



Association of  
Institutional Investors (API)

# Research report on PJSC AEROFLOT

as of 09/30/2016



RESEARCH LABORATORY FOR BUSINESS COMMU-  
NICATIONS, NATIONAL RESEARCH UNIVERSITY  
HIGHER SCHOOL OF ECONOMICS

## Capital structure

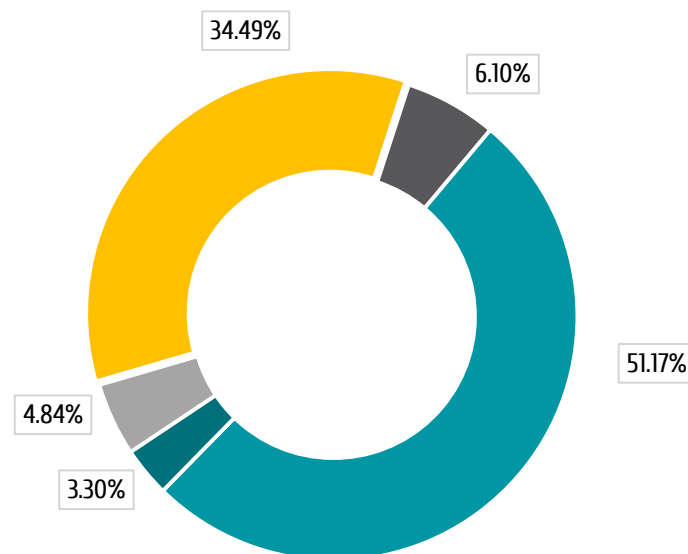
The controlling stake belongs to the Government, the majority shareholder's effective voting stake in the Company (including the shareholding of a substantial shareholder controlled by it) is 54.47%. The Company has a package of quasi-treasury shares (4.84%) voting for the management team's representative on the Board of Directors (BoD).

The BoD includes 2 representatives of the management, 6 representatives of the Russian Federation and 3 independent directors (INEDs), including 1 INED nominated and elected by institutional and portfolio investors. The free-float and the activity of minority shareholders makes it possible to elect at least 2 candidates to the current BoD. This requires consolidation of 12.5% to 13.5% of the shareholders, depending on the quorum.

## Corporate governance self-assessment

*According to the Company, Aeroflot complied with 64, partially complied with 11, failed to comply with 4 out of 79 principles and recommendations of the Corporate Governance Code in 2015.*

### Breakdown of voting shares



- Russian Federation (Rosimushchestvo)
- Rostec Group
- Quasi-treasury shares
- Institutional & portfolio investors
- Individuals



# Summary of CG practice

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- The BoD and the management team effectively shape, monitor and implement the Company's strategy;
- 3 of the 11 BoD members are independent (INED), 2 of 3 INEDs are well-known to the market as INEDs and open for contact;
- at the AGMs in 2015-2016, the shareholders approved new or restated corporate by-laws legally recognizing most of the CG Code recommendations;
- high standards of information disclosure for shareholders' meetings and in the mandatory disclosure system;
- the Company has partially implemented the CG Code recommendations as regards the need for a majority vote of the elected BoD members for decision-making on key issues of the Company's activity (7 of 10 issues) and for considering essential issues at BoD meetings (6 of 19 issues);
- the owners of 2% of shares have the right to propose an agenda item for the BoD meeting (the owners of at least 10% have the right to convene a BoD meeting);
- the Company uses a "Hotline" system of confidential information delivery to the BoD / Audit Committee (the best practice among the companies covered by the research);
- the BoD pays special attention to relations with shareholders and the investment community revisiting this issue regularly (at least once every 6 months);
- the Company implements a long-term motivation program (3 years) for executive top managers and other key employees involving financial instruments based on the Company's shares; payments are contingent on the achievement of KPIs and the stock price growth vs. the Company's key competitors;
- a procedure for returning wrongfully / unreasonably received bonus payments exists at the Company (no disclosure).

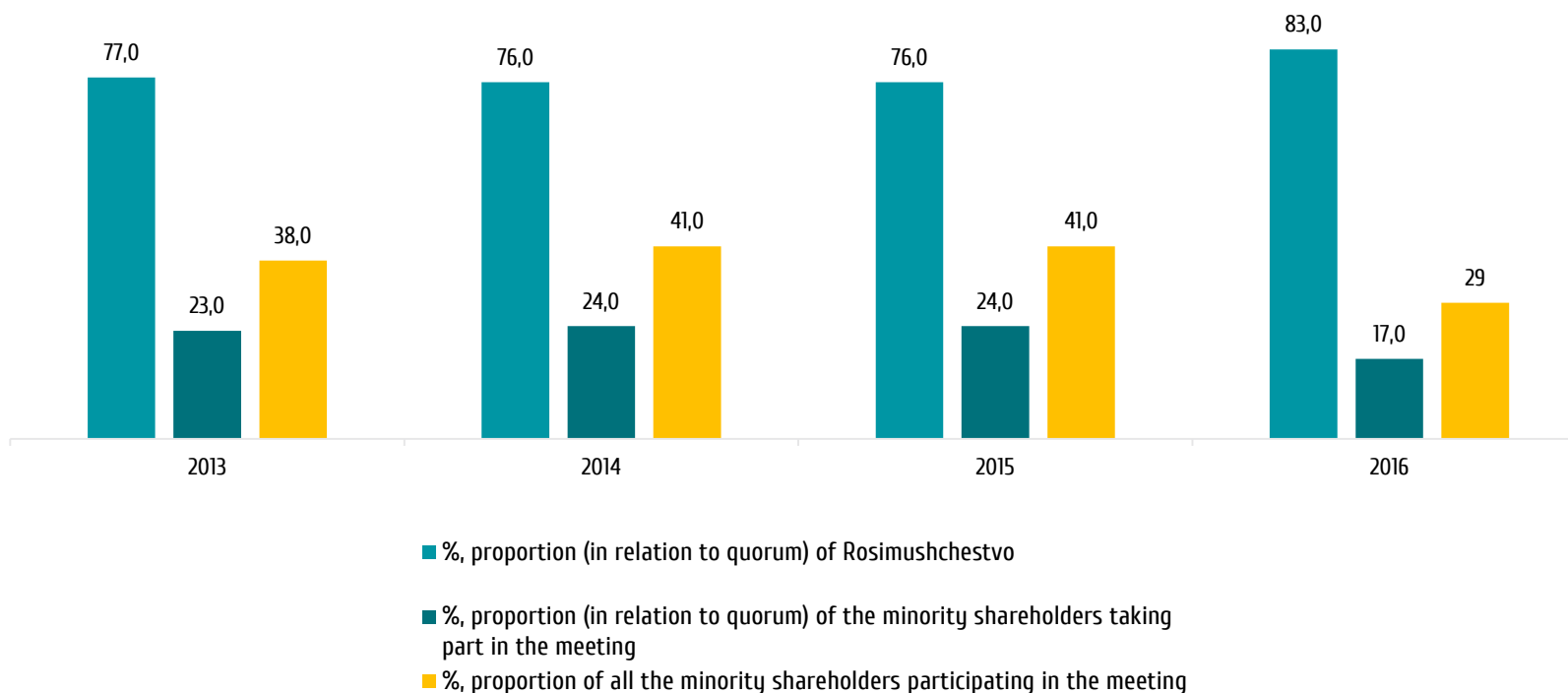
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- despite the recognition of the BoD control over the exercise of rights related to quasi-treasury shares in the Regulations on the procedure for exercising the rights related to quasi-treasury shares (January 2016, the document is not disclosed, but conditionally positive practice), the actual implementation is purely negative: the voting of quasi-treasury shares at the AGM has a decisive impact on the election of the management's representative to the Board of Directors;
- the dividend policy (conditionally negative) can be improved;
- individual voting by the BoD members is not disclosed in notices on resolutions made by the BoD;
- the procedure for preparing and submitting recommendations on BoD candidates to the controlling shareholder is not formalized;
- 'Any Other Business' items are put on agendas of some BoD meetings without providing specifics: the non-disclosure of their substance implies the possibility of such items covering significant issues without prior distribution of related materials;
- The Company does not disclose the top management remuneration system parameters, including the correlation between the remuneration and the actual achievement of KPIs;
- the BoD has no powers in relation to significant aspects of subsidiary companies' activity (formation of management bodies, approval of corporate by-laws, etc.). As for the BoD members' access to information on controlled companies, INEDs do not tend to believe that additional regulation of the process of obtaining information on controlled companies is expedient;
- The BoD has increased the number of BoD members required for converting the agenda of a meeting in absentia to the agenda of a physical meeting from one to two. Our recommendation is to restore the right of every single BoD member (the best practice among the companies covered by the research!) to request consideration of significant issues, primarily related party transactions and major transactions, at a physical meeting.



## General shareholders meeting: activity of shareholders, related party transactions

The GSM quorum has been in the range of 71.27%-73.97% in the past 4 years, the lower threshold was reached in 2016. Private shareholders taking part in the meeting (about 27.5% of all minority shareholders) accounted for 17% of the quorum in 2016, which is lower than in 2014-2015. In 2015, the GSM approved 5 related party transactions for a total amount of RUB 92.9 billion and 7 deals worth \$1.2 billion. In 2016, the GSM approved 4 deals, including transactions which the Company may effect in the normal course of business in future, in the amount of RUB 92.8 billion/\$100K and 1 transaction for the financing of the purchase of aircraft in the amount of \$417 million.



## Information on the shareholders of PJSC AEROFLOT, according to Bloomberg data and information disclosure by the shareholders

<i>Shareholder Name</i>	<i>Voting stake</i>	<i>Comment on voting</i>
RUSSIAN FEDERATION	51.17	No voting policy, Rosimushchestvo votes as instructed by the Government of Russia.
AEROFLOT-FINANCE	4.84	Quasi-treasury shares, the voting is subject to approval by the BoD since 2016. The quasi-treasury shares usually vote for a management team representative.
EAST CAPITAL ASSET MANAGEMENT AB	1.6	The shareholder takes into account ESG factors and actively contributes to corporate actions. The shareholder nominated 2 INEDs at the AGM in 2015 and 2 INEDs 2016. 1 of them was elected at the AGMs in 2015 and 2016.
PICTET FUNDS	1.27	According to the UK Stewardship Code compliance report published by the shareholder, PICTET FUNDS declares a passive approach to participation in corporate actions (with exceptions possible under certain conditions). The shareholder also declares taking advice from a proxy advisory firm (ISS) for voting purposes. The voting details are not disclosed, but ISS recommended voting for 2 independent directors nominated by one of the institutional investors at the 2016 AGM.
ASHMORE GROUP PLC	0.8	The shareholder publishes a UK Stewardship Code compliance report according to which it always votes in the best interests of its clients at shareholder meetings. The shareholder denies using the services of proxy advisory firms. Voting details are disclosed at the client's request.
HSBC INVESTMENT FUNDS	0.75	The shareholder publicly discloses the history of voting at the AGM since 2013 for most of its funds. At the 2016 AGM, the shareholder voted for 4 independent candidates (3 of them were elected to the BoD), 2 representatives of the management (CEO of Aeroflot, CEO of Rossiya airlines) and Chairman of the Aeroflot BoD. The shareholder discloses the global principles of voting at GSmS noting its reliance on best practices when making voting decisions.
PROSPERITY CAPITAL MANAGEMENT UK	0.62	The shareholder is actively involved in corporate actions and implements the responsible investment principles in practice. At the 2016 AGM, the shareholder voted for the candidate nominated by minority shareholders.



Shareholder Name	Voting stake	Comment on voting
ALLIANZ SE	0.53	The shareholder discloses the details of its voting policy and its approaches to voting. The shareholders only disclose voting details for its funds in relation to investments in the US market.
HANDELSBANKEN FONDER AB	0.48	The shareholder discloses the CG policy particularly declaring participation in GSMs of the companies they invest in. Voting details is not disclosed. The shareholder discloses a list of companies it does not invest in, along with a list of companies it keeps in touch with over infringements of international standards and principles (to the extent of the ESG philosophy), for instance, this list, among others, includes two Russian companies, Gazprom and LUKOIL, with a negative environmental impact referred to as the reason.
BLACKROCK	0.44	The shareholder discloses both global corporate governance principles and regional approaches to voting and engagement with companies. Information on voting in the last corporate season is disclosed. The shareholder did not vote at the AGM in 2016. Recommendations of proxy advisory firms are followed.
NORGES BANK	0.4	At the 2016 AGM, the shareholder voted for two independent directors nominated by a minority shareholder. The shareholder discloses the voting policy and its voting history (the way it actually voted) in the last 4 years. The shareholder has so far not nominated BoD/Supervisory Board (SB) candidates in Russia, unlike other countries. Recommendations of proxy advisory firms are followed.



# General shareholders meeting: disclosure of information, essential aspects

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- The GSM-related materials are disclosed in the English and Russian languages 30 days prior to a GSM, according to the standards of corporate by-laws;
- the GSM-related materials specify the persons proposing agenda items and candidates to the BoD and the Audit Commission;
- draft documents are submitted for approval at GSMs with comparison tables attached to them reflecting the changes proposed to separate provisions of such documents and the rationale for such changes;
- the timeframe for proposing agenda items and candidates to the BoD and the Audit Commission is increased to 70 days, one of the longest deadlines among Russian companies;
- the Company's annual report includes details on related party transactions approved by the BoD and the GSM in the reporting year, specifying, among others, the counterparty, subject, amount, parties in interest and the management body which approved the transaction;
- the BoD has a meaningful position on GSM agenda items, unlike most of the similar documents at other PJSCs (whether the Company is ready to disclose to shareholders the dissenting opinions of BoD members on GSM agenda items, should they be expressed, is an open question);
- materials related to the approval of related party transactions are informative, disclose the key parameters of the transactions proposed for approval.

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- the BoD' proposal for approving the auditor at the AGM does not contain any details on the Company's auditors (except for names), including a description of the selection procedures ensuring independence and fairness of the auditors, information on the proposed auditors' fees for all audit and non-audit services (including the cost of their services in the preceding year) and other material terms of the agreements with the auditors.

## Comment on the results of voting at GSMs

The Company's shareholders have come across an unreasonable treatment by some of the nominal holders of the sanctions regime imposed by Western countries on certain listed individuals and legal entities. Aeroflot is NOT included in the list of Specially Designated Nationals (the SDN or sanction list), but a member of its Board of Directors is personally included in this list. Some of the custodians prevented the shareholders from exercising their rights refusing to execute their clients' instructions for this reason. In this connection, many of the shareholders wishing, for example, to vote for an independent director supported by other institutional investors in 2016 were unable to do that. As a result, 3 independent directors were eventually elected, although the election of 4 INEDs (including 2 INEDs supported by minority shareholders) was possible.



## Board of Directors: international and domestic practice

BoD activity aspect	Deutsche Lufthansa AG	Delta Airlines Corp	American Airlines Group, Inc.	PJSC Aeroflot
INEDs/total number of BoD members	20/20 (if all staff representatives are INEDs), otherwise 16/20	11/14	12/13	3/11
Participation in meetings of BoD and committees in 2015	95%, no further details are disclosed	12 BoD members, attendance ratio at least 75%  No data available for committees	6 BoD meetings, attendance ratio at least 75% for BoD and committees (no details disclosed)	BoD held 20 meetings (incl. 9 physical meetings), attendance ratio 100% (including expressions in writing); Audit Committee held 10 meetings (100% attendance), Personnel and Remuneration Committee held 8 meetings (1 non-attendance - 99%)
Remuneration of BoD members / actual payments based on 2015 performance*  *according to the 2015 annual report	€240K to BoD Chair, €80K to BoD member, €120K to Deputy BoD Chair, €60K to Audit Committee Chair, €30K to Audit Committee members, €40K to head of another committee, €20K to member of another committee Actual: €80–280K	BoD member \$90K + \$160K in the form of restricted phantom shares (payable at following meeting) \$30K to Senior Director \$20K to Committee Chair, \$10K to Committee member Actual: \$215–518K	\$90K to BoD member, \$20K to Audit Committee Chairman, \$15K to Audit Committee member, \$12.5K to member of another committee, \$15K to head of another committee, \$30K to senior INED + \$140K in the form of restricted stock to each BoD member	Base remuneration: RUB 1.8 million. Multiples: 4.5 for BoD Chairman, 2 for Chair of committee, 1.5/2.75/3.75 for member of 1/2/3 committees + bonus for capitalization under long-term 2016–2019 program (up to 150% of the base remuneration in total). Actual: RUB 3.1–4.7 million in base remuneration + 2013–2015 stock options plan (RUB 1.1–3.4 million) for the 12-month period.

*The remuneration payable to the BoD of Aeroflot includes a long-term motivation component with variable benefits linked to the target level of capitalization. The practice is quite interesting but controversial as not all CG experts support the BoD members' participation in such motivation schemes. Of special note is the low amount of base remuneration at Aeroflot versus (conditional) peers. The independent directors also noted the relatively low remuneration of the BoD members.*





## Board of Directors: practical activity aspects

### Chairman of the Board of Directors

*Kirill Androsov*

(representing the Russian Federation),  
Managing Director, Altera Investment Fund, no shareholding in the  
Company.

### Chairman of Personnel and Remuneration Committee

*Igor Kamenskoy (INED)*

Managing Director, Renaissance Broker LLC,  
no shareholding in the Company.

### Chairman of the Audit Committee

*Vasily Sidorov (INED)\**

General Director, LLC Agency for Recapitalization of Infrastructure and  
Long-term Assets / ARIDA, no shareholding in the Company.

*Alexey Germanovich (INED)\**

Member of the Executive Board, Saint Petersburg State University  
Development Fund, no shareholding in the Company.

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*The API met with 2 of the 3 INEDs and had an opportunity to communicate with an ex-BoD member (INED until the 2016 AGM). The independent directors who met with us are open to contact with the shareholders.*

*Please find below the summary of BoD members' comments, including the API's expert opinion based on the results of these meetings. We appreciate the BoD members' participation in the interview and believe that such annual meetings with the Company's investors and shareholders are extremely useful for assessing the BoD performance and making decisions on the voting for candidates to the BoD at general shareholders meetings, among other things.*



## Board of Directors: practical activity aspects

In the period under review (2015 and 9 months of 2016), the BoD held 31 meetings, including 20 meetings in 2015 (9 physical meetings and 11 meetings in absentia, according to the 2015 annual report). The 2015 disclosure system specifies a different number of meetings (19 against 20 meetings) and does not expressly indicate the form of BoD meetings; from the press releases one could infer that the wording "Chaired by" (Kirill Androsov) implies a meeting held in the form of joint attendance.

*In the above-said period, the BoD considered 242 issues, including:*

- approval of related party transactions (102 issues or 42.1%, the BoD considered 151 transactions in the amount of RUB 117,887.9 million and \$1,267.9 million, including transactions which the Company could effect in future in the normal course of business, for a total amount of RUB 109 billion, submitted for approval at the AGM in 2015);
- implementation of Aeroflot Group's strategy (5 issues) + several issues considered separately (IT, marketing strategy, development of the Group's services (4 issues);
- consideration of reports on performance results (8 issues);
- financial plan (6 issues);
- remuneration of the management team (6 issues);
- long-term development program (LTDP, 2 issues);
- KPI (CEO + LTDP) (2 issues);
- risk management (1 issue).

*The Company pays special attention to strategy; according to INEDs, any BoD member can formulate the current priorities of the strategy and identify the present state of the Company.* The BoD separately addresses LTDP-related issues (taking into account the Government's instruction and the Group's strategy) and focuses on specific aspects (IT, marketing, service) demonstrating a customer-oriented approach which the Company pursued even before the Government's initiative to make the LTDP a mandatory requirement.

*The managers actively collaborate with all BoD members; the sole executive body (CEO), according to INEDs, is open to contact, "the dialogue is at an advanced level typical for a market-minded privately held Company."*

We note that the disclosure system does not contain information on the consideration by the BoD of risk management system-related matters, including related reports, in the period under review. The only case mentioned in the disclosure system is the approval of the risk management regulations. That said, *most of the risk management-related issues, including approaches to hedging against forex risks, were addressed at the Audit Committee meetings.*

*The BoD has approved the long term management motivation program effective from 2016 to June 30, 2019.*

The approaches, KPIs and main principles are not disclosed, but, according to INEDs, the Company is committed to market-oriented policies and practices.

*The BoD Chairman is highly committed to the BoD activity;* while ensuring a formally sufficient number of physical meetings (virtually every month, except for the generally accepted vacation periods), he also advocates a meaningful approach to work, taking into account the requests and requirements of the BoD members and the Company.

For instance, *the Company's budget for the following financial year is considered by the BoD reasonably in advance and in two stages* (according to the disclosure of corporate actions in 2015-2016), namely, in October and November, based on a preliminary forecast of the Group's operating performance.

The Company and the BoD make extensive use of benchmarks both in terms of strategy and for setting budget and motivation targets.



## Board of Directors: practical activity aspects

*The presence of the undefined 'Any Other Business' item on the agenda should be regarded as a negative element in the BoD activity.* In practice, this item may imply consideration of significant issues without providing materials required for decision-making to BoD members in advance. Proceeding from the disclosure materials, the Company's equity participation in OJSC TRANSAERO was actually included in the 'Any Other Business' section. We recommend that the Company abandon this practice as the required level of secrecy can be ensured through restrictions on the disclosure of information on the most sensitive issues.

*The BoD has an experience of voting "against"* (in particular, 1 BoD member voted "against" on 5 related party transactions, 2 of the 3 INEDs voted in the negative<sup>1</sup> on the Company's equity participation in OJSC TRANSAERO) and "abstained" (2 BoD members on 2 transactions and one BoD member on 31 agenda items).

*The multitude of cases where one of the BoD members voted 'abstained' on related party transactions and some corporate by-laws proposed for approval (31 times in total), in our view, calls for additional disclosure* on the part of Company, certainly including an appropriate statement/comment from the abstaining BoD member. We understand that this issue primarily concerns the "dissident" BoD member. The Company represented by the BoD or the management team may provide for the possibility of such disclosure, which would raise shareholders' awareness of the position of BoD members, while BoD members will have to substantiate their repeated "protest" voting on certain types of issues for all the shareholders.

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<sup>1</sup> as regards the equity participation in OJSC TRANSAERO, we deliberately requested from the INEDs information on the BoD members voting "against" (Vasily Sidorov and Marlen Manasov, both INEDs), as we regard this very case of voting as a key evidence of the CG system's efficiency, with truly, not just technically, independent directors in practice.

On a separate note, based on the Company's comment,<sup>2</sup> the BoD made a decision formalized in a corporate by-law which allows any BoD member to request consideration of any issue at a physical meeting, even if the issue is scheduled for consideration at a meeting in absentia. While we certainly commend this practice in terms of the INED efficiency, especially as regards related party transactions, the number and amount of which is essential for the BoD activity, this document is not publicly disclosed and can be modified by a simple majority vote of the BoD members at any time without appropriate disclosure. *According to INEDs, such a scenario already occurred - now an issue can be shifted from consideration in absentia to the agenda of a physical meeting only if 2 BoD members require that. Our recommendation is that the Company abandon this practice and restore the original approach which we consider to be one of the best practices in the BoD activity.*

The charter only provides for the BoD's powers in relation to the Company's subsidiaries to the extent of their economic activities (making or approving transactions) and does not vest the BoD with powers concerning other significant issues (e.g., formation of management bodies: the BoD and CEO).

As regards provision of information to BoD members, including information on controlled companies, *INEDs note they have had no problems with access to any requested information*

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<sup>2</sup> see the Company's comment in the report of the Government Expert Council and the Moscow International Financial Centre Taskforce on implementing the Corporate Governance Code as of August 22, 2016.



## Board of Directors: practical activity aspects

(some of the information may be provided at the Company's office, given the confidential treatment).

As regards the regulation of sponsorship and charity issue, the BoD has approved the regulations on the generation and application of the sponsorship and charity funds. The BoD annually considers the sponsorship of Russian sports clubs. *The BoD's approaches to setting limits on the charity and sponsorship spending are not publicly disclosed.*

According to INEDs, the Company has established a fairly negative practice of holding joint meetings of BoD committees one day prior to the BoD meeting to address the BoD meeting agenda items. While this approach to meetings of the BoD committees ensures maximum attendance by members of the committees, it leaves insufficient time for the development of a dissenting position for the BoD meeting, if

any. Besides, long meetings (more than 4-5 hours) impair the concentration required to consider the most complicated issues.

In January 2016, the BoD approved the Regulations on the procedure for exercising the rights related to quasi-treasury shares of PJSC Aeroflot according to which the management team's proposals for the procedure of exercising the rights related to voting these shares are subject to approval by the BoD. The document is not disclosed, and neither is information on the consideration and approving by the BoD of the management's proposals for voting this package (there is no such BoD agenda item in the information disclosure system). At the 2015 and 2016 AGMs, the voting of quasi-treasury shares paved the way for Dmitry Saprykin, a representative of the management team, to the BoD. Since 2015, he has been CEO of the Company's largest subsidiary Rossiya airlines, which notably increases the risk of a conflict of interest in the BoD when certain issues are considered.



## Audit Committee

*The Audit Committee consists of 3 members, 2 INEDs, including the Chairman.*

In 2015, the committee held 10 meetings, including 9 physical meetings!

Unlike the situation at most of the other PJSCs, *the Company's Audit Committee directly considers the budget and certain financial issues (financial hedging, provision of loans, transactions related to the aircraft fleet development, reports on reviews of other entities' debts to the Company), as well as the procurement policy.* The Audit Committee also attends to its traditional responsibilities (internal audit department's reports, internal audit control system improvements, risk management system regulation). *Of special note is the Chairman's highly professional approach to organizing the committee's activity.*

## Personnel and Remuneration Committee

*3 of the 5 committee members are INEDs, the other two members being non-executive directors.*

The Personnel and Remuneration Committee (PRC) formulates the policy, principles and criteria for determining the amount of remuneration for BoD members, the CEO and members of the Management Board (including the development of short-term and long-term management motivation programs), supervises the adoption and implementation of this policy.

The PRC oversees the process of induction training given to newly elected BoD members.

*In 2015, the PRC held 8 meetings, including 5 meetings in the form of joint attendance.* The Committee addressed the standard range of issues (remuneration, KPIs, corporate by-laws / internal documents). The Committee also considered candidates to BoD members representing interests of the Russian Federation in 2016. *Why the Committee only considered potential representatives of interests of the Russian Federation remains an open question. The related proposal preparation procedure is not formalized.*

No assessment of the BoD was conducted in the period under review. The BoD members take an ironic attitude towards self-assessment suggesting that this should be exclusively reserved to the shareholder.



# Essential CG aspects

## External auditor

Law firm JSC BDO Unicon is approved as the auditor of the Company's Russian GAAP (RAS) statements for the year 2016 (the price of the audit contract effective in 2016–2018 is RUB 10,578,000, 34.5% of the initial bid price), while JSC PricewaterhouseCoopers Audit is approved as the auditor of Aeroflot Group's consolidated financial statements according to IFRS standards for the year 2016 (the price of the contract effective 2016–2018 is RUB 66,375,000, 85.7% of the initial bid price). *Neither the scope of non-audit services provided by the external auditor nor information on the auditor selection competition and the role of the Audit Committee in the tendering procedures is disclosed.* This information should be disclosed in materials prepared for GSMS.

## Internal audit, internal control, risk management

In 2015, the Company took the following measures to improve internal audit and internal control efficiency: structural optimization of the internal audit department; development of an internal audit methodology according to international practices (including special internal audit techniques, drawing-up of a risk-based plan and development of procedures for assessing internal audit efficiency based on KPIs); teaching global professional internal audit standards to employees of the internal audit department, *launch of a system of confidential information delivery to the BoD, the Audit Committee and the internal audit department using, among other things, the "hotline" mechanism (email).*

Judging by INEDs' comments, *the "hotline" solution assumes a direct independent access to Audit Committee members, among others; it is suggested that this mechanism undergo testing, followed by consideration of the possibility to engage an independent operator to pro-*

*cess messages, according to best practices.* We welcome the absolutely progressive attitude of the Company and the Audit Committee and hope to see it adopted by others.

The internal audit department's reports on the progress in implementing the annual activity plan, on audits performed and on implementing the internal audit department's recommendations are regularly submitted to the Audit Committee.

The Company has adopted and disclosed by-laws concerning the anti-corruption policy, violation reporting to the BoD (the Audit Committee) and the management of conflicts of interest. This should be regarded as a case of best corporate practices.

On a practical side of risk management efforts, we note the total loss of RUB 25.47 billion from hedging operations in 2014–2015 which essentially affects the Company's financial result. As part of the CG system, the Company discloses the consideration by the Audit Committee of the hedging issue in 2015, an evidence of the system's proper operation. The BoD's position and the consideration of this issue, if any, by the BoD remain undisclosed. It should be noted that, according to INEDs, despite the existing regulatory framework, the Company did not have an executive personally responsible for the risk management system as of the reporting date.

## Dividend policy

The Company has a dividend policy approved in 2014. The basic dividend payout ratio is 25% of Aeroflot Group's consolidated IFRS net profit; depending on the values of specific metrics taking into account results of the reporting year, cash flows, debt leverage, the base level can be 20% or 15%. The Company did not pay dividends in 2016 (on account of a RUB 18.9 billion loss posted in 2015) and in 2015 (due to



an IFRS loss of RUB 17.1 billion, adjusted for extraordinary expenses, in 2014 – although the Company's RAS profit amounted to RUB 14 billion in the same year). It should be noted that the BoD did not explain to the shareholders its recommendation to pass dividends.

In our view, the Company's current business development cycle and the recent changes in the Government's philosophy of earning dividends as a shareholder call for the consideration by the Board of Directors of amendments to the current dividend policy so as to enable the Company to spend 50% of its consolidated IFRS net profit on dividends subject to the achievement of the required metrics, which would be the best practice among peers.

History of dividend payments by PJSC Aeroflot	2010	2011	2012	2013	2014	2015
Proportion of net profit, %	10.0	19.2	26.0	25.0	-	-
Accounting standard applying to net profit calculation	RAS	RAS	RAS	RAS	IFRS	IFRS

Payout ratios at (conditional) peers	Deutsche Lufthansa AG	Delta Airlines Corp	American Airlines Group Inc.	Turkish Airlines
Payout ratio	13.6%	7.9%	3.7%	0% (coverage of prior years' losses)

## Management remuneration system disclosure practice at international peers of PJSC Aeroflot

The Company does not disclose information on the proportion of long term remuneration which, according to partial information disclosure, does exist. *We welcome the availability of long-term motivation, Aeroflot being one of the most forward-looking state-owned company in this respect (as confirmed by INEDs, among others), but the level of disclosure, unfortunately, is in line with the current Russian practice, which prevents assessment of the management remuneration sys-*

*tem's compliance/non-compliance with international peers/practices. Of particular note is that investors prioritize the possibility of disclosing information primarily on the remuneration system: disclosure of individual remuneration of the sole executive body (CEO) or other employees is subject to debate, but not a top priority in terms of the system performance. Disclosure of 5 highest-paid employees' remuneration is possible. Please see the best practices below.*



<i>Approximate proportions of CEO remuneration components (based on payment forecast, incl. shares) in 2015</i>	<i>Deutsche Lufthansa AG</i>	<i>Delta Airlines Corp</i>	<i>American Airlines Group Inc.</i>	<i>PJSC Aeroflot</i>
Fixed annual remuneration	47%	5%	6%	55%
Annual bonuses	23%	21%	59%	45%
Long-term component	30%	74%	35%	n/a

**Disclosure of information on shareholdings of Management Board members as of September 30, 2016**

<i>Management Board member</i>	<i>Rounded-off value of share package</i>
Vitaly Saveliev	RUB 157 million
Vladimir Antonov	RUB 0.56 million
Igor Chalik	RUB 0.15 million
Igor Parakhin	RUB 0.009 million

<i>2015</i>	<i>Deutsche Lufthansa AG</i>	<i>Delta Airlines Corp</i>	<i>American Airlines Group Inc.</i>	<i>PJSC Aeroflot</i>
Disclosure, all payments, incl. in the form of stock, estimates of future payments	CEO+CF0+3 top managers. Actual: CEO €1,207K in salary, €593K in bonus, €133K in long-term bonuses, €626K in options (indicative)	CEO+CF0+3 top managers. Actual: CEO \$800K in salary, \$3,200K in bonus, \$7,667K in shares (restricted stock units), \$3.8 million in options.	CEO+CF0+2 top managers. Actual: CEO \$231.5K in salary, \$387.4K in bonus, \$10,330K in shares (restricted stock units)	Management Board (11 members) in total: Salaries and compensations RUB 198.6 million, annual bonuses: RUB 163.97 million





2015	Deutsche Lufthansa AG	Delta Airlines Corp	American Airlines Group Inc.	PJSC Aeroflot
KPIs influencing the short-term (annual) variable remuneration component (incl. the fixed relative weight of the KPI, if any)	Multiple of 0.8-1.2 x base level depending on individual KPIs of manager Base level depends on operating margin of Lufthansa Group	Income before tax 50% Monthly operational KPIs 25% Income per seat-mile vs. peers 25%	Adjusted income before tax	TSR 10%; ROIC 20%; long-term debt /EBITDAR 5%; integral KPI of innovation activities 5 %; investment program efficiency 5%; reduction of expenses for available seat-kilometer / ASK 5%; share of state support in financing 5%; time accuracy of flights 5%; flight safety 15%; seat load factor 10%; labor productivity 15%
KPIs influencing the long-term variable remuneration	Marg. EBIT and EACC (earnings after cost of capital ) for 3 years 70%, environmental protection, customer satisfaction, personnel efficiency 30%. For options: stock price growth above target level	Average annual operating margin vs. peers 50%, quality of customer services 15% for domestic customers, 10% for international, ROIC 25%	Average annual operating margin before tax, adjusted for extraordinary expenses vs. peers	Not disclosed
Long-term bonuses	25% of base annual remuneration. Multiple of 1 to 2 (but not to exceed 150% of 2-year salary); payment period: 2 years, calculation period: 3 years. Options: a 4-year period	Restricted shares, options (5-year calculation period) and phantom shares (1/3 each, CEO)	Restricted stock units (calculation and payment period of 3 years)	The stock options plan was completed in 2015. The long-term motivation program is approved for a period until June 30, 2019. Based on the annual report, motivation principles are similar to those underlying the motivation program for BoD members.



## Corporate social responsibility

In 2015, PJSC Aeroflot allocated RUB 1.9 billion for sponsorship. The funds were spent on football (67.5%) and other sports projects (23%), cultural projects (9.5%) and promotion of the Company's brand abroad through international cooperation.

In 2015, Aeroflot contributed RUB 50 million to the target capital fund of the Far Eastern Federal University.

Aeroflot Group carries passengers by air to the Far East of Russia, Kaliningrad and Simferopol under the government's program of subsidizing socially important air flights. In 2015, the Company transported 325 thousand passengers under this program. The amount of reimbursement is not disclosed.

The Company has also developed and implemented its own program of flights to these regions at flat rates. The Company has launched two seasonal flat rates to Kaliningrad and Simferopol: a 'reduced winter' fare and a 'summer' fare. In the reporting year, the Company provided services to 1,465 thousand passengers under the flat rate program. The Company's net related expenditure is not disclosed.

The Aeroflot group undertook and successfully honored the obligation to transport approximately 2 million passengers of Transaero (a distressed air company which ceased operations), including 1.8 million passengers transported by Transaero flights under the operational control and at the expense of Aeroflot Group.

	Delta Airlines Corp	American Airlines Group Inc.
Direct charity expenses (\$ thousand)	23,600	22,500
% of consolidated net profit	0.52%	0.30%

## Information disclosure

The mandatory disclosure of information is generally consistent with the law. Most of the notices of related party transactions approved by the BoD disclose essential parameters of such transactions, which should be regarded as a good practice. In some cases, the price parameters of related party transactions are not disclosed, but *the annual report discloses ALL essential parameters of the transactions effected in the reporting period*, including the subject matter, timeframe, parties, price (limits), rationale for recognizing related-party interest, the body approving the transaction.

It should be noted that the Company failed to meet the statutory disclosure deadlines 12 times in the period under review.

The Company does not disclose individual voting of the BoD members in the mandatory disclosure system, which prevents adequate assessment of the BoD members' position(s) on certain significant agenda items (this especially concerns independent directors). Our

recommendation is that the Company should disclose individual voting and discuss the possibility of providing the voting BoD members' comments on their positions in case of repeated voting 'abstained' or 'against' on certain types of agenda items.

The form of BoD meetings mostly remains undisclosed in the Company's material facts. Besides, the number of BoD meetings in 2015 according to the disclosure system is 19, i.e. one less than the number of meetings specified in the 2015 annual report.

There is a discrepancy between different sources as regards the number of quasi-treasury shares: according to the list of affiliates as of September 30, 2016, Aeroflot-Finance LLC, a company controlled by Aeroflot, has 4.83661% of shares, while clause 6.1. of the Company's report for the 3rd quarter specifies that the number of Aeroflot shares held by its controlled entities is 49,918,611 or 4.49468%.

