadly in line with the market.

+10%

Year-on-year increase in Adjusted EBITDA

40%*

Adjusted EBITDA Margin (2015: 38%*)

While moving rapidly to address the changing market, we kept our focus on maintaining a high level of operational efficiency. This is evident in our Empty Run Ratio for gondola cars, which reduced to 38%, compared with 39% in 2015, while the Total Empty Run Ratio (for all types of rolling stock) improved further to 48%, from 51% in the previous year. As always, our team of experts worked hard to enhance our effectiveness by analysing data and operational options. Among other things, this resulted in improved logistics and gains in transportation speed. The Average Number of Loaded Trips per Railcar increased by 1% year-on-year and the Average Distance of Loaded Trip by 6% year-on-year.

All of this enabled us to reinforce our market share of overall Russian freight rail turnover, which reached 7.8%, compared with 7.3% in 2015.

Delivering results

Our strong performance in the gondola segment drove an improvement across key financial indicators. The Group's Adjusted Revenue rose by 5% year-on-year, fuelled by increased Net Revenue from Operation of Rolling Stock, which was up by 9% year-on-year. Efficient cost management enabled us to continue to control Total Operating Cash Costs, which increased by 1%, an unprecedentedly low level. Despite the weakness in the rail tank car segment, as mentioned, Adjusted EBITDA rose by 10% year-on-year to RUB 17.7 billion*, driving the Adjusted EBITDA Margin to 40%*, compared with 38%* in 2015, which is really quite an achievement.

As anticipated, there were more capital repairs required during the year. This and the continued selective acquisition of new petrochemical tank containers and second-hand gondola cars caused a year-on-year increase in the Group's capital expenditure (CAPEX) of 146% to RUB 4.9 billion*[1]. Large-scale CAPEX remained on hold in 2016. Importantly, Globaltrans continued to generate decent Free Cash Flow of RUB 8.9 billion* (2015: RUB 9.6 billion*), which enabled further deleveraging, with Net Debt to Adjusted EBITDA falling to 0.7x*, compared with 1.0x* at the end of 2015.

Given this comfortable debt level and the Group's overall solid financial position, the Board has proposed a strong dividend for 2016 and approved an enhanced dividend policy, which is now linked to Attributable Free Cash Flow and Leverage Ratio.

Opportunistic approach to investments

Our results clearly indicate that we are operating well and are positioned favourably in the market. Nonetheless, we are always looking for ways to create value for our business and our shareholders. As such, I am a firm believer in not only optimising existing investments, but also exploring new sectors and potential areas for development. As a result, for example, in 2014, we started a niche project and entered the segment for rail transportation of petrochemicals. This progressed well, and during 2016 we bought 550 new petrochemical tank containers to support the development of this area. This approach has paid off. While the business is small, it is doing well, and our total fleet of tank containers amounted to 1,080 units at the year-end. It is a great model of how we can leverage the experience and skillset at the heart of our business to reap real benefits for the future.

We have also taken this opportunistic approach to strengthening our fleet. We are fortunate to have one of the modern, large fleets in the industry and, as buying new rolling stock looked unattractive due to low returns, we turned to the secondary market, where we were able to acquire 665 gondola cars over the year. We will continue to pursue this approach to investment activity, with a focus on strengthening our business when we see an opportunity that adds clear longer-term value.

We have navigated various market cycles and are a stronger and more competitive company today than even a couple of years ago. We are moderately optimistic about the year ahead. During the first months of 2017, demand in the gondola segment was solid. While there are still some headwinds in oil products and oil, I am as confident as ever in our team's ability to mitigate the external pressures we may face and deliver outstanding service and create value for both our clients and investors.

Valery Shpakov
Chief Executive Officer

1 The Group's CAPEX on a cash basis (including "Purchases of property, plant and equipment" (which includes maintenance CAPEX), "Purchases of intangible assets" and "Acquisition of subsidiary undertakings – net of cash acquired").