CEO Review

Valery Shpakov
Chief Executive Officer

DEAR SHAREHOLDERS,

The spread of the COVID-19 virus disrupted economic activity across Russia. Our industry did not escape the impact of this although it was very much a year of two halves for freight rail transportation.

In the first half of 2020, demand slumped as the sector suffered the full economic impact of COVID-19; in the second half, our markets recovered and overall freight rail turnover returned to pre-COVID levels.

Globaltrans again delivered a resilient business performance even at this exceptionally challenging time. We outperformed the market in freight rail turnover, secured further new contracts and extensions of existing contracts, and invested in the growing specialised container transportation segment. Although our financial results were inevitably impacted by the weak market conditions, our focus on cost control and expansion CAPEX flexibility resulted in the Group delivering increased Free Cash Flow and solid dividends for shareholders as targeted and announced beforehand.

I am very proud of the spirit, commitment and agility shown by our workforce in responding to what has been a very demanding environment over the past year.

Managing COVID-19 risks

At the outset of the pandemic, we identified the key priority areas we needed to focus on: safeguarding the health and safety of our employees, supporting our customers, and ensuring the business stayed fully operational. All subsequent management decisions were made with these priorities firmly in mind.

Safety is management's top priority and in the heightened risk environment we were operating in last year, it took on even greater urgency. We quickly instituted additional precautions to protect the health and wellbeing of our employees and engaged with them to ensure appropriate measures were being taken. We made sure we were operating within the rules and guidelines set out by the government such as introducing distance working where it was feasible to do so. We also introduced a raft of practical measures to safeguard our employees and customers, including:

- the transfer of a large number of employees to remote working;
- rigorous cleaning schedules at all our workplaces;
- measures to minimise contact between staff and enforce social distancing;
- additional protective equipment and clothing for those that needed it;
- information on government guidelines.

Highlights

In 2020, we once again outperformed the market. By leveraging our operating platform to efficiently switch between cargoes depending on demand, the Group's Freight Rail Turnover grew 2.2% year on year, despite the market suffering a 2.2% decline.

In the context of the challenging economic climate stemming from the COVID-19 pandemic, our financial results were inevitably impacted. The Group's Adjusted Revenue was down 20% year on year to RUB 54.9 billion, largely reflecting weaker pricing conditions in the gondola segment. Adjusted EBITDA at RUB 26.8 billion was down 32% compared to the record result set in 2019 of RUB 39.6 billion. Our Adjusted EBITDA Margin held up well at a robust 49%, down from 57% in the prior year. Management's efforts to optimise costs proved successful, and despite ongoing inflationary pressures, we reduced Total Operating Cash Costs by 1% year on year. Excluding regulated RZD Empty-Run regulatory tariffs the year-on-year decline in Total Operating Cash Costs was 9%.

The Group produced strong Free Cash Flow[1] generation of RUB 15.1 billion, up 14% on the previous year. The financial impact of weaker markets on operating activities was more than offset by an 83% year-on-year targeted cut in expansion CAPEX, the release of working capital and a decline in Tax paid.

The Group continued to benefit from a strong balance sheet and low leverage. The year-end Net Debt to Adjusted EBITDA ratio stood at 1.01 times up from 0.6 times at the end of the prior year. We managed to significantly improve the financing terms with the average weighted interest rate down to 6.9% compared to 8.1% at the end of the previous year.

Our markets

Market conditions for the freight rail industry fluctuated considerably over the course of 2020. In the first half of the year, the industry suffered as economies locked down as a result of the COVID-19 pandemic before staging a comeback in the second half as economies began to reopen with pent-up global demand for industrial commodities driving a recovery in cargo volume dynamics.

Overall freight rail turnover for the industry in 2020 dropped 2.2% year on year, although again with a very clear split in performance between the two halves of the year. Freight rail turnover was down 5.3% year on year in the first half as a result of the COVID-19 pandemic followed by a 1% year-on-year increase in the second half stimulated by greater export activity and currency weakness.

Overall freight transportation volumes for the year ended down 2.7% year on year. The first half saw a fall in volumes of 4.5% year on year, with downward pressure experienced in all key cargo segments, except construction materials. Cargo volume dynamics gradually improved over the second half with overall freight volumes down only 0.9% year on year.

[1] Free Cash Flow is net of principal elements of lease payments for leases with financial institutions presented for both years (2019 and 2020). During H1 2020 the entire financial lease portfolio was refinanced to bilateral loans, therefore principal elements of lease payments were eliminated from both years for comparison purposes.

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The non-oil (bulk) cargo segment fared better than the overall market with the overall volumes in the segment decreasing 1.1% year on year. The performance was uneven across the individual transport segments. Weakness in coal and metallurgical cargoes, down 4.8% and 3.5% year on year respectively, was partially offset by strength in construction materials where volumes grew by a healthy 4.2% year on year[1].

The oil products and oil segment was particularly affected by the COVID-19 pandemic and the resultant international and domestic travel restrictions and lockdowns. Due to these constraints, fuel consumption fell significantly, a situation further exacerbated by the OPEC+ agreement on oil production cuts. Overall freight rail volumes in the segment fell 10% year on year.

Market pricing revealed a mixed segmental picture. The pricing pressure in the gondola segment we experienced in the latter part of 2019 continued, the result of an ongoing oversupply of gondolas combined with lower demand. In contrast, the rail tank segment experienced relatively stable railcar operator rates despite weak demand.

Operational performance

It was clear that the sector would not be immune to the unprecedented trading conditions of 2020, and so management's focus was on the things we could control, namely operational efficiency, superior client service, and cost discipline.

In the rail logistics industry, operational efficiency is a source of competitive advantage, and even more so in periods of market stress. Globaltrans' operating model gives us an edge in such times as we can adapt our logistics to respond to rapid changes in routes and cargo flows and flex our gondola fleet to capture demand changes in freight segments. We took full advantage of this important capability in 2020.

As I mentioned earlier, despite the volatile conditions, we delivered 2.2% year-on-year growth in Freight Rail Turnover while the overall market declined by that same amount in 2020. In non-oil bulk cargo operations, our Freight Rail Turnover increased 4.9% year on year, benefitting from the efficiency with which we were able to migrate railcars between different cargoes.

In the tank car segment, our operations were affected by those trends described above that severely impacted demand across the industry – global lockdowns, reduced fuel consumption in Russia, and the OPEC+ agreement on crude oil productions cuts. This was reflected in the 13.3% year-on-year decline in the Group's Freight Rail Turnover in this segment.

The Group's Average Price per Trip, a key metric, suffered due to weak pricing in the gondola segment, partially offset by more stable pricing dynamics for tank car operators in the oil products and oil segment. As a result, Average Price per Trip declined 19% year on year.

In a challenging environment, we managed the logistical test of adapting to the changes in cargo patterns. Whilst not immune from the headwinds created by the volatile conditions, we managed to restrict the increase in our gondola Empty Run Ratio, an important indicator of our operating efficiency, which rose to 45% from 42%. This remains among the lowest in the industry. The Total Empty Run Ratio for all types of railcars also increased to 51% compared to 49% in the previous year.

[1] Metallurgical cargoes including ferrous metals, scrap metal and irone ore; coal including coke; construction materials including cement.

As one of the leaders in the provision of freight logistics, we maintained a high level of client retention in 2020. We signed a new one-year deal with EVRAZ, significantly expanding our cooperation with them. We also extended our service contracts with MMK for a further two years until September 2024, and with Metalloinvest for an additional one year until the end of December 2021. Our success in retaining key clients continued into 2021 with a new service contract signed with Rosneft for five years until the end of March 2026. Long-term service contracts provide for better volume visibility and lower pricing volatility and enable logistical efficiencies. Our strong portfolio of service contracts with five leading businesses accounted for about 64% of the Group's Net Revenue from Operation of Rolling Stock in 2020, helping to underpin the Group's business model.

Capital expenditure

Given the market volatility and pricing pressures we observed coming into 2020, we had already signalled that our plans envisaged only a modest level of expansion CAPEX for the year. Due to the specifics of our business model, which includes ownership of long-life assets, we have discretion over our expansion CAPEX and can adjust it in light of market conditions.

In light of the economic impact of the COVID-19 pandemic, we confined expansion CAPEX to targeted investments into the growing niche segment for the rail transportation of petrochemicals and high-grade steel in specialised containers. To support our developing business in this segment, we acquired 300 flat cars in 2020 taking our expansion CAPEX for the year to RUB 1.1 billion*, down 83% year on year. Consequently, our Total CAPEX fell 49% year on year to RUB 6.9 billion[2] in 2020 and consisted primarily of maintenance CAPEX.

Outlook

How the freight rail sector performs over the next year will largely depend on how quickly the economy can recover from the pandemic. The introduction of mass vaccination programmes alongside the gradual easing of lockdowns provide grounds for optimism in this regard.

The pricing environment remains mixed with some further weakness in gondolas rates at the beginning of the year compared to the second half of 2020 and with the rail tank segment experiencing relatively steady pricing. The issue of gondola oversupply is likely to continue to weigh on the industry. In light of this, we anticipate maintaining our freeze on expansion investment this year. Total CAPEX is expected to mostly include maintenance and to remain in the range of RUB 6-7 billion in 2021, which will support the Group's Free Cash Flow generation.

2021 has started well helped by a recovery in global demand for both energy and basic materials, which has driven increased freight volumes. Recent rail freight statistics support this view with average daily overall Russian freight turnover in the first quarter of 2021 ahead 3.1% year on year[3].

We have a flexible business model, well-balanced portfolio of assets, strong management, and a consistent focus on efficiency and cost control. These factors, together with almost entirely discretionary expansion CAPEX mid-term, are expected to support our ability to deliver strong dividends.

As is evident from our 2020 performance, Globaltrans is well positioned to benefit from a sustained recovery in our markets and we remain cautiously optimistic about our prospects for 2021.

Valery Shpakov
Chief Executive Officer

[2] Total CAPEX is net of principal elements of lease payments for leases with financial institutions presented for both years (2019 and 2020). During H1 2020 the entire financial lease portfolio was refinanced to bilateral loans, therefore principal elements of lease payments were eliminated from both years for comparison purposes.

[3] Estimated by the Company. Average daily overall freight rail turnover better illustrates the market trends taking into account higher base in February 2020 due to a leap year.