# BRUNSWICK RAIL LIMITED
# FULL YEAR 2013 RESULTS
# MANAGEMENT'S DISCUSSION AND ANALYSIS
# 2 April 2014

Management's discussion and analysis of financial conditions and results of operations is based on the audited consolidated financial statements 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") in 2013 declined by 17% from US$ 306.2m in 2012 to US$ 255.3m in 2013
- Adjusted EBITDA declined by 24% from US$ 257.3m in 2012 to US$ 194.7m in 2013
- Adjusted EBITDA margin contracted to 76.3% in 2013 from 84.0% in 2012
- Profit for the year 2013 was US$ 28.0m
- Net Cash from operating activities in 2013 was US$ 182.6m
- Debt to Adjusted EBITDA ratio in 2013 was 3.7x
- Capital expenditures in 2013 were US$ 105.8m, of which US$ 100.2m was directed towards discretionary growth

## Operational Highlights

- The total fleet stood at 24,619 railcars as of 31 December 2013 including 208 railcars in finance lease and 580 undelivered railcars
- The Group continued to diversify its fleet and took delivery of 2,564 new railcars of which 1,670 were tank cars, 190 - grain hoppers and 200 - gas tank cars while selling 561 old gondolas
- In addition, the Group contracted 1,062 specialized railcars (500 grain hoppers, 500 universal platforms, 62 new generation gondolas) of which 482 were already delivered as of 31 December 2013
- The combined effects of the above decreased the share of gondolas in portfolio from 63% in 2012 to 60% in 2013
- The utilization rate maintained at 100%
- Average remaining lease tenor increased from 2.9 years in 2012 to 3.4 years in 2013; and average fleet age is maintained at around 5 years (one of the youngest fleets in the market)
- The reorganization of the Group's Russian operating companies via a merger into a new operating entity aiming to streamline the overall structure, improve transparency and reduce costs was finalized in November 2013

<u>Commenting on 2013 results, Brunswick Rail CEO Alex Genin said:</u>

"Without a doubt, 2013 was a challenging year for the rail freight sector in Russia and inevitably this impacted our key financial performance indicators. On the other hand, our operational performance was strong, as we retained our position as Russia's number one player on the operating leasing market.

We expanded and diversified our fleet during the year, reaching almost 25,000 cars. We focused on optimizing operational efficiencies, and completed a process of corporate reorganisation, which has already helped to streamline our internal business processes while also making the business more transparent for our investors.

Looking ahead, while we are still to see clear signs of recovery in the market, we have entered 2014 with a strong financial position. There could be attractive opportunities for growth in the current market, and to the extent that we believe deals to be value accretive, we will be well placed to consider them."

Nicolas Pascault, CFO Brunswick Rail added:

"Our solid financial performance in what was a difficult market environment reconfirmed the resilience of our business model.

Adjusted EBITDA, although down year-on-year, was nevertheless a robust USD 194.7m, and we saw ongoing strong cash generation from operating activities of USD 182.6m.

The recently completed internal reorganization of our Russian operating companies combined with on-going efficiency programs will bring real benefits through operational synergies, cost reduction and enhanced transparency.

The recent issue of Preference Shares to the EBRD will provide us with ammunition at a time when we believe railcar prices have reached the bottom of the cycle whilst securing an additional important strategic shareholder. The incremental revenue and EBITDA that can be generated from the proceeds should allow for an increase in our levels of financing, without putting our key credit ratios under pressure. We believe that the EBRD's investment represents a strong vote of confidence in our business, management and overall business plan."

**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 almost 25,000 railcars (as of 31 December 2013), which represents approximately 2% of the total Russian railcar fleet. For the year ended 31 December 2013, the Group generated gross revenue of USD 255.3m and Adjusted EBITDA of USD 194.7 million.

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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 the year ended 31 December 2013 and 31 December 2012:

| | 2013 | 2012 |
|---|---|---|
| | | *Restated* |
| | *(in US$ thousand)* | |
| **Gross revenue** | **255,274** | **306,232** |
| Hedging with non-derivatives effect | (5,835) | (2,326) |
| **Net revenue** | **249,439** | **303,906** |
| Cost of services | (27,432) | (23,143) |
| Property tax | (13,233) | (16,419) |
| Staff compensation, excluding share based compensation | (14,847) | (12,933) |
| Other operating expenses | (18,348) | (13,165) |
| Other operating income | 101 | 330 |
| **Operating profit before share based compensation and depreciation** | **175,680** | **238,576** |
| Share based compensation | (11,806) | (12,484) |
| Depreciation | (71,644) | (68,024) |
| **Operating profit** | **92,230** | **158,068** |
| Finance costs | (66,015) | (85,255) |
| Finance income | 1,657 | 1,365 |
| Revaluation of embedded derivatives on mezzanine | 15,858 | (12,087) |
| Net foreign exchange translation (losses) / gains | (1,729) | 26,342 |
| **Profit before income tax** | **42,001** | **88,433** |
| Income tax expense | (13,983) | (27,196) |
| **Profit for the year** | **28,018** | **61,237** |

**Revenue**

The following table sets forth the breakdown of the Group's total revenue for the year ended 31 December 2013 and 31 December 2012:

| | 2013 | 2012 |
|---|---|---|
| | *(in US$ thousand)* | |
| Full service operating leases | 141,231 | 151,579 |
| Triple-net operating leases | 86,322 | 113,375 |
| **Operating lease income** | **227,553** | **264,954** |
| Finance leases | 1,493 | 1,985 |
| Transportation services income | 26,228 | 39,293 |
| **Gross revenue** | **255,274** | **306,232** |

Operating lease income decreased by US$ 37,401 thousand, or 14.1% from US$ 264,954 thousand in 2012 to US$ 227,553 thousand in 2013. This decrease was primarily due to (i) the downturn in transportation industry accompanied by a significant drop in spot market daily rates, (ii) the lost revenue on 1,000 railcars which were suspended for examination by the regulator in the first half 2013 and (iii) increase of rental holidays during railcars repairs.

The decrease in revenue described above was partly compensated by additional revenue from new railcars acquired during 2013.

Revenue from full-service operating leases didn’t change significantly while, at the same time, revenue from triple-net operating leases decreased, being in line with the Group's strategy to focus on full-service leases as its principal product.

Finance lease income decreased in 2013, mostly due to maturity of finance lease contracts for 862 railcars in the second half 2012. No new finance lease contracts were signed, being consistent with the Group's strategy to discontinue offering this product to its clients.

Transportation income decreased by US$ 13,065 thousand, or 33.3% from US$ 39,293 thousand in 2012 to US$ 26,228 thousand in 2013 as a result of the decline in Russian rail freight volume by 2.8% compared to the corresponding period last year and a drop in spot prices.

The Group’s gross revenue was adjusted by US$ 5,835 thousand for the effect of hedging with non-derivatives financial liabilities in accordance with IAS 39 which the Group applied from the second quarter of 2012.

**Cost of services**

| | 2013 | 2012 |
|---|---|---|
| | *(in US$ thousand)* | |
| Depot repairs | 16,545 | 9,414 |
| Other transportation services expenses | 5,090 | 2,449 |
| Transportation services subcontracted | 4,300 | 10,484 |
| Other railcar expenses | 1,217 | 588 |
| Railcar insurance | 280 | 208 |
| **Total cost of services** | **27,432** | **23,143** |

**Depot repairs**

Depot repairs increased by US$ 7,131 thousand, or 75.7%, from US$ 9,414 in 2012 to US$ 16,545 in 2013. The increase was due to a) ageing of the Group’s fleet, b) extension of the Group’s feet and c) the increase of the share of full service operating leases of the Group.

**Other transportation services expenses**

During 2013, other expenses relating to transportation services amounted to US$ 5,090 thousand compared to US$ 2,449 thousand in 2012. These expenses represent mainly the Russian Railways rail tariffs for empty-run. The increase of expenses for empty-run related to the on-going weak transportation volumes and an oversupply of gondolas in the market.

**Transportation services subcontracted**

During 2013 the Group incurred expenses on the transportation services subcontracted in the amount of US$ 4,300 thousand in comparison with US$ 10,484 thousand spent in 2012. The decrease of expenses relates to the decline of demand for freight transportation as well as the increase of own railcars deployed in the transportation business from 2,252 railcars as at 31 December 2012 to 2,649 railcars as at 31 December 2013.

**Other railcar expenses**

Other railcar expenses increased by US$ 629 thousand, or 107.0%, from US$ 588 thousand in 2012 to US$ 1,217 thousand in 2013. The increase is due to relocation expenses related to remarketing of railcars and daily access to RZD database.

**Railcar insurance**

Railcar insurance increased by US$ 72 thousand, or 34.6%, from US$ 208 thousand in 2012 to US$ 280 thousand in 2013 due to the increase in number of railcars.

**Property tax**

Property tax decreased by US$ 3,186 thousand, or 19.4% from US$ 16,419 thousand in 2012 to US$ 13,233 thousand in 2013. The main reason is that starting from 1 January 2013 newly accounted moveable property (including railcars) is not subject to property tax.

**Staff compensation, excluding share based compensation**

Staff compensation increased by US$ 1,914 thousand, or 14,8%, from US$ 12,933 thousand in 2012 to US$ 14,847 thousand in 2013. The increase was mostly due to salary indexation mainly for inflation from 1 January 2013.

**Other operating expenses**

Other operating expenses increased by US$ 5,183 thousand, or 39,4%, from US$ 13,165 thousand in 2012 to US$ 18,348 thousand in 2013. The main increase resulted from the recognition of a specific provision for bad debts in the amount of US$ 5,114 thousand. The Group undertakes every possible effort to collect the doubtful receivables and considers that the provision created is sufficient to cover these. No other trade and other receivables are considered impaired.

**Other operating income**

During 2013 other operating income amounted to US$ 101 thousand in comparison with US$ 330 thousand in 2012 where the Group received income due to maturity and earlier termination of finance lease contracts.

**Share-based compensation**

Share-based compensation decreased by US$ 678 thousand, or 5.4%, from US$ 12,484 thousand in 2012 to US$ 11,806 thousand in 2013. The decrease is mainly due to the modification of a share based plan offset partly by the introduction of new long term incentive plans for the management of the Group in the second half of 2012.

**Depreciation**

Railcar depreciation increased by US$ 3,620 thousand, or 5.3%, from US$ 68,024 thousand in 2012 to US$ 71,644 thousand in 2013. The increase was mainly due to further growth of railcar fleet.

**Finance costs**

Finance costs decreased by US$ 19,240 thousand, or 22.6%, from US$ 85,255 thousand in 2012 to US$ 66,015 thousand in 2013. In 2012 the Group prepaid the outstanding syndicated loans using part of the Eurobond proceeds and recognized additional finance costs in the amount of US$ 22,228 thousand represented mainly by prepayment fees, written off unamortized borrowing costs and costs on early termination of interest rate swaps.

**Finance income**

Interest income increased by US$ 292 thousand, or 21,4%, from US$ 1,365 thousand in 2012 to US$ 1,657 thousand in 2013. The increase was primarily due to an increase in bank deposits.

**Revaluation of embedded derivatives on mezzanine**

The embedded derivatives relate to certain derivatives identified in the US$ 60m mezzanine agreement. The embedded derivatives are fair valued at each reporting date using option pricing models based on the Black-Scholes model. The revaluation of the embedded derivatives on mezzanine amounted to US$ 15,858 thousand in 2013.

**Net foreign exchange translation (losses)/ gains**

In 2013 the Group recognized net foreign exchange translation losses in the amount of US$ 1,729 thousand in comparison with net foreign exchange translation gain in 2012 in the amount of US$ 26,342 thousand. The decrease in the fluctuation of net foreign exchange translation (losses) / gains resulted from the application of hedge accounting with non-derivatives pursuant to IAS 39 to mitigate the exposure to foreign currency risk since 2Q 2012.

**Profit before income tax**

Profit before income tax decreased by US$ 46,432 thousand, or 52,5%, from US$ 88,433 thousand in 2012 to US$ 42,001 thousand in 2013. The decrease was mainly to due decline in operational results as explained above partially compensated by reduction in finance costs.

**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$ 13,213 thousand, or 48.6% from US$ 27,196 thousand in 2012 to US$ 13,983 thousand in 2013. The decrease in the Group's tax charge was due to the decrease in profitability of the Group in 2013.

**Profit for the year**

The Group’s profit for the year 2012 and 2013 amounted to US$ 61,237 thousand and US$ 28,018 thousand respectively. The decrease in the Group’s profitability was due to the 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 year ended 31 December 2013 and 31 December 2012:

| | 2013 | 2012 *Restated* |
|---|---|---|
| Adjusted EBITDA (in US$ thousand) | 194,748 | 257,321 |
| Adjusted EBITDA Margin (in %) | 76.3 | 84.0 |
| Adjusted Net Profit (in US$ thousand) | 30,697 | 84,748 |

**Adjusted EBITDA**

Adjusted EBITDA is a measure used by the Board to assess the performance of 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 amortization and other non-cash charges, exceptional and non-recurring items.

| | 2013 | 2012 *Restated* |
|---|---|---|
| | *(in US$ thousands)* | |
| **Profit for the year,** | **28,018** | **61,237** |
| plus / (minus) | | |
| Income tax expense | 13,983 | 27,196 |
| Depreciation | 71,644 | 68,024 |
| Property tax | 13,233 | 16,419 |
| Finance income | (1,657) | (1,365) |
| Finance costs | 66,015 | 85,255 |
| Net foreign exchange translation losses/(gains) | 1,729 | (26,342) |
| Share-based compensation | 11,806 | 12,484 |
| Revaluation of embedded derivatives on mezzanine | (15,858) | 12,087 |
| Hedging with non-derivatives effect | 5,835 | 2,326 |
| **Adjusted EBITDA** | **194,748** | **257,321** |

Adjusted EBITDA decreased by US$ 62,573 thousand or 24.3% from US$ 257,321 thousand in 2012 to US$ 194,748 thousand in 2013. The decrease is mainly due to the following factors:

- The downturn in the market which resulted in negotiations with the clients for decreasing daily rates with a negative impact on revenue in the amount of US$ 28,687 thousand in 2013;
- Lost revenue of the Group during the examination and suspension from operations of 1,000 oil tanks in the first half of 2013 in the amount of US$ 2,706 thousand;
- Increase in depot repairs by US$ 7,131 thousand;
- Recognition of the specific provision for bad debts in the amount of US$ 5,114 thousand as discussed above.

**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 decreased from 84.0% in 2012 to 76.3% in 2013. The decrease of Adjusted EBITDA Margin resulted from the decrease in gross revenue as well as the increase in cost of services and other operating expenses.

**Adjusted Net Profit**

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

| | 2013 | 2012 *Restated* |
|---|---|---|
| | *(in US$ thousand)* | |
| **Net profit for the year** | **28,018** | **61,237** |
| Finance costs incurred on loan prepayments and refinancing | - | 22,228 |
| Share-based compensation | 11,806 | 12,484 |
| Revaluation of embedded derivatives on mezzanine | (15,858) | 12,087 |
| Net foreign exchange translation losses/(gains) | 1,729 | (26,342) |
| Hedging with non-derivatives effect | 5,835 | 2,326 |
| Related tax effect | (833) | 728 |
| **Adjusted net profit** | **30,697** | **84,748** |

Adjusted net profit for the year decreased by US$ 54,051 thousand or 63.8% from US$ 84,748 thousand in 2012 to US$ 30,697 thousand in 2013 which demonstrates the impact of softening in transportation industry on the core operating financial performance of the Group as discussed above.

## Liquidity and Capital Resources

### *Capital expenditures*

The Group incurred capital expenditures to fund the acquisition of rolling stock. Capital expenditures on railcar maintenance are not significant due to the young age of most of the Group's fleet however this is expected to increase in line with the age of the fleet. In 2013 capital expenditures amounted to US$ 105,805 thousand. Capital expenditures are related to the acquisition of 1,062 new railcars in the amount of US$ 100,212 thousand and replacement of wheelsets in the amount of US$ 5,593 thousand.

### *Cash flows*

The following table sets forth the principal components of the Group's consolidated statement of cash flows for 2013 and 2012:

| | 2013 | 2012 |
|---|---|---|
| | *(in US$ thousands)* | |
| Net cash generated by operating activities | 182,624 | 241,695 |
| Net cash used in investing activities | (98,127) | (175,514) |
| Net cash used in financing activities | (91,943) | (44,574) |
| **Net (decrease) / increase in cash and cash equivalents** | **(7,446)** | **21,607** |
| Cash and cash equivalents at beginning of the year | 71,975 | 50,847 |
| Exchange losses on cash and cash equivalents | (1,903) | (479) |
| **Cash and cash equivalents at end of year** | **62,626** | **71,975** |

### *Net cash from operating activities*

Net cash from operating activities decreased by US$ 59,071 thousand, or 24.4%, from US$ 241,695 thousand in 2012 to US$ 182,624 thousand in 2013. The decrease was primarily due to the decrease in revenue resulting from a drop in spot market daily rates in 2013 and increase in depot repairs and other operating expenses.

### *Net cash used in investing activities*

Net cash used in investing activities decreased by US$ 77,387 thousand, or 44.1%, from US$ 175,514 thousand in 2012 to US$ 98,127 thousand in 2013. The decrease was primarily due to the decline in railcar purchases in 2013.

### *Net cash used in financing activities*

The Group didn't attract any new financing in 2013. Net cash used in financing activities in the amount of US$ 91,943 represents mainly interest payments and dividends paid in 2013.

### *Capital resources*

On 1 November 2012 the Group issued a five-year US$600 million Reg S/144A Eurobond with a 6.5 per cent coupon. Out of the US$600 million proceeds, approximately US$270 million were used to repay the EBRD-IFC syndicated loan and US$225 million to repay the IFC syndicated loan. The remaining US$105 million were used to expand the Group's railcar fleet. As a result, the Group significantly improved its debt structure. As at 31 December 2012 the Group's debt consisted of the unsecured Eurobond, the finance lease payables and a shareholder loan in the total amount of US$ 743,586 thousand. No new financing or repayment occurred in 2013. The Group's debt structure remained unchanged with total borrowing of US$ 728,080 thousand as at 31 December 2013.

All pledges of rolling stock and shares in certain Group companies, assignments of certain contractual rights under lease and supply contracts under syndicated loans were removed due to the loans repayment in 2012. There were no new pledges in 2013.

As at 31 December 2013 the Group's borrowings carry fixed interest rates except for the shareholder's loan.

The following table sets forth the maturity profile of the Group's debt as of 31 December 2013, excluding finance lease payables:

| | 2013 | 2012 |
|---|---|---|
| **Maturity of borrowings, excluding finance lease payables** | *(in US$ thousands)* | |
| Less than 1 year | 6,500 | - |
| Later than 1 year and not later than 3 years | 14,740 | 14,740 |
| Later than 3 years and not later than 5 years | 587,846 | 592,044 |
| **Total** | **609,086** | **606,784** |

The following table sets forth the maturity profile of the Group's finance leases as of 31 December, 2013.

| | 2013 | 2012 |
|---|---|---|
| **Maturity of finance lease payables** | *(in US$ thousands)* | |
| Not later than 1 year | 110,236 | 8,928 |
| Later than 1 year and not later than 3 years | 3,347 | 120,247 |
| Later than 3 years and not later than 5 years | 2,869 | 3,758 |
| Over 5 years | 2,542 | 3,869 |
| **Total** | **118,994** | **136,802** |

The balance of the mezzanine facility at 31 December 2012 and 31 December 2013 was US$ 64,624 thousand and US$ 64,872 thousand respectively. The mezzanine facility is fully subordinated to Eurobond based on a Notice on subordination dated 15 October 2012.

The Group had no credit facilities at 31 December 2012. During 2013 the Group had access to overdraft facilities of US$ 90,000 thousand out of which US$ 60,000 thousand are committed and US$ 30,000 thousand are uncommitted. None of these facilities was utilized by the end of 2013 year.

***Working capital***

The table below sets forth the components of the Group's working capital for 2013 and 2012:

| | 2013 | 2012 |
|---|---|---|
| | *(in US$ thousands)* | |
| **Current assets** | | |
| Cash and cash equivalents | 62,626 | 71,975 |
| Advances to customs | - | 3,405 |
| Advances paid for rail tariffs | 555 | 2,979 |
| Trade and other receivables | 36,300 | 14,051 |
| Finance lease receivables | 1,268 | 1,047 |
| Current income tax prepayments | 544 | 523 |
| **Current liabilities** | | |
| Trade and other payables | (18,071) | (13,489) |
| Current income tax liabilities | (353) | (638) |
| VAT payable | (4,868) | (7,133) |
| Other taxes payable | (1,345) | (4,284) |
| **Working capital** | **76,656** | **68,436** |

Working capital increased by US$ 8,220 thousand or 12.0% from US$ 68,436 thousand as of 31 December 2012 to US$ 76,656 thousand as of 31 December 2013. The main increase in working capital is due to recognized receivables related to sale of railcars in December 2013. This increase was partially compensated by less cash balances at the end of 2013.

***Off-balance sheet arrangements***

As at 31 December 2013 the Group had no material off-balance sheet arrangements.

## Contractual obligations and commercial commitments

As at 31 December 2013, no member of the Group had any material obligation as a guarantor or surety of the obligation of any person, not being a member of the Group, which is not reflected on the balance sheet.

As at 31 December 2013 the Group was not aware of any contingent tax, litigation or other liabilities, which could have a material effect on the result of operations or financial position of the Group and which have not been accrued or disclosed in the Group's Financial Statements.

## Critical Accounting Estimates and Judgments

Critical accounting estimates and judgments are those that require the application of management's most challenging, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies involve judgments and uncertainties that are sufficiently sensitive to result in materially different results under different assumptions and conditions.

The main critical accounting estimates and judgments are applied to valuation of the embedded derivatives and share-based compensation, impairment of railcars and provision for doubtful debts. A detailed description of the critical accounting estimates and judgments used in preparing the Group's Financial Statements is set out in the Group's audited consolidated financial statements.