



Association of
Institutional Investors (API)

Research report on PJSC UAC as of 09/30/2016



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Brief capital structure overview

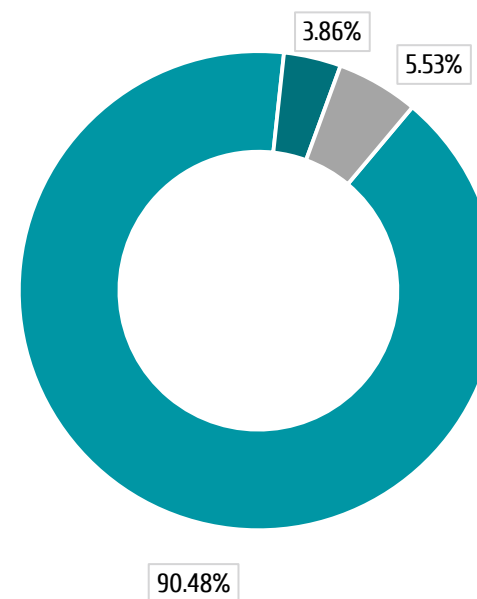
The Company's capital structure resulted from the contribution to its authorized capital of stakes in publicly and privately-owned aircraft manufacturers. The number of quasi-treasury shares, according to reports for the second and third quarters of 2016, exceeds the total number of shares. For capital structure calculation purposes, the number of quasi-treasury shares was reduced by 3 digit positions (the last three digits were discarded).

The Company's free float does not allow minority shareholders to influence the formation of the Board of Directors, while the nomination of a Board of Directors (BoD) member is possible and was implemented in practice.

Corporate governance self-assessment

According to the Company, UAC complies with 39, partially complies with 29, fails to comply with 11 out of 79 recommendations of the 2014 Corporate Governance Code.

Breakdown of voting shares



- Russian Federation
- Minority shareholders
- VEB Group



Summary of CG practice

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- The BoD is vested with rather broad powers as regards subsidiaries, including essential aspects of their activities (formation of executive bodies, changes in the authorized capital, etc.);
- only issues where resolutions should be passed by a simple majority of votes may be considered at BoD meetings in absentia. Issues that require a qualified majority or unanimity of votes are only considered at physical meetings (conditionally positive, given that such issues cover the smaller part of the Corporate Governance (CG) Code recommendations at the Company).

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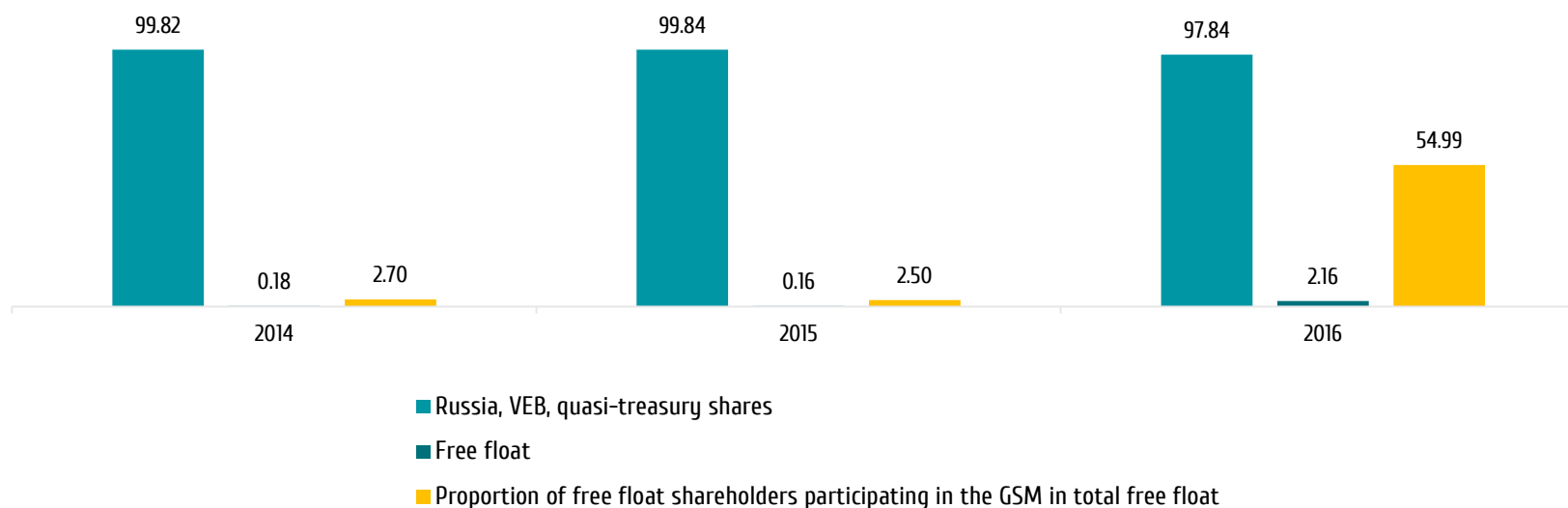
- Only 2 of the 11 BoD members are independent. Both are recognized as independent directors (INEDs) by a BoD resolution with the wording "due to an exceptional need to ensure compliance of PJSC UAC with the mandatory listing requirements," despite the affiliation of both candidates with the Company at the moment of this resolution;
- the Company does not disclose information on the BoD committees (including their current members) and the documents governing their activities on its website;
- no disclosure of specific approaches to structuring the top management's remuneration, including the correlation between the remuneration and the achievement of KPIs;
- the system of remuneration of BoD members is not consistent with the shareholders' interests and does not meet the CG Code recommendations;
- the basic documents (Articles of Association, regulations on management and control bodies) were approved in 2010. While 6 amendments were made to the Articles in 2015-2016, the legislative innovations and CG Code recommendations (concerning the procedure for exercising rights carried by securities, the procedure for notifying shareholders of resolutions made at general shareholders meetings / GSMs, etc.) were almost completely disregarded;
- the Company's website only provides information on the 2016 GSM;
- the CG Code recommendation concerning the need for a qualified majority of votes for passing BoD resolutions on the key aspects of the Company's activities is not followed completely;
- information on persons proposing GSM agenda items is not disclosed;
- the notices on resolutions made by the BoD do not disclose details on related party transactions (except for the names of counterparties) and related voting results, including the votes cast for different voting options (except for the total number of votes and the statement of passing a resolution);
- the shareholders have no right to convene a BoD meeting.



General shareholders meeting: activity of shareholders, related party transactions

The rather low free float percentage (about 4% on the 2016 AGM date) prevents minority shareholders from electing at least one independent director (no chart of changes in the minority shareholders' participation in GSMs is provided for lack of information value). The activity of the minority shareholders at the 2016 AGM was relatively high, even though their votes can only influence the approval of certain interested party transactions (55% of the free float, which most likely indicates the concentration of share packages in the hands of a single investor).

5 transactions for a total amount of RUB 181 billion, 1 related party transaction (a surety in the amount of RUB 32.5 billion) and 29 related party transactions which may be effected in the normal course of business in future for a total amount of RUB 67 billion were approved at the GSM in 2015. Next year, 44 related party transactions which may be effected in the normal course of business in future for a total amount of RUB 879.4 billion were approved at the GSM.



Information on the shareholders of PJSC UAC, 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	90.48	No voting policy, Rosimushchestvo votes as instructed by the Government of Russia.
VNESHECONOMBANK	5.53	No voting policy, voting most likely according to the Government's interests and instructions.
LGT CAPITAL PARTNERS LTD	0.01	The shareholder is a signatory of PRI, According to its 2016 reporting documents, the shareholder voted in 93% of all the ballot papers received from companies as their shareholder. The shareholder receives recommendations from a proxy advisory firm. The voting information is not publicly disclosed.
POLUNIN CAPITAL PARTNERS LTD	0.01	According to the shareholder's report on following the UK Stewardship Code recommendations (2015), the shareholder votes in the interests of its clients at the GSM. Voting details are disclosed at the client's request.
FLEXSHARES TRUST	0.01	The voting right is exercised by investment consultant Northern Trust Investments which discloses its voting policy, including approaches to determining its position on particular issues.



General shareholders meeting: disclosure of information and essential aspects

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- the Company's Articles of Association provide for the disclosure of GSM-related materials no later than 30 days prior to the GSM date;
- the GSM-related materials specify the persons proposing candidates for election to the Board of Directors and the Internal Audit Commission (IAC);
- the period for proposing agenda items and candidates to the BoD and the IAC is increased to 60 days;
- 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, amount, parties in interest and the management body which approved the transaction.

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- no information is disclosed on the auditor's remuneration for audit and non-audit services and other material terms of the agreements with the auditor.
- no information is disclosed on the persons proposing GSM agenda items;
- the Company only discloses materials related to the last two 2016 GSMS, which prevents appropriate evaluation of the quality of information disclosure to shareholders as regards amending the Articles of Association and the corporate by-laws, as well as other specifics of the GSM information support (conditionally negative).



Board of Directors: international and domestic practice

BoD activity aspect	Lockheed Martin Corporation	The Boeing Company	Airbus Group SE	PJSC UAC
INEDs/total number of BoD members	11/12	12/13	11/12	2*/11
Participation in meetings of BoD and committees in 2015 Number of meetings / Attendance	BoD: 10 meetings (over 75%) Committees: attendance >75% (details remain undisclosed)	BoD: 31 meetings (attendance ratio >90%) Committees: attendance ratio exceeds 97% (no further details disclosed)	BoD: 9 meetings (attendance ratio exceeds 91%) Audit Committee (AC): 5 meetings (attendance ratio 93%) Remuneration, Nomination and Governance Committee: 6 meetings (attendance ratio 96%)	BoD: 32 meetings, attendance ratio 95% (1 member missed 50%), Audit Committee: 33 meetings (100% attendance, but the format of meetings is undisclosed), HR and Remuneration Committee: 10 meetings (100%)
Remuneration of BoD members / actual payments for 2015	\$145K to BoD member Up to \$145K in deferred shares per BoD member: \$25K to Senior INED \$25K to Chair of AC \$20K to Chair of Management Development & Compensation \$15K to other Chairs of Board committees. Actual: \$272 - \$309K (for full year), incl. shares	\$130 -175K in monetary form + \$165K in shares. Actual: \$303-371K (for full year), incl. shares	€180K to BoD Chair, €80K to BoD member; €30K to committee chairs; €20K to committee members; €10K per BoD meeting to BoD Chair, €5K per BoD meeting to BoD member. Actual: €105-250K (for full year)	Base remuneration: RUB 0.2-1 million per year, depending on revenues adjusted for weighted average KPI achievement ratio and BoD meeting attendance ratio. 30% for BoD chairmanship, 20% for committee chairmanship, 10% for committee membership, uplifts are added together. Actual: RUB 0.53 - 1.3 million (public servants not entitled to remuneration)

* fail to meet CG Code recommendation criteria, recognized as independent directors by a BoD resolution.

The BoD remuneration system at UAC is not consistent with the generally established CG practices; in absolute terms, the remuneration is not commensurate with the amounts payable by conditional peers and most of the Russian companies covered by the research, the remuneration system needs to be revised.



Board of Directors: practical activity aspects

Chairman of the Board of Directors

Denis Manturov (representing the Russian Federation)

Minister of Industry and Trade of Russia,
no shareholding in the company;

Chairman of the Audit Committee

*Evgeny Yurchenko (INED)**

President, Popov Investment Cooperation Fund,
no shareholding in the company;

Chairman of the Strategy Committee

Boris Alyoshin (INED)

Adviser to UAC President on Science and Technology,
no shareholding in the company.

** Due to a tight schedule, we had no time to meet with the Chairman of the Audit Committee during the research, despite his readiness for a meeting. The second BoD member recognized by the BoD as an independent director and the Company itself did not respond to the API's request for a meeting. Therefore, given the poor information disclosure, the Board of Directors' performance cannot be evaluated at a minimum possible level.*

In the period under review (2015 and 9 months of 2016), the BoD held 57 meetings (201 issues considered). 37 issues (18%) concerned approving related party transactions, with a total of 591 deals considered.

Other aspects considered at BoD meetings:

- key performance indicators (4 issues);
- financial and economic plan / budget (4 issues);
- long-term development program (6 issues);
- decision-making on significant issues of subsidiaries and affiliates, including the formation of their management bodies (10 out of 11 issues).

It should be noted that the BoD considered approving the Group's budget, KPIs, the internal audit department's activity plan and other documents for the financial year at the end of the 1st quarter of the planning period, which is quite late.

Recommendations of the 2014 CG Code in respect of issues requiring a qualified majority of BoD members in attendance are partially followed. The Articles of Association provide for a qualified majority of 11/14 BoD members; however, the number of BoD members was reduced from 14 to 11 in 2012, while the related provisions in the Articles of Association were not amended as appropriate. The requirement to pass resolutions by a qualified majority, a majority of elected BoD members or unanimously applies to 14 issues within the competence of the BoD, but only 4 of them fully or partially comply with the CG Code recommendations.

The Board of Directors Regulation provides for the possibility of alternative wordings of BoD resolutions, but there is no mechanism for negotiating them with BoD members who are not in attendance.

No self-evaluation or external evaluation of the BoD performance was conducted in 2015, no external organization was engaged to conduct an independent evaluation in the last three years.



Audit Committee (AC)

The AC consists of two conditionally independent directors. The Chairman of the Committee is one of these INEDs.

The Audit Committee Regulation is not disclosed. According to the Regulation on the system of internal control over the Company's financial and economic activities, the Audit Committee is vested with the following powers: preparation of external auditor-related proposals for GSMs, consideration of the auditor's opinion, assessment of efficiency of internal control procedures, control over the budget discipline, financial stability and liquidity, expert review of internal and external financial statements of the Company and its subsidiaries, control over transactions involving affiliates, initiation of audits and inspections of the Company's financial and economic activities. In 2015, the AC held 33(!) meetings, more than any other company covered by the research (the format of the meetings was not disclosed). The range of issues considered by the Committee included preliminary approval of transactions (10), recommendations of the BoD on their approval (17), audit of companies and subsidiaries (7), endorsement of the plan of measures aimed at implementing the 2014 CG Code recommendations, the plan of efficiency improvement measures.

HR and Remuneration Committee (HRRC)

The HRRC consists of three members: one of them is recognized by the BoD as an independent BoD member, the other two, including the Chairman, represent the Russian Federation.

The HRRC Regulation is not disclosed. According to the Board of Directors Regulation, the HRRC is vested with the following powers: development of principles (criteria) for the remuneration of BoD members, Management Board members and the President, development of proposals concerning material terms of the contracts with them; regular performance evaluation of the President and the Management Board, preparation of proposals for their possible reappointment; development of policies and standards for executive recruitment, development of the senior staff motivation and stimulation system and methods.

At its 10 meetings held in 2015, the HRRC considered the following issues: recommendations to the BoD concerning subsidiaries (6); corporate structure (4); concurrent service of the Company's top managers in other positions (4), termination of powers and election of the sole executive body (SEB), drawing up of the contract with it, recommendations on the remuneration of BoD and IAC members, the list of candidates to the BoD and the IAC for the corporate year 2016-2017.

The degree of formality in the HRRC activities cannot be assessed without conducting meetings with HRRC members as appropriate.



Essential CG aspects

External auditor

In April 2015, the procurement commission approved Audit and Consulting Firm Top-Audit LLC licensed to deal with state secret as the Company's auditor for 2015 and 2016 following an open competition. Information on the terms and conditions of bidding, the participants, the scope and cost of audit services, as well as the role of the Audit Committee is not disclosed, except for noting the consideration by the Committee of the candidate for external auditor in the annual report.

Internal audit, internal control, risk management

The internal audit system at the Company failed to meet the CG Code recommendations and the applicable international internal audit standards in 2015. In particular, the Audit Committee did not consider a number of issues within its scope and authority, including candidates for the position of head of the internal audit (IA) division, the budget, activity plan and reports of the IA division. At the same time, the AC considered the approval of transactions, the external audit of statements and the comprehensive audit of subsidiaries. The internal audit and internal control functions are not completely differentiated in the internal audit and control department.

The BoD approved the Company's internal audit policy and risk management policy as late as in 2015. Besides, no business process and risk management department existed until December 2015. Before that, the Company did not go beyond approving the Regulation on the system of internal control over the Company's financial and economic activities (2011). The disclosure system provides no information on the regular consideration by the BoD of risk management-related issues. Therefore, the current condition and efficiency of the risk management and internal audit system can only be evaluated based on the 2016 results, subject to adequate information disclosure. In our view, the BoD does not pay enough attention to these issues (or proper information disclosure).

Dividend policy

The dividend policy has not been updated since it was adopted in 2013. According to the document, the Company aims at setting the amount of dividends equal to 25% of the consolidated IFRS net profit earned by it, a payout ratio meeting the good practice criteria. The Company paid 25.5% of its RAS (Russian GAAP) net profit based on its business activities in 2013, 25% of the RAS net profit (unadjusted for earnings from the positive balance of exchange rate differences related to currency resources on the Company's accounts) based on the 2014 performance. No 2015 dividends were paid due to the absence of net profit.

2014 dividend payout ratios at UAC vs. (conditional) peers

	Lockheed Corp.	The Boeing Company	Airbus Group SE	PJSC UAC*	PJSC UAC* (net profit unadjusted for exchange rate differences)
Payout ratio*	48.8%	40.6%	40.3%	5.5%	25.0%

* 2014 data are provided, both adjusted and unadjusted for exchange rate differences (the Company generated a loss according to IFRS); no 2015 dividends were paid by the Company due to the absence of net profit.



Disclosure of the management motivation system at peers

Approximate proportions of CEO remuneration components at UAC vs. peers in 2015

	<i>Lockheed Corporation</i>	<i>The Boeing Company</i>	<i>Airbus Group SE</i>	<i>PJSC UAC</i>
Fixed annual remuneration	8%	12%	18%	69%
Annual bonuses	28%	18%	25%	31%
Long-term component	64%	70%	58%	0%

	<i>Lockheed Corp.</i>	<i>The Boeing Company</i>	<i>Airbus Group</i>	<i>PJSC UAC</i>
Disclosure: all payments, incl. in the form of stock, estimate of future payments	CEO+CF0+3 top managers Actual (CEO): \$1,603K in salaries, \$5,477K in annual bonus, \$3,618K according to LTIP, \$8,900K in deferred shares	CEO+CF0+3 top managers. Actual (CEO): \$1,350K in salaries, \$1,962K in annual bonus, \$2,600K in long-term remuneration, deferred component of annual bonus, \$5,100K in long-term remuneration in deferred shares	CEO: €1,400K in salaries, €1,930K in bonus, €3,148K in long-term remuneration, €1,400K in deferred shares	Collective executive body (10-13 members) Actual: RUB 2.9 million for participation in the collective executive body's activity, RUB 39.5 million in salaries, RUB 18.96 million in bonuses
KPIs influencing the short-term (annual) variable remuneration component (incl. the fixed relative weight of the KPI, if any)	Finance: orders 20%, sales 20%, operating profit 30%, operating revenue 30% (60% in total) + strategic and operating objectives (40% in total) + targets in segments + individual KPIs	The Group's economic profit (net operating profit after tax, net assets multiplied by the cost of capital), other KPIs (descriptive disclosure)	50% in aggregate: EBIT (45%), FCF (45%), ROCE (10%); 50% for individual KPIs (achievements and behavior).	15 KPIs. Key KPIs: TSR (15%), ROE (15%), revenue, net margin, debt/revenue, cost reduction (50% for fin./econ. indicators in total), labor efficiency, R&D volume, share of exports
KPIs influencing the long-term variable remuneration	Relative TSR (50%), ROIC (25%), revenue (25%)	Relative TSR, economic profit (see above)	Positive EBIT, EPS (75%), FCF (25%)	No
Long-term bonuses	LTIP in cash (20%), and deferred restricted stock units (30%), payment period 3 years + shares for KPIs (50% of total remuneration) calculation period 3 years	Cash bonuses for KPI achievement (50%), bonuses for KPI achievement in restricted stock units (25%), accrued restricted stock units (25%). Calculation period 1 or 3 years (depending on type of remuneration), payment period 3 years	Cash remuneration (up to 75%), deferred shares (25% or more). Shares: calculation period 3 years, payment period 3 years (5 years for certain tranches).	No



Information disclosure

The notices on resolutions made by the BoD do not disclose essential parameters of related party transactions (except for the names of counterparties) and related voting results (including individual voting), which prevents understanding of the positions of BoD members (especially those recognized by the BoD as independent directors).

The Company does not disclose the current members of the BoD committees and the effective Regulation on Committees on its website. The disclosure system only provides information on the heads of the committees. The only source of information on members of the committees is the Company's press center (the News section of the website).

According to the information disclosure system, the collective executive body's incentives include salaries, bonuses for the service on the Management Board, bonuses for the achievement of KPIs and one-time bonuses for special achievements; it is not clear what payments are covered by the disclosure, the reported amounts are not commensurate with those paid by conditional peers or other companies covered by this research.

The correlation between the remuneration of executive bodies and the achievement of target KPIs is governed by the Regulation on the remuneration of the President and the Regulation on the remuneration of Management Board members of PJSC UAC. The document is not disclosed. In our opinion and in accordance with international practice, the Board of Directors should at least consider disclosing the remuneration system, including the ratios between the fixed and variable components, the long-term and short-term incentives and the correlation between the payments for the reporting period and the KPI achievement. The Company discloses that the President's and BoD members' employment contracts stipulate their personal responsibility for achieving the KPIs set by the BoD.

Charity and social responsibility

In 2015, the total sponsorship expenses of the Company and its subsidiaries amounted to RUB 103 million, and sports accounted for 95% of that amount (RUB 98.9 million), support of educational projects (universities and specialized secondary educational institutions) cost the Company RUB4.2 million (4%), the remaining spending (assistance to children, patriotic projects, contributions to social organizations) being less than 1% of the total amount. The Company's charity expenses amounting to RUB 265.3 million have a similar structure. The Company accounted for a mere 8.5% of UAC Group's total charity expenses, 32% of its sponsorship spending, while the share of PJSC Company Sukhoi was 77% and 42%, respectively. The charity to profit ratios of the Company and its peers were not compared due to heavy losses incurred by the Company and the Group in 2015.

