The list of questions and answers covered during the conference call related to 1H16 Trading Update and FY16 EBITDA guidance

FESCO Transportation Group (“FESCO”, the “Group”) provides the answers to the questions received prior the conference call related to 1H16 Trading Update and FY16 EBITDA guidance (the “Call”) and covered during the Call. These answers are prepared based on the edited abstracts from the management speech on the Call and additional information, where it is applicable.

The full audio record of the Call is available on the Group’s website:
http://www.fesco.ru/upload/iblock/48d/FESCO_confcall_12-08-2016.mp3

Question 1

Your 1H16 results seem to imply only $14m EBITDA for 2Q16, which is 43-44% lower Q-o-Q and Y-o-Y basis while implied 2Q16 revenue was $132m, which is only 26% lower Y-o-Y and 5% higher Q-o-Q basis. In terms of volumes 2Q16 seemed to have been better than 1Q16 (or not much worse) so why such a low EBITDA?

Answer provided during the Call:

EBITDA decreased on Q-o-Q basis mainly due to following reasons:

- Main downward trend was in Shipping Division due to seasonality, income from icebreakers and Antarctic expedition is produced in the 1Q16 only. Together with reduced time-charter rates for selected container vessels, the Shipping Division results went down by $14m on Q-o-Q basis.
- We see improvement in the Liner and Logistics Division and Railway Division compared to the 1Q16, which is not enough to offset drop in the Shipping Division.
- Port Division shows improvement of volumes, but, combined with reduced earnings per unit and additional personnel costs allocated to 2Q16, the result is flat Q-o-Q basis.

Question 2

Please comment on the Company’s cash balance of $24m as at June 30, 2016. One would expect that with $41m cash balance as of March 31, 2016, and c. $10m generated in 2Q16 the total cash balance should be around $50m, so please comment on the cash use over 1H16.

Additional comment:

This analysis seems to account only for cash generation / usage from EBITDA and Capex, disregarding all other uses. Detailed information on actual 1H16 figures is available in the published IFRS statements.

Question 3

Please comment on the segment contribution to your EBITDA guidance of $84.4m to $89.4m for FY16. Which segments could outperform and which segments have highest risk to underperform?

Answer provided during the Call:

In 1H16, mainly Port and Shipping Divisions generated the large portion of EBITDA. In 2H16, we anticipate better financial results from Liner and Logistics and Rail Divisions as we expect an increase in export-import sea container and intermodal transportation volumes. At the same time, the Shipping Division EBITDA in 2H16 is expected to be lower due to seasonality.

Full year EBITDA guidance is based on certain market recovery over 1H16, which is fundamental for Liner and Logistics Division and Port Division in terms of volumes. We also anticipate increase of market share in some of our core segments as a result of increased commercial activity. Big pressure on the inbound rates remains, so this leaves risk on achieving our expectations. On the other hand, market improvement over current forecast potentially gives an upside in volumes, i.e. earnings. Railway Division forecast is quite ambitious, yet we believe that it is realistic and achievable. Shipping Division anticipates projects in the free market for icebreakers and Antarctic expedition, which are not supported by fixed contracts yet.

Question 4 and 5

(4) How do you see your Port and Rail businesses performing vs. the peers in 2016 (GlobalPorts, GlobalTrans and Transcontainer) who would be reporting their 1H16 results shortly as well? Are there any specific reasons for underperformance vs. the peers?

(5) Please comment why your assessment of the rail container transportation market seems more pessimistic than that of Transcontainer as per below?

- Transcontainer market assessment: In 1H16, the Russian rail container market grew by 6.1% Y-o-Y to 1,538 thousand TEU. In terms of segment breakdown in 1H16, domestic transportation volumes surged by 14.4% Y-o-Y and export transportation by 1.0% Y-o-Y, while import transportation volumes fell by 5.3% and transit was down 3.3% Y-o-Y.
- FESCO market assessment: In 1H16, rail container transportation volumes on the East-West-East route fell by 6% compared to 1H15, with import rail transportation suffering a decline of 11%, consistent with the decline in import container handling volumes by 14%, offset by a modest 3% recovery in overall internal rail container transportation

Answer provided during the Call:

The majority of FESCO's operations are located in the Russian Far East and the Group offers services mainly along the East-West-East transport corridor. The market where we operate is fragmented. We would like to underline that East – West – East corridor still gives a better yield, compared to other markets in Russia, including domestic transportation.

We define our container handling market in the Far East with including only relevant ports, which are open for all market players. In regard with the rail transportation market, we look at the East-West-East transport corridors only, where FESCO is present. This might give certain variance to officially published trade statistics.

Additional comment:

The Group did not comment on its expectations vs. peers, but rather the market at large. As mentioned on the conference call, the Group operates on the East-West-East route, the performance and expectations for which are different from those for the entire Russian market.

Question 6

How does the company account for income from the leased railcars (as part of NefteTransService ("NTS") lease deal)? Is it included into EBITDA?

Answer provided during the Call:

All leased railcars are passed on for sub-leasing to NTS. Expenses and revenue are included in EBITDA in 2Q16.

Question 7

Please, comment why you expect still significant 9% decline in the port container throughput for the Far East and 8% decrease for FESCO's port container throughput volumes in 2H16 Y-o-Y basis, given that the market data seem to indicate recovery in 2Q16 (5% increase in May Y-o-Y basis and modest 2% decline in June Y-o-Y basis).

Answer provided during the Call:

Container volumes had been decreasing since the beginning of 2015 and started to recover only in 2Q16. We believe that the container market will perform better 2H16 compared to 1H16. However, our forecast is careful and we expect that the market will decrease in 2H16 compared to 2H15, as markets remain highly volatile.

Additional comment:

The container handling market has a seasonality with highest throughput volumes in summer; and the Port normally performs better in Q2 and Q3.

The year 2015 had unusual dynamics due to FOREX fluctuation. The volumes dropped in summer time in anticipation of rouble recovery; and there was an unexpected increase in volumes at the end of the year (stock replenishment).

In 2014-2015, the container handling market was volatile. Currently we observe signs of recovery on the market.

Question 8

Port container volumes were 77.7 thousand TEU in 2Q16 vs. 70.6 thousand TEU in 1Q16, laden containers were 57.5 thousand TEU in 2Q16 vs 46.8 thousand TEU in 1Q16, general cargo throughput was 715 thousand tonnes in 2Q vs. 600 thousand tonnes in 1Q16. Given the Port posted $14m EBITDA in 1Q16 alone, it is likely to have much better results in 2Q16. Therefore, the Port alone should have generated more than reported consolidated EBITDA in 2Q16 – please explain.

Additional comment:

Please, refer to the Question 1, audio record of the conference call and published 1H16 IFRS results.

Question 9

Please comment, why the Company expects 8% decline in the Port volumes in 2H16 and at the same time assumes 10% Y-o-Y growth in Liner and Logistics volumes in 2H16 while these businesses are interrelated.

Answer provided during the Call:

The port volumes include empty containers that continue to decline in 2016, and the Liner and Logistics volumes include laden volumes only.

Question 10

Please comment on the main cost cutting and liquidity preservation measures made in 1H16 and planned in 2H16. Please comment, which cost saving initiatives of the management have already been and will be implemented this year.

Answers provided during the Call:

Overall, the Group managed to maintain EBITDA margin at 15.3%, mainly due to effective cost control and optimisation.

The Group implemented its cost optimisation programme planned for 2015, which resulted in about $55m benefit.

In 2016, we continue to implement cost optimisation measures, and we expect to generate around $20m in savings.

In line with the strategy, the Group leased out 6,085 gondola cars to NTS in 1H16, which will result in increased income and cost optimisation in the 2H16.

We continue to optimise our sea line routes and we attracted additional partners to our vessel sharing agreements to reduce the costs and enhance operational efficiency. An annual effect is estimated to be close to $6m.

Additional comment:

In 2016, the Company expects to generate around $20m in savings through the implementation of cost optimization measures, including:

During 1H2016:

- Reorganization of the Group's companies structure, including centralization of financial, IT, legal functions, as well as staff optimisation
- Optimization of sea line routs and attraction of additional partners for vessel sharing agreements, which allowed reducing voyage costs
- Renting out gondola cars to NTS, which will provide additional source of revenue and optimise the costs

During 2H2016:

- Further optimisation of administrative staff on the Group level and production staff in Shipping and Port Divisions
- The Group is looking for opportunities to improve its operations and business processes through the implementation of best practices in operations management and business performance management, which will result in further costs optimisation, enhance of quality and speed of its services, and overall improvement in the Group's business performance.

Question 11

Could you please provide a Capex guidance for 2H16? Would you expect a similar level of Capex as in 1H16? Does the amount includes / assumes disposals? Could you please comment on the significant disposals made in 1H16 and planned in 2H16?

Answer provided during the Call:

We expect a slight Capex growth in 2H16 that amounts to $20m in total for FY16. Capex mainly consists of wheel-sets and capital repairs of rolling stock and dry-docks repairs. This amount excludes disposals.

Question 12

Why Russkaya Troika has not been included in the reporting perimeter now, which is not consistent with the Group's previous reporting and hence difficult to compare?

Additional comment:

Addressed in the published financials, which follow the regular format.