

Renewal

Aeroflot Group improved its financial results thanks to strong operational growth, a net positive FX effect and a proactive approach to network and revenue management, which resulted in higher profitability. Higher revenue, higher operating and net profit, and strong free cash flow in 2016 allowed the Company to deleverage and strengthen its financial position.

FINANCIAL REVIEW

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Financial Highlights

Financial Highlights

RUB MILLION, UNLESS OTHERWISE STATED

Item	2015	2016	Change, %
Revenue	415,173	495,880	19.4
EBITDAR ¹	103,118	137,567	33.4
EBITDAR margin, %	24.8	27.7	2.9 p.p.
EBITDA ²	58,703	78,004	32.9
EBITDA margin, %	14.1	15.7	1.6 p.p.
Operating profit	44,107	63,254	43.4
Operating profit margin	10.6	12.8	2.2 p.p.
Profit / (loss) for the period	(6,494)	38,826	-
Net profit margin	-	7.8	-

In 2016, Aeroflot Group significantly improved its financial performance, driven by solid operating results, which determined both expansion of business volumes and improvement of margins. The volume factor is associated with the growth in passenger traffic and passenger turnover by 10.3% and 14.8%, respectively. A 3.2 p.p. growth in the passenger load factor to 81.5% was one of the key drivers behind higher margins since it helped earn extra revenues without increasing fixed and semi-fixed costs.

Other factors boosting performance were a proactive approach to network and revenue management and a net positive FX effect on revenue and costs. As a result, EBITDA and EBITDAR increased by 1.6 p.p. and 2.9 p.p. y-o-y to 15.7% and 27.7%, respectively.

The above factors as well as no extra costs included in the 2016 consolidated statement of profit and loss due to commitments to transport Transaero's passengers (in 2015, the total expensed costs amounted to RUB 16,811 million) supported net profit growth, to reach RUB 38,826 million in 2016.

Note. Immaterial deviations in numbers in the charts and tables subtotals of the Annual Report are due to rounding.

¹ EBITDAR = EBITDA + operating lease expenses.

² EBITDA = operating profit + depreciation and amortisation + customs duties.

Traffic and other revenue

Revenue

RUB MILLION, UNLESS OTHERWISE STATED

Item	2015	2016	Change, %
Revenue from passenger flights	349,574	421,377	20.5
including scheduled flights	343,428	403,760	17.6
charter flights	6,146	17,617	x2.9
Revenue from cargo	9,631	12,589	30.7
Total traffic revenue	359,205	433,966	20.8
Other revenue	55,968	61,914	10.6
including revenue from airline agreements	31,596	35,923	13.7
revenue from partners under the frequent flyer programme	10,275	11,846	15.3
other revenue	14,097	14,145	0.3
TOTAL REVENUE	415,173	495,880	19.4

In 2016, Aeroflot Group's revenue increased by 19.4% y-o-y to RUB 495,880 million.

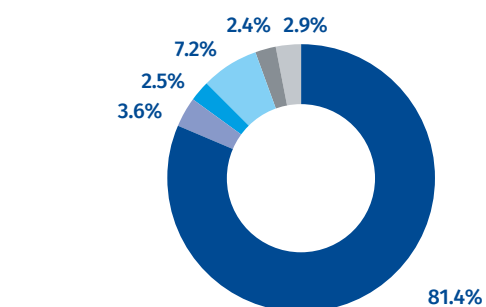
Revenue from scheduled passenger flights increased by 17.6% to RUB 403,760 million, driven by a 10.3% y-o-y increase in the Group's passenger traffic in 2016 and the year-average Rouble exchange rate movements leading to a growth in revenue from international services denominated in foreign currencies.

Revenue from charter flights rose almost threefold to RUB 17,617 million, supported, among other things, by the growth in this segment following the launch of Rossiya airline's charter programme.

Revenue from cargo increased by 30.7% y-o-y to RUB 12,589 million on the back of additions of long-haul aircraft to the Group's fleet and a 31.6% growth in the cargo and mail volumes.

Other revenue was up 10.6% y-o-y and stood at RUB 61,914 million, primarily due to an increase in revenue from airline agreements denominated in foreign currency following the depreciation of the Russian currency and higher revenue from banks under the Aeroflot Bonus programme.

Revenue breakdown, 2016

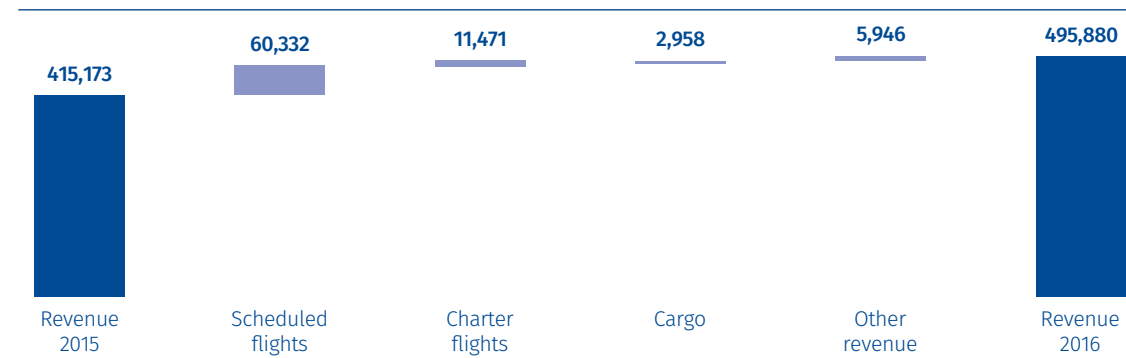


- Scheduled flights
- Charter flights
- Cargo
- Airline agreements
- Aeroflot Bonus
- Other revenue

Traffic and other revenue (continued)

Revenue growth decomposition

RUB MILLION



Yields

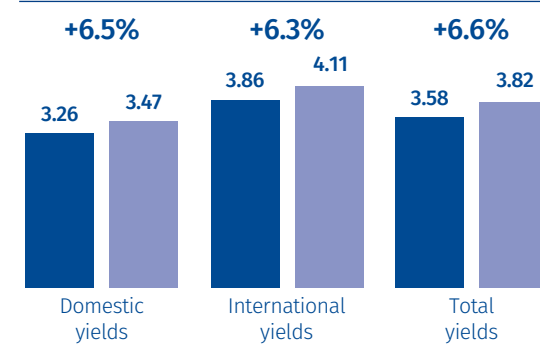
In 2016, scheduled flight yields increased by 6.6%, including yields on international destinations (by 6.3%) and on domestic destinations (by 6.5%). International yield growth primarily resulted from the foreign exchange effect as all fare groups (for outbound and inbound flights and for international transit) are denominated in foreign currencies. Despite the gradual appreciation of the Russian rouble throughout 2016, the average RUB/EUR exchange rate, which directly impacts the y-o-y change in yields, increased by 9.5% (RUB 67.78 per EUR in 2015, RUB 74.23 per EUR in 2016).

The upward trend in domestic yields was driven by the higher demand for domestic flights, which enabled the Company to raise the passenger load factor by 4.1 p.p. to 83.5% with no additional promotion. Moreover, in 1H 2016 domestic yields were supported by the lower VAT rate, which was reduced from 18% to 10% in mid-2015.

In addition to market factors, the Group's development also led to structural changes in revenue contributions from airlines. In particular, Rossiya airline increased its share of "long-haul" flights with lower yields. The low-cost carrier Pobeda is also actively expanding its operations.

Scheduled flight yields

RUB



● 2015 ● 2016

Operating Costs

Operating Costs

RUB MILLION, UNLESS OTHERWISE STATED

Item	2015	2016	Change, %
Aircraft, traffic and passenger servicing	75,186	87,227	16.0
% of revenue	18.1	17.6	(0.5 p.p.)
Staff	55,619	64,682	16.3
% of revenue	13.4	13.0	(0.4 p.p.)
Operating lease	44,415	59,563	34.1
% of revenue	10.7	12.0	1.3 p.p.
Aircraft maintenance	32,042	38,236	19.3
% of revenue	7.7	7.7	-
Sales and marketing, administration and general expenses	26,084	30,294	16.1
% of revenue	6.3	6.1	(0.2 p.p.)
Depreciation, amortisation, and customs duties	14,596	14,750	1.1
% of revenue	3.5	3.0	(0.5 p.p.)
Communication expenses	12,890	14,697	14.0
% of revenue	3.1	3.0	(0.1 p.p.)
Other expenses	15,852	21,595	36.2
% of revenue	3.8	4.4	0.6 p.p.
Operating costs, excluding aircraft fuel	276,684	331,044	19.6
% of revenue	66.6	66.8	0.2 p.p.
Aircraft fuel	94,382	101,582	7.6
% of revenue	22.7	20.5	(2.2 p.p.)
TOTAL OPERATING COSTS	371,066	432,626	16.6
% of revenue	89.4	87.2	(2.2 p.p.)

In 2016, aircraft fuel costs increased by 7.6% y-o-y to RUB 101,582 million. Despite the growth in traffic and higher flight hours, aircraft fuel costs were almost flat due to lower average fuel prices denominated in roubles for the same period and initiatives implemented by the Group to boost its fuel efficiency, which improved the Group's specific fuel consumption rates.

Operating costs less aircraft fuel increased by 19.6% y-o-y to RUB 331,044 million.

The cost of aircraft, traffic and passenger servicing stood at RUB 87,227 million, up 16.0% y-o-y. Excluding the foreign exchange impact, these costs went up by 13.6%, driven by the Group's expansion and higher traffic. This cost item was also impacted by higher fares of some Russian airports.

Staff costs went up by 16.3% y-o-y to RUB 64,682 million, mainly due to indexation of salaries of eligible employee categories in early 2016 and the employment of over 4,000 of Transaero staff.

Operating Costs (continued)

Operating lease expenses stood at RUB 59,563 million, a 34.1% increase y-o-y, primarily driven by the effect of the Rouble exchange movements (this item is almost entirely denominated in foreign currency). Excluding the foreign exchange impact, these costs went up by 24.2%. Other factors contributing to operating lease expenses included fleet expansion (the net increase in the Group's leased fleet was 37 aircraft, or 18.5% growth y-o-y) and a higher average LIBOR 3M rate in the reporting period (0.74 against 0.3 in 2015).

Aircraft maintenance costs increased by 19.3% y-o-y to RUB 38,236 million. Excluding the foreign exchange impact, these costs went up by 13.6%, due to growth in flight hours and higher additional costs on preparing aircraft to be phased out.

Sales and marketing, administration and general expenses gained 16.1% y-o-y and reached RUB 30,294 million, driven by higher sales and marketing expenses pegged to foreign currencies and the IT infrastructure enhancement. Excluding the foreign exchange impact, these expenses went up by 11.2%.

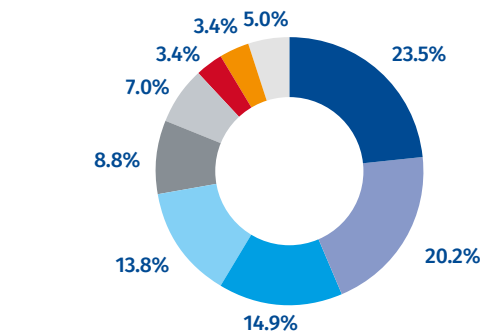
Depreciation, amortisation and customs duties increased by 1.1% y-o-y to RUB 14,750 million.

Communication expenses went up by 14.0% y-o-y and amounted to RUB 14,697 million as a result of higher rouble equivalent of global distribution systems expenses denominated in foreign currency.

Other expenses increased by 36.2% y-o-y to RUB 21,595 million due to allocations to provisions for overdue accounts receivable and for aircraft maintenance.

As a result of the above factors, Aeroflot Group posted an operating profit of RUB 63,254 million (12.8% of revenue) for 2016. EBITDAR amounted to RUB 137,567 million, with a 2.9 p.p. increase in margin to 27.7%. EBITDA amounted to RUB 78,004 million, with a 1.6 p.p. increase in margin to 15.7%.

Operating costs breakdown, 2016

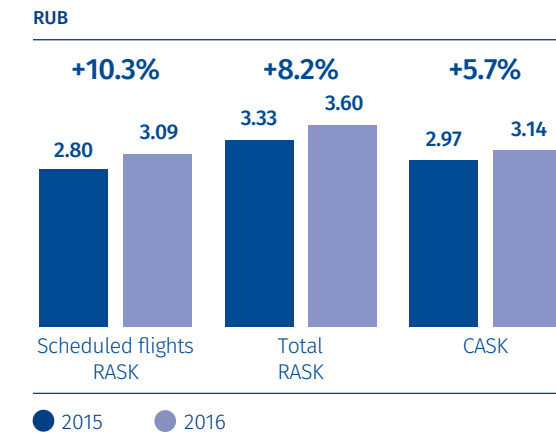


- Aircraft fuel
- Aircraft, traffic and passenger servicing
- Staff
- Operating lease
- Aircraft maintenance
- Sales and marketing, administration and general expenses
- Depreciation, amortisation, and customs duties
- Communication expenses
- Other expenses

Unit revenue and costs

Effective management of the route network, capacity and revenue, and tight cost control provided for Aeroflot Group's RASK growth rate outstripping the CASK growth rate. In 2016, the scheduled RASK was RUB 3.09 per seat-kilometre, up 10.3% y-o-y, while CASK amounted to RUB 3.14, up 5.7% y-o-y.

Revenue and Cost per Available Seat-Kilometre



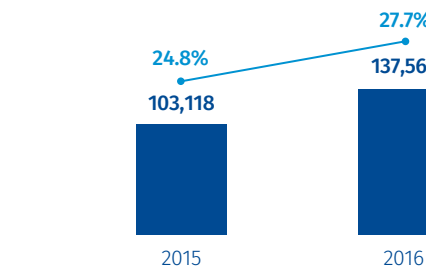
EBITDA and EBITDAR

In 2016, Aeroflot Group's EBITDA amounted to RUB 78,004 million, with EBITDA margin growing to 15.7% (14.1% in 2015). EBITDAR for 2016 was RUB 137,567 million, with EBITDAR margin reaching 27.7%.

(24.8% in 2015). Margins were driven by revenue growth outstripping cost inflation as a result of the aforementioned factors.

EBITDAR and EBITDAR margin

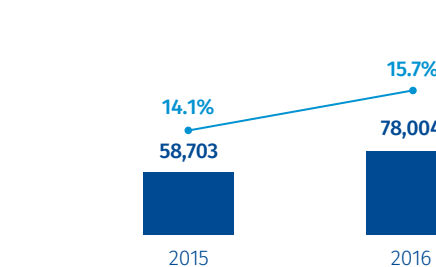
RUB MILLION AND %



- EBITDAR
- EBITDAR margin

EBITDA and EBITDA margin

RUB MILLION AND %



- EBITDA
- EBITDA margin

Finance Income and Costs

Non-operating profit and loss

RUB MILLION, UNLESS OTHERWISE STATED

Item	2015	2016	Change, %
Operating profit	44,107	63,254	43.4
Loss from sale and impairment of investments, net	(9,159)	(2,935)	(68.0)
Finance income	15,811	19,802	25.2
Finance costs	(28,556)	(9,443)	(66.9)
Hedging result	(23,746)	(12,310)	(48.2)
Share of results of associates	(17)	12	-
Result from disposal of subsidiaries	-	(5,099)	-
Profit/(loss) before income tax	(1,560)	53,281	-
Income tax expense	(4,934)	(14,455)	x2.9
PROFIT/(LOSS) FOR THE PERIOD	(6,494)	38,826	-

Finance income for 2016 increased by 25.2% y-o-y to RUB 19,802 million, mainly due to the foreign exchange gain primarily coming from the return of aircraft pre-delivery payments.

Finance costs decreased by 66.9% y-o-y to RUB 9,443 million, primarily due to the recognition of loss on derivative financial instruments following transactions execution in 2015 and rouble appreciation throughout 2016.

The hedging result of RUB 12,310 million is attributable to settlements under financial instruments recognised in equity, as well as to the effect of revenue hedging with liabilities in USD (finance lease).

As a result of the effect of the above operational and non-operational factors on revenue and costs, Aeroflot Group posted a net profit of RUB 38,826 million for 2016.

Cash Flows

Condensed consolidated statement of cash flows

RUB MILLION, UNLESS OTHERWISE STATED

Item	2015	2016	Change, %
(Loss)/profit before income tax	(1,560)	53,281	-
Depreciation and amortisation	13,306	13,395	0.7
Change in provisions	10,882	8,845	(18.7)
Foreign exchange loss/(gain)	849	(15,597)	-
(Gain)/loss on change in fair value of derivative financial instruments	(11,885)	53	-
Realised loss on hedging	23,745	12,310	(48.2)
Interest expense	7,737	8,907	15.1
Loss on derivative financial instruments, net	19,803	-	-
Loss on disposal of subsidiaries and accrual of provision for impairment of investments	9,159	8,034	(12.3)
Gain on recovery of VAT	(8,021)	-	-
Other adjustments	272	(3,425)	-
Working capital changes and income tax paid/refunded	5,377	(9,091)	-
Net cash flows from operating activities	69,664	76,712	10.1
Purchases of property, plant and equipment and intangible assets	(9,196)	(10,222)	11.2
Proceeds from sale of assets held for sale	-	6,471	-
Purchases of investments and deposits placement	(20,393)	(10,435)	(48.8)
Proceeds from sale of investments and deposits return	6,405	9,840	53.6
Proceeds from acquisition/sale of a subsidiary, net	-	9	-
Prepayments/return of prepayments for aircraft, net	(14,880)	10,556	-
Other	(706)	1,047	-
Net cash (used in)/from investing activities	(38,770)	7,266	-
Free cash flow	30,894	83,978	171.8
Proceeds from loans and borrowings	73,331	30,885	(57.9)
Repayment of loans and borrowings	(36,267)	(72,991)	101.3
Repayment of the principal of financial lease liabilities	(19,455)	(27,024)	38.9
Interest paid	(5,914)	(6,954)	17.6
Dividends paid	(88)	(49)	(44.3)
Proceeds from settlement of derivative financial instruments, net	(39,682)	(4,362)	(89.0)
Net cash used in / from financing activities	(28,075)	(80,495)	186.7
Effect of exchange rate fluctuations	1,327	(2,700)	-
Net increase/(decrease) in cash and cash equivalents	4,146	783	(81.1)
Cash and cash equivalents at the beginning of the year	26,547	30,693	15.6
CASH AND CASH EQUIVALENTS AT THE END OF THE YEAR	30,693	31,476	2.6

Cash Flows (continued)

Cash flows from operating activities

In 2016, net cash flows from operating activities reached RUB 76,712 million (RUB 69,664 million in 2015), with profit before income tax amounting to RUB 53,281 million (loss of RUB 1,560 million in 2015). Key non-cash adjustments made to income before income tax to arrive to net cash flows from operating activities for 2016 were related to:

- changes in provisions in the amount of RUB 8,845 million (RUB 10,353 million in 2015), mainly attributed to accrual of the provision for scheduled maintenance and repair of aircraft, and the provision for doubtful accounts;
- hedging result in the amount of RUB 12,310 million (RUB 23,746 million in 2015) attributable to the effect of revenue hedging with liabilities in foreign currency in the amount of RUB 8,316 million and realised loss on hedging derivative instruments subject to hedge accounting in the amount of RUB 3,994 million;
- loss on sale of investments and accrual of provision for impairment of investments and loans issued, in the amount of RUB 8,034 million, mainly attributed to disposal of JSC Vladivostok Air, CJSC Aeroflot-Cargo and impairment of long-term financial investments in JSC Sheremetyevo International Airport;
- foreign exchange gain in the amount of RUB 15,597 million (loss of RUB 849 million in 2015);
- depreciation and amortisation of RUB 13,395 million (RUB 13,306 million in 2015).

Working capital

In 2016, working capital change was RUB 3,663 million, mainly impacted by an increase in accounts receivable and prepayments by RUB 6,915 million (RUB 2,251 million in 2015) in line with the revenue growth by 19.4% in 2016.

Cash flows from operating activities were largely affected by an increase in accounts payable and accrued liabilities, in line with the growth in operating costs by 16.6% in 2016.

Free cash flow

In 2016, free cash flow totalled RUB 83,978 million, up by RUB 53,084 million, or 171.8% y-o-y, which was driven by the increase in net cash flows from investing activities by RUB 46,036 million, and the increase in net cash flows from operating activities by RUB 7,048 million.

Key drivers of y-o-y change in net cash flows used in investing activities were:

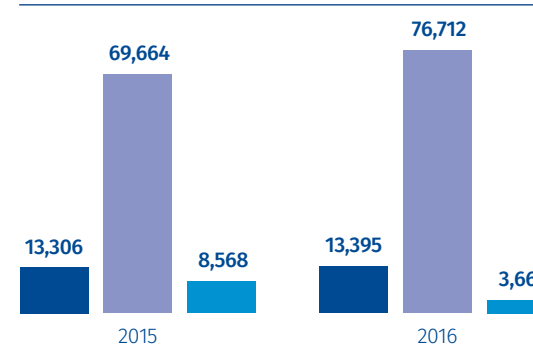
- placement of deposits totalling RUB 10,435 million (RUB 11,741 million in 2015);
- return of deposits totalling RUB 9,840 million, primarily to Pobeda and Aurora airlines, due to maturing (RUB 6,375 million in 2015);
- prepayments of RUB 18,806 million (RUB 22,708 million in 2015) for 22 Airbus A350 aircraft expected to be delivered in 2018–2023, and Airbus A320/A321 aircraft expected to be delivered in 2017–2018, and return of prepayments of RUB 29,362 million (RUB 7,828 million in 2015) for Boeing 777, Airbus A320/321, and SSJ100;
- purchases of property, plant and equipment and intangible assets, totalling RUB 10,222 million (RUB 9,196 million in 2015);
- proceeds from sale of assets held for sale, totalling RUB 6,471 million.

In 2016, the internal financing ratio (net cash flows from operating activities to capital expenditure) stood at 2,092.0% (813.1% in 2015).

Cash and cash equivalents grew by RUB 783 million (2.6% y-o-y) to RUB 31,476 million, driven, among other factors, by the effect of exchange rate fluctuations in the amount of RUB 2,700 million (RUB 1,327 million in 2015).

Net capital expenditure, cash flows from operating activities, depreciation and amortisation

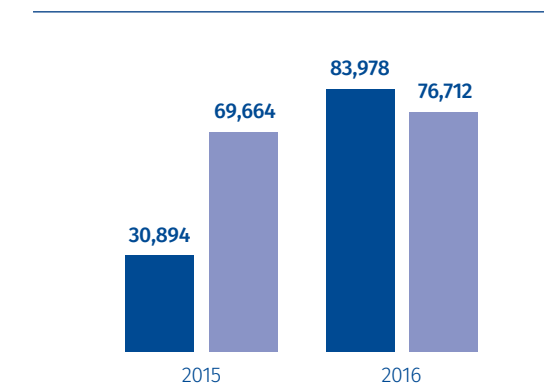
RUB MILLION



- Depreciation and amortisation
- Net cash flows from operating activities
- Net capital expenditure

Cash flows from operating activities and free cash flow

RUB MILLION



- Free cash flow
- Net cash flows from operating activities

Capital Expenditure

In 2016, purchases of property, plant and equipment primarily included two DHC-8 aircraft to Aurora Airlines purchased for RUB 2,807 million, and equipment acquired by PJSC Aeroflot under finance lease for RUB 2,156 million.

Purchases of intangible assets in 2016 mainly included SAP development software, as well as other software solutions and licences for office and other IT systems.

Net capital expenditure

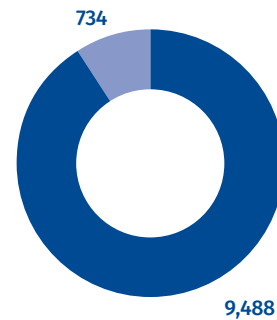
RUB MILLION, UNLESS OTHERWISE STATED

Item	2015	2016	Change, %
Purchases of property, plant and equipment and intangible assets	(9,196)	(10,222)	11.2
Purchases of investments	(5)	–	–
Proceeds from sale of assets held for sale	–	6,471	–
Proceeds from sale of property, plant and equipment	603	84	(86.1)
Gain on disposal of investments	30	–	–
NET CAPITAL EXPENDITURE	(8,568)	(3,667)	(57.2)

Capital Expenditure (continued)

Purchases of property, plant and equipment and intangible assets

RUB MILLION



- Purchases of property, plant and equipment
- Purchases of intangible assets

Non-current assets

In 2016, non-current assets decreased by 7.0% and reached RUB 169,161 million. The change was mainly attributable to reduction in deferred tax assets by RUB 9,380 million, primarily resulting from the decrease in finance lease liabilities backed by the rouble appreciation and repayment of liabilities.

In addition, the change in non-current assets was influenced by lower prepayments for aircraft in 2016 as delivery time got closer, and reclassification of prepayments to current assets. Net change in prepayments for aircraft amounted to RUB 7,461 million.

Current assets

Current assets decreased by 2.4% and reached RUB 130,146 million, primarily driven by disposal of assets held for sale, following the sale of six Airbus A321, one Airbus A320 and two Airbus A319 aircraft with the total residual value of RUB 4,504 million.

Equity

In 2016, equity, including non-controlling interest, grew to RUB 40,769 million.

The key driver behind this change was the decrease in the hedging reserve of RUB 30,533 million, which comprised revaluation of derivatives confirmed to be effective under IAS 39 and revaluation of finance lease liabilities. Another contributor to the gain was retained earnings, which primarily went up due to the profit of RUB 37,443 million earned in 2016 and attributable to the shareholders of the Company. For more details on share capital see Note 32 to the 2016 consolidated financial statements (Appendix to this Annual Report).

Current liabilities

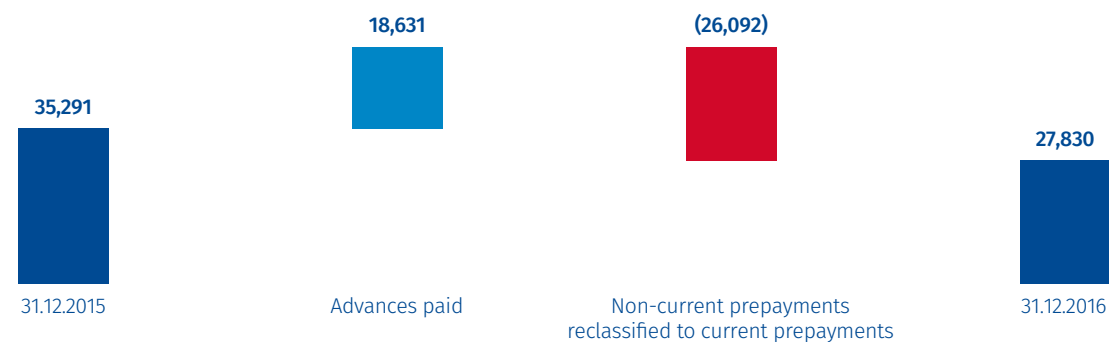
In 2016, total current liabilities decreased by 32.2% y-o-y (by RUB 57,356 million), primarily driven by a reduction of RUB 44,776 million in short-term loans and borrowings and the current portion of long-term loans and borrowings. The decrease was also attributed to a RUB 7,371 million reduction in liabilities related to assets held for sale, a RUB 4,883 million decrease in accounts payable and accrued liabilities, a RUB 2,215 million decrease in provisions for liabilities, a RUB 3,911 million decrease in finance lease liabilities, and a RUB 4,853 million decrease in derivative financial instruments. Unearned traffic revenue grew by RUB 10,353 million, and deferred revenue related to frequent flyer programme by RUB 300 million.

Non-current liabilities

In 2016, non-current liabilities decreased by 20.4%, and reached RUB 137,813 million. The key drivers behind this decrease were finance lease liabilities, which went down by RUB 37,877 million due to the rouble appreciation in 2016, and the reclassification of finance lease liabilities from non-current to current liabilities.

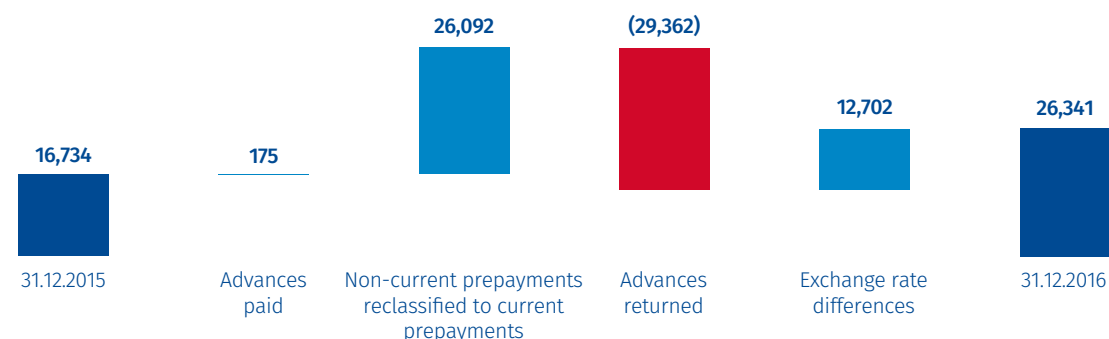
Change in prepayments for aircraft (non-current portion)

RUB MILLION



Change in prepayments for aircraft (current portion)

RUB MILLION



Debt and Liquidity

Debt

RUB MILLION, UNLESS OTHERWISE STATED

Item	31.12.2015	31.12.2016	Change, %
Loans and borrowings	68,460	20,367	(70.2)
Finance lease	164,524	122,736	(25.4)
Pension liabilities	745	805	8.1
Total debt	233,729	143,908	(38.4)
Cash, cash equivalents and short-term investments	36,610	37,795	3.2
NET DEBT	197,119	106,113	(46.2)
Net debt / EBITDA ratio	3.4x	1.4x	-

As at 31 December 2016, total debt reduced by 38.4% y-o-y, to RUB 143,908 million, primarily driven by scheduled and early repayments of loans and borrowings, revaluation of finance lease liabilities following the y-o-y change in the RUB/USD exchange rate as at 31 December 2016, and the reduction of the number of aircraft under finance lease agreements by nine aircraft (by 15.8% y-o-y).

Aeroflot Group's loans and borrowings were both fixed-rate and variable-rate and were mainly used to finance the working capital. The shares of foreign currency and rouble-denominated liabilities in the loan portfolio are 23.9% and 76.1%, respectively.

Loan portfolio as at 31 December 2016

RUB MILLION, UNLESS OTHERWISE STATED

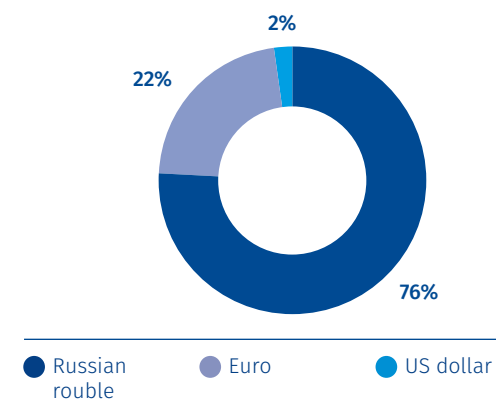
Bank	Currency	Short-term loans and borrowings and current portion of long-term loans and borrowings	Long-term loans and borrowings
Sberbank of Russia	RUB	4,831	7,863
VTB Bank	EUR	4,478	-
Sovcombank	RUB	-	2,800
Other	USD	-	395
TOTAL		9,309	11,058

The share of foreign currency loans decreased due to the effect from revaluation of loans backed by the rouble appreciation throughout 2016, and repayments of more expensive borrowings ahead of schedule.

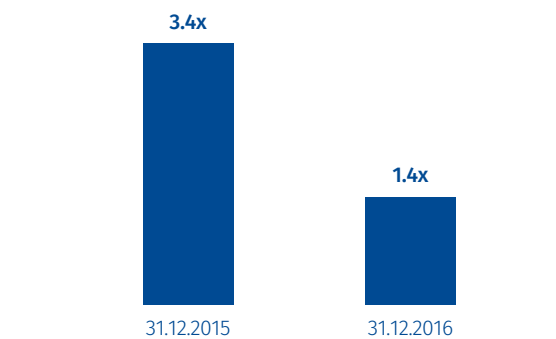
Finance lease liabilities are entirely denominated in foreign currencies; however, 46.4% of liabilities under finance lease agreements mature as late as 2021 and further.

As at 31 December 2016, Aeroflot Group had RUB 89,247 million undrawn credit lines from major Russian and international banks.

Breakdown of loans and borrowings by currency as at 31 December 2016



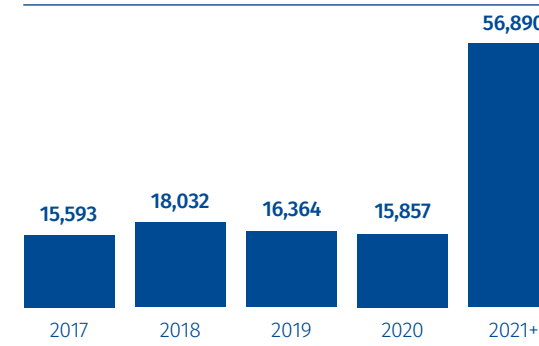
Net Debt / EBITDA ratio



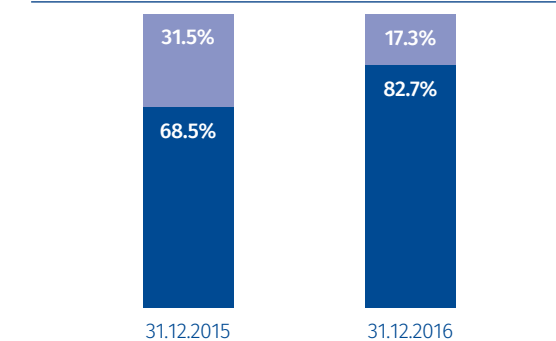
Note. Excluding operating lease capitalisation

Finance lease repayment schedule

RUB MILLION



Breakdown of total debt



● Non-Current liabilities
● Current liabilities