

BRUNSWICK RAIL LIMITED
HALF YEAR 2014 RESULTS
MANAGEMENT DISCUSSION AND ANALYSIS
24 September 2014

Management discussion and analysis of financial conditions and results of operations is based on the interim consolidated financial information of Brunswick Rail Limited and its subsidiaries (together “the Group”) prepared in accordance with International Financial Reporting Standards (“IFRSs”).

Financial Highlights

- Revenue before hedging with non-derivatives (“Gross Revenue”) declined by 21.0% from US\$ 136.5m for the six months ended 30 June 2013 (“6m 2013”) to US\$ 107.8m for the six months ended 30 June 2014 (“6m 2014”)
- Adjusted EBITDA declined by 10.6% from US\$ 98.8 in 6m 2013 to US\$ 88.3m in 6m 2014
- Adjusted EBITDA margin increased to 81.9 % in 6m 2014 from 72.4% in 6m 2013
- Profit in 6m 2014 was US\$ 12.0m
- Net cash from operating activities in 6m 2014 was US\$ 78.5m
- Capital expenditures in 6m 2014 were US\$ 90.8m, of which US\$ 87.2m was directed toward discretionary growth

Operational Highlights

- The total fleet stood at 25,580 railcars as of 30 June 2014, including 208 railcars on financial lease and 184 undelivered railcars
- The Group continued to diversify its fleet and took delivery of 1,732 new railcars, while selling 165 old gondolas and 200 old mineral hoppers as part of the Group’s fleet management programme to reduce the age of the fleet and diversify the fleet into specialized cars
- The combined effects of the above decreased the share of gondolas in the Group’s portfolio from 60% as at 31 December 2013 to 58% as at 30 June 2014
- The fleet utilization rate remained at 100%
- Average remaining lease tenor is around 3.2 years; average fleet age has been reduced to less than 5 years (one of the youngest fleets in the market)

Commenting on the 1H interim results, Brunswick Rail CEO Alex Genin said:

“Brunswick Rail made solid progress in developing our business in the first half of 2014.

Altogether, we took delivery of 1,732 new specialized railcars during the period, through value-accretive deals, thereby diversifying our fleet away from gondolas and reducing the age of our fleet. Following these prudent acquisitions, we intend to focus on cash preservation and client retention until market visibility improves.

We once again maintained 100% utilization of our fleet, while at the same time growing our client portfolio with 3 new clients.

In addition, management successfully negotiated contract tenor extensions with several of our clients, increasing the Average Remaining Lease Tenor to 3.2 years compared to 3.0 years at the end of the first half of last year.

With a business model that has proven resilient throughout a challenging market environment and a strong financial position recently reinforced through proceeds from equity and debt issuances, we are confident that Brunswick Rail is on track to build on our position as Russia’s leading operating lessor.”

Nicolas Pascault, CFO of Brunswick Rail, added:

“We continued to operate profitably in the first half of 2014. Revenue decreased primarily as a result of the weak operating environment and decline in transportation volumes, but thanks to targeted cost cutting measures, our Adjusted EBITDA and cash generated from operations remained strong and only slightly lower than in the first half of 2013, while our EBITDA margin increased.

Thanks to Brunswick Rail’s high quality client portfolio, overall current clients’ payment performance remained stable despite this challenging market environment.

Through cost cutting, efficiency programmes and reduced repair expenses, we successfully reduced operating expenses across a number of key categories during the period, which contributed to our increased profit margin for the half.

Brunswick Rail also completed two milestone transactions in the recent months. In March, we issued preference shares to the European Bank for Reconstruction and Development to raise up to US\$150 million, from which US\$50 million was drawn. In July, despite a challenging environment, we signed a two years credit facility agreement for over RUB 8bn with a group of international banks to fund our growth. Shortly thereafter, we used part of it to refinance short term indebtedness owed to VTB Group, increasing the average tenor of our debt maturities and financial flexibility.”

About Brunswick Rail:

Brunswick Rail is a private railcar operating lessor providing freight railcars to large corporate clients in Russia. Established in 2004, Brunswick Rail currently owns a fleet of more than 25,000 railcars (as of 30 June 2014), which represents approximately 2% of the total Russian railcar fleet. For the six months ended 30 June 2014, the Group generated gross revenue of US\$ 107.8m and Adjusted EBITDA of US\$ 88.3m.

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Financial results – IFRS financial measures

The following table sets forth each of the Group's consolidated income statement line items for 6m 2014 and 6m 2013:

	6m 2014	6m 2013
	<i>(in US\$ thousand)</i>	
Gross revenue	107,761	136,474
Hedging with non-derivatives effect.....	(11,587)	408
Net revenue	96,174	136,882
Cost of services.....	(15,353)	(20,311)
Property tax.....	-	(8,117)
Staff compensation, excluding share-based compensation	(4,858)	(6,151)
Other operating expenses.....	(3,703)	(11,594)
Other operating income.....	2,821	372
Operating profit before share-based compensation and depreciation	75,081	91,081
Share-based compensation.....	(1,485)	(5,189)
Depreciation and amortisation	(29,891)	(36,559)
Operating profit	43,705	49,333
Finance costs.....	(32,428)	(32,697)
Finance income.....	341	509
Revaluation of embedded derivatives on mezzanine	1,194	17,052
Net foreign exchange translation gains/ (losses).....	4,309	(4,782)
Profit before income tax	17,121	29,415
Income tax expense.....	(5,136)	(6,150)
Profit for the period	11,985	23,265

Revenue

The following table sets forth the breakdown of the Group's total revenue in 6m 2014 and 6m 2013:

	6m 2014	6m 2013
	<i>(in US\$ thousand)</i>	
Full service operating leases	68,080	80,132
Triple-net operating leases	30,037	39,966
Operating lease income	98,117	120,098
Transportation services income	8,976	15,613
Finance leases	668	763
Gross revenue	107,761	136,474

The total fleet of the Group as at 30 June 2014 was 25,580 railcars. During 6m 2014 the Group continued to diversify the fleet and took delivery of 1,732 new specialized railcars. There were 184 contracted but not delivered railcars as of 30 June 2014. The railcars acquired include 420 grain hoppers, 26 cement hoppers, 150 box cars, 270 universal platforms and 866 tank cars. During 6m 2014, 165 old gondolas and 200 mineral hoppers were sold to customers as part of the Group's fleet management program to (i) reduce the fleet age and (ii) diversify the fleet into specialized cars. In addition, 10 damaged railcars were retired from service following the receipt of the insurance proceeds. A total of 677 railcars were transferred during the period from operating leases to the transportation business which, as at 30 June 2014, deploys 3,326 railcars.

In this challenging environment, overall current clients' payment performance remains stable.

Operating lease income decreased by US\$ 21,981 thousand, or 18.3% from US\$ 120,098 thousand in 6m 2013 to US\$ 98,117 thousand in 6m 2014. This decrease was primarily driven by gondola spot market daily rate decreasing from US\$ 18-21 per day on average during 6m 2013 to US\$ 13-15 per day on average during 6m 2014. Other key factors that explain the decrease are: (i) on-going weak transportation volumes, (ii) a continuous surplus of gondolas in the market, and (iii) the Russian Ruble depreciation during 6m 2014. In line with the decrease in gondola rates most types of specialized railcars have seen a softening both in new railcar prices and daily rates.

The Group's management has been proactive in negotiating with clients and in exchange for rate adjustments has successfully negotiated contract tenor extensions and indexation clauses at the option of the Group. In that respect, the Average Remaining Lease Tenor has increased to 3.2 years compared to 3.0 years at the end of the corresponding period last year. All of the 1,732 railcars delivered in 6m 2014 were attached to long-term contracts with customers.

Revenue from full service operating leases decreased by US\$ 12,052 thousand, or 15.0% from US\$ 80,132 thousand in 6m 2013 to US\$ 68,080 thousand in 6m 2014. Revenue from triple-net operating leases decreased by US\$ 9,929 thousand, or 24.8% from US\$ 39,966 thousand in 6m 2013 to US\$ 30,037 thousand in 6m 2014. Decrease in revenue from full-service and triple-net operating leases is comparable and explained by factors described above.

Transportation income decreased by US\$ 6,637 thousand, or 42.5% from US\$ 15,613 thousand in 6m 2013 to US\$ 8,976 thousand in 6m 2014 as a result of on-going weak transportation volumes in Russian rail freight in 6m 2014 and further decrease in spot prices.

Finance lease income hasn't decreased significantly in 6m 2014 in comparison with 6m 2013. No new finance lease contracts were signed, being consistent with the Group's strategy to discontinue offering this product to its clients.

The Group's gross revenue was adjusted by US\$ 11,587 thousand for the effect of hedging with non-derivatives financial liabilities in accordance with IAS 39 which the Group applied from 2012. Hedging with non-derivative losses relate to non-cash F/X translation losses recycled from other comprehensive income as a result of the ruble depreciation against the USD which are presented below Adjusted EBITDA.

Cost of services

	<u>6m 2014</u>	<u>6m 2013</u>
	<i>(in US\$ thousand)</i>	
Depot repairs.....	10,006	13,195
Other transportation services expenses	3,096	2,637
Other railcar expenses.....	1,970	619
Transportation services subcontracted	174	3,720
Railcar insurance.....	107	140
Total cost of services	<u>15,353</u>	<u>20,311</u>

Depot repairs

Depot repairs decreased by US\$ 3,189 thousand, or 24.2% from US\$ 13,195 in 6m 2013 to US\$ 10,006 in 6m 2014. The decrease was mainly due to lower average depot repair costs per railcar which decreased by 15% in 6m 2014 compared to 2013 as a result of management's success in achieving higher purchase efficiency.

Other transportation services expenses

Other transportation expenses increased by US\$ 459 thousands, or 17.4% from US\$ 2,637 in 6m 2013 to US\$ 3,096 in 6m 2014. Other transportation expenses represent the rail tariffs for empty-run which increased due to weak transportation market.

Other railcar expenses

Other railcar expenses increased by US\$ 1,351 thousand, or 218.3%, from US\$ 619 thousand in 6m 2013 to US\$ 1,970 thousand in 6m 2014. The main increase is due to one-off railcar re-registration costs in the amount of US\$ 1,056 thousand incurred as a result of the merger of Russian operating companies at the end of 2013.

Transportation services subcontracted

During 6m 2014 the Group incurred expenses on transportation services subcontracted in the amount of US\$ 174 thousand in comparison with US\$ 3,720 thousand spent in 6m 2013. The decrease in expenses relates to the decline of demand for freight transportation as well as the increase of own railcars deployed in the transportation business from 2,525 railcars as at 30 June 2013 to 3,326 railcars as at 30 June 2014.

Railcar insurance

Railcar insurance decreased by US\$ 33 thousand, or 23.6%, from US\$ 140 thousand in 6m 2013 to US\$ 107 thousand in 6m 2014 due to negotiation of lower premiums with insurance companies.

Property tax

Property tax decreased by US\$ 8,117 thousand, or 100.0% in 6m 2014 due to a change in tax legislation in respect of movable property (including railcars) exempted from property tax.

Staff compensation, excluding share-based compensation

Staff compensation decreased by US\$ 1,293 thousand, or 21.0%, from US\$ 6,151 thousand in 6m 2013 to US\$ 4,858 thousand in 6m 2014. The decrease was mostly due to a reduction in headcount to achieve efficiencies as part of the reorganization project of the Group.

Other operating expenses

Other operating expenses decreased by US\$ 7,891 thousand, or 68.1%, from US\$ 11,594 thousand in 6m 2013 to US\$ 3,703 thousand in 6m 2014. The decrease is mainly attributable to the reversal of a specific provision for bad debts in the amount of US\$ 6,934 thousand recorded in 6m 2013. No provision for bad debts was recorded in 6m 2014. The decrease was partly offset by one-off expenses associated with preparation to a potential IPO process in the amount of US\$ 564 thousand which were expensed in 6m 2014.

Other operating income

During 6m 2014 other operating income amounted to US\$ 2,821 thousand in comparison with other operating income of US\$ 372 thousand in 6m 2013. The Group successfully closed the sale of the doubtful receivable for which a provision was recognized in 2013 and a net gain of US\$ 1,590 thousand was recognized in 6m 2014. In addition a US\$ 1,347 thousand gain from the aforementioned sale of railcars was recorded within other operating income.

Share-based compensation

Share-based compensation decreased by US\$ 3,704 thousand, or 71.4%, from US\$ 5,189 thousand in 6m 2013 to US\$ 1,485 thousand in 6m 2014. The decrease relates mainly to shares vested to management during 2013 and changes, where applicable, in the valuation of the plans.

Depreciation and amortisation

Depreciation decreased by US\$ 6,668 thousand, or 18.2%, from US\$ 36,559 thousand in 6m 2013 to US\$ 29,891 thousand in 6m 2014. The decrease is explained by two factors: (i) retranslation effect from functional to presentation currency due to an increase of average foreign exchange rate in 6m 2014 (34.41) in comparison with 6m 2013 (32.28) and (ii) a prospective revision of useful life of wheelsets.

Finance costs

Finance costs, which did not change significantly, decreased by US\$ 269 thousand, or 0.8%, from US\$ 32,697 thousand in 6m 2013 to US\$ 32,428 thousand in 6m 2014. No new borrowings were attracted during 6m 2014.

Finance income

Interest income decreased by US\$ 168 thousand, or 33.0%, from US\$ 509 thousand in 6m 2013 to US\$ 341 thousand in 6m 2014. The decrease was primarily due to a decrease in bank deposits.

Revaluation of embedded derivatives on mezzanine

The embedded derivatives relate to certain derivatives identified in the US\$ 60m mezzanine facility which are fair valued at each reporting date using an option pricing model based on the Black-Scholes model. The fair value gains recognized during 6m 2014 amount to US\$ 1,194 thousand which are lower than fair value gains recorded in 6m 2013 of US\$ 17,052 thousand as a result of a change in estimates.

Net foreign exchange translation gains/ (losses)

In 6m 2014 the Group recognized net foreign exchange translation gains in the amount of US\$ 4,309 thousand in comparison with net foreign exchange translation losses in 6m 2013 in the amount of US\$ 4,782 thousand. FX gains recognized in 6m 2014 are due to (i) positive FX revaluation of cash and cash equivalents in 6m 2014 and (ii) the application of hedge accounting with non-derivatives pursuant to IAS 39 which mitigates the exposure to foreign currency risk on Eurobonds.

Profit before income tax

Profit before income tax decreased by US\$ 12,294 thousand, or 41.8%, from US\$ 29,415 thousand in 6m 2013 to US\$ 17,121 thousand in 6m 2014. The decrease was mainly due to a decline in operational results as described above.

Income tax expense

The Group includes companies incorporated in Bermuda, Cyprus, Ireland and Russia with income tax rates of 0%, 12.5%, 25% and 20%, respectively. The Group's income tax expense decreased by US\$ 1,014 thousand, or 16.5% from US\$ 6,150 thousand in 6m 2013 to US\$ 5,136 thousand in 6m 2014 in line with the decrease in profitability of the Group in 6m 2014.

Profit for the period

The Group's profit for the 6m 2013 and 6m 2014 amounted to US\$ 23,265 thousand and US\$ 11,985 thousand respectively. The decrease in the Group's profitability was due to factors discussed above.

Financial results – non-IFRS financial measures

The following table sets forth each of the Group's non-IFRS financial measures for the 6m 2014 and 6m June 2013:

	<u>6m 2014</u>	<u>6m 2013</u>
Adjusted EBITDA (in US\$ thousand)	88,288	98,790
Adjusted EBITDA Margin (in %).....	81,9	72,4
Adjusted Net Profit (in US\$ thousand)	<u>18,417</u>	<u>15,645</u>

Adjusted EBITDA

Adjusted EBITDA is a measure used by the Board to assess the performance of the operating segments of the Group, since Adjusted EBITDA is a key performance indicator in terms of how the business is perceived by investors and how much cash it is generating. Adjusted EBITDA is defined as earnings before interest, tax, depreciation and amortisation and other non-cash charges, exceptional and non-recurring items.

	<u>6m 2014</u>	<u>6m 2013</u>
	<i>(in US\$ thousands)</i>	
Profit for the period,	11,985	23,265
plus / (minus)		
Income tax expense.....	5,136	6,150
Net foreign exchange translation (gains) / losses.....	(4,309)	4,782
Revaluation of embedded derivatives on mezzanine.....	(1,194)	(17,052)
Finance income.....	(341)	(509)
Finance costs.....	32,428	32,697
Depreciation and amortisation	29,891	36,559
Share-based compensation	1,485	5,189
Professional services associated with preparation to a potential IPO process	564	-
Railcars re-registration costs.....	1,056	-
Property tax.....	-	8,117
Hedging with non-derivatives effect.....	11,587	(408)
Adjusted EBITDA	88,288	98,790

Adjusted EBITDA decreased by US\$ 10,502 thousand or 10.6% from US\$ 98,790 thousand in 6m 2013 to US\$ 88,288 thousand in 6 months 2014. The decrease is mainly due to the decrease in revenue for the reasons described above which was largely compensated by a decrease in cost of services and other operating expenses.

Adjusted EBITDA Margin

Adjusted EBITDA Margin is a measure used by the Board to assess the operating profitability of the Group. Adjusted EBITDA Margin is defined as Adjusted EBITDA divided by gross revenue, expressed as a percentage. Adjusted EBITDA Margin shows the cost efficiency of the Group and shows its ability to cover long term debts. Adjusted EBITDA Margin increased from 72.4% in 6m 2013 to 81.9% in 6m 2014 partly as a result of the settlement of doubtful receivable in 6m 2014.

Adjusted Net Profit

The Board utilizes an additional reporting measure to assess the profitability of the Group, whereby they adjust profit for the period for items management believes are non-recurring or not directly embedded within the core operating business cycle of the Group.

	<u>6m 2014</u>	<u>6m 2013</u>
	<i>(in US\$ thousand)</i>	
Net profit for the period	11,985	23,265
plus / (minus)		
Net foreign exchange translation (gains) / losses.....	(4,309)	4,781
Revaluation of embedded derivatives on mezzanine	(1,194)	(17,052)
Share-based compensation.....	1,485	5,189
Railcar re-registration costs	1,056	-
Professional services associated with preparation to a potential IPO process	564	-
Hedging with non-derivatives effect.....	11,587	(408)
Related tax effect.....	(2,757)	(130)
Adjusted net profit	18,417	15,645

Adjusted net profit for the period increased by US\$ 2,772 thousand or 17.7% from US\$ 15,645 thousand in 6m 2013 to US\$ 18,417 thousand in 6m 2014. The increase is primarily due to the reduction in property tax and depreciation.