Globaltrans

2022 Annual Report & Accounts

Related party transactions

For the purposes of this Annual Report and the Group's Consolidated Management Report and Consolidated Financial Statements, parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operational decisions as defined by IAS 24 "Related Party Disclosures". In considering each possible related party relationship, attention is directed to the substance of the relationship, not merely the legal form. Related parties may enter into transactions, which unrelated parties might not, and transactions between related parties may not be effected on the same terms, conditions and amounts as transactions between unrelated parties.

Litten Investments Ltd, controlled by a Director of the Company, has a shareholding in the Company of 5.1% as at 31 December 2022 (31 December 2021: 5.1%)[1]. Goldriver Resources Ltd, controlled by a Director of the Company, has a shareholding in the Company of 3.1% as at 31 December 2022 (31 December 2021: 3.1%)[2]. As at 31 December 2022, another 0.1% (31 December 2021: 0.2%) of the shares of the Company are controlled by Directors and key management of the Company. For further details on Globaltrans' shareholder structure, please see the Share Capital section of this Annual Report on page 122.

For further details on the transactions carried out with the above related parties, please see Note 35 of the Group's Consolidated Management Report and Consolidated Financial Statements which is included in the Financial Statements section of this Annual Report. Except as set out in this section and Note 35 of the Group's Consolidated Management Report and Consolidated Financial Statements, during the period 1 January to 31 December 2022, there were no transactions or proposed transactions that were material to either the Company or any related party nor were there any transactions with any related party that were unusual in their nature or conditions.

1 Beneficially owned by Alexander Eliseev, Non-executive Director and co-founder of Globaltrans.
2 Beneficially owned by Sergey Maltsev, Chairman of the Board of Directors, Chief Strategy Officer and co-founder of Globaltrans.

Risk Management

Globaltrans faces a wide range of potential and current risks to its business. To identify, evaluate and mitigate these risks, the Group has established a system for monitoring and controlling uncertainties and risks that it faces. This system is overseen by a dedicated risk management function.

The Board of Directors has overall responsibility for the Group's risk management.

The Board, as part of its role in providing strategic oversight and stewardship of the Company, is responsible for maintaining a sound risk management and internal control system. As part of that system, the Board determines principal risks and sets respective risk tolerance levels. Globaltrans has adopted a risk management policy that provides a consistent framework for the identification, assessment, management and, where possible, mitigation of risks.

The oversight of risk management is delegated to the Audit Committee. The Board has delegated to the CEO the responsibility for the effective and efficient implementation and maintenance of the risk management system. The Directors, through the Audit Committee, review the systems that have been established for this purpose and regularly evaluate their effectiveness. Appropriate actions are then taken to manage the risk to an acceptable level as defined by the Board.

Ultimately, risk management aims to establish and maintain a holistic view of risks across the enterprise, so capabilities and performance objectives are achieved via risk-informed resources and investment decisions.

Globaltrans bases its risk management activity on a series of well-defined risk management principles, derived from experience, best practice and in accordance with corporate governance principles. The Group's risk management principles consist of nine interdependent and interconnected components that aim to provide a holistic view of risk across the whole organisation.

In addition, in January 2021, the Board established the ESG Committee to analyse and oversee risks related to environmental, social and governance issues.

Risk Management

RISK MANAGEMENT PRINCIPLES

Enterprise-wide

Risks that the Group faces should be managed on an enterprise-wide basis as a continuous and developing process that runs throughout the Group's strategy and the implementation of that strategy.

Systematic and structured

Risk management should involve recognised processes and activities in a systematic, methodical way that ensures the results of risk management activities are reliable, robust and comparable.

Based on top-down and bottom-up approach

Risk management should evaluate the potential upside and downside of all risks that could affect the Group. It should increase the probability of success and reduce both the probability of failure and the uncertainty of achieving the Group's overall objectives. Risk management activity should include the development and implementation of risk response actions to remove or mitigate all risks the Group faces, transfer them to a third party or accept them.

Forward-thinking approach

Risk management should be forward-thinking. It should involve identifying and preparing for what might happen rather than always managing retrospectively. Risk management should encourage the Group to manage proactively rather than reactively.

Integrated into the Group's business

Risk management should be embedded in all of the Group's practices and business processes (including business and strategic planning, budgeting and decision-making) so that it is relevant, effective, efficient and sustained. All Group staff should be responsible and accountable for managing the risks in their activities.

Aligned with the Group's objectives

Risk management should be aligned with the Group's objectives and provide reasonable assurance regarding the achievement of those objectives.

Integrated into corporate culture

Risk management should be a part of the Group's corporate culture. All employees should be aware of the relevance of risk to the achievement of their objectives.

Clear and understandable

Risk management principles, methods and tools should be clear and easily understood by the Group's employees.

Evolving

The Group's risk management system should be continually evolving. The management of risks is an ongoing process and it is recognised that the level and extent of the risk management system will evolve as the Group evolves.

Principal Risks and Uncertainties

Globaltrans has grouped risks that it considers significant into key categories — strategic, operational, compliance and financial. This list is not exhaustive, and the order of information does not reflect the probability of occurrence or the magnitude of any potential effect. The current geopolitical situation and conflict surrounding Russia and Ukraine creates additional risks, which may have significant impacts on the business of the Group and its business environment. Additional risks not currently known or that are currently considered immaterial could also have an impact on the Group's business, financial condition, operational results and prospects, decisions of regulatory authorities in the EU, the UK, Russia and other jurisdictions, including the suspension of trading of its GDRs on the LSE may affect the price of GDRs. We monitor and assess risks on an ongoing basis and we make efforts to control and mitigate such risks to the extent possible.

STRATEGIC: RISKS THAT INFLUENCE THE GROUP'S ABILITY TO ACHIEVE ITS STRATEGY

General Economic Situation and Operating Environment

Description

The Group and its subsidiaries operate mainly in Russia and other emerging markets. Emerging markets, such as Russia and Kazakhstan, are subject to greater risks than more developed markets, including significant economic, political, social, legal and legislative uncertainties. Moreover, the Group's business depends on demand in the Russian freight rail transportation market, which in turn depends on certain key commodity sectors and, accordingly, on economic conditions in Russia, Europe and elsewhere.

A decrease in production and demand for key commodities in Russia, or in adjacent countries where the commodities of the Group's key customers are shipped by rail, as a result of a technological shift, economic downturn, political crisis or another event in Russia or another relevant country (such as the recent conflict between Russia and Ukraine), may negatively impact the Group's business and growth prospects.

In addition to the human impact, the spread of Coronavirus (COVID-19) continues to affect global businesses and may lead to further and/or continued lockdowns, trade wars and turbulence in different currencies. The Group's outlook for 2023 may be further impacted by the Coronavirus outbreak, which continues to cause uncertainty.

Risk Management

The freight rail market may experience reduced demand stemming from the effects of COVID-19. The Company cannot predict the full impact of COVID-19 on its markets, business or prospects although they may be materially adversely impacted by the rapidly evolving situation. Also, the appearance of new pandemics or other dangerous illnesses could seriously affect the global and local business environment and lead to negative consequences for the Group's business. Significant levels of COVID-19 illness in the Group or its key clients could interfere with the stability of the Group's operations.

The sanctions imposed on the Russian Central Bank and a number of commercial banks, the restrictions for capital movements outside the Russian Federation, sanctions imposed by the United States, the European Union, the United Kingdom and a number of other countries on the biggest Russian industrial groups and other institutions, companies and individuals may adversely affect the business environment in which the Group operates and the prospects of the Group and may result in long-term disruption and economic downturn in Russia and/or the other countries to which the Group is directly or indirectly exposed. The restrictions on the export of certain Russian commodities or change in directions of supply for Russian commodities may have a negative impact on the freight rail transportation market and the Group's business.

The threat of sanctions against the Group's existing customers and the existing sanctions imposed, any deterioration in or threat to their financial condition and/or the temporary closure of certain markets (whether as a result of the current situation in Ukraine or otherwise) may decrease demand for the Group's services and/or negatively impact the Group's logistics.

Moreover, many businesses are taking a cautious approach to sanctions and export compliance matters and have adopted internal policies more restrictive than are strictly required by the applicable rules which may adversely affect the willingness of counterparties to deal with our business. In addition, the current situation in Ukraine has a negative impact on the Group's business and assets in Ukraine and/or on the ability of the Group to carry on business in Ukraine. Some of the Group's railcars which were in Ukraine or used to transport cargo from Russia into or through the territory of Ukraine (about 5% of the Group's Total Fleet) have been blocked in Ukraine.

The restrictions on Russian-based companies' ability to transfer capital outside the Russian Federation currently impacts and may further impact the ability of the Company's subsidiaries to make payments to the Company or to make payments between the Company's bank accounts in Russia and abroad. At present, the Group is unable to upstream material amounts of cash to the Company's bank accounts outside of Russia as a result of these restrictions. Further, the weakening of the Russian rouble against the US dollar and Euro and the accelerated inflation in Russia may have a negative impact on the Group's operating costs and costs of repairs. In addition, the Group may experience difficulties in making the payments due to potential refusal of certain banks to maintain the Group's bank accounts or to make payments from these accounts.

The situation in Russia and Ukraine and the resulting sanctions imposed on Russia and other persons connected to Russia by various countries around the world as well as sanctions and restrictive measures imposed by Russia may have unforeseen, long-term and far-reaching consequences for the global economy, the Russian economy and the freight rail transportation industry in Russia.

These consequences, including restrictions and limitations on the business activity of Russian companies (including access to funds located outside of Russia) and widespread and/or localised economic downturn and/or volatility, could have an adverse and unforeseen impact on the Group's business, operational results and financial effect on the Group's performance.

Controls and mitigating factors

Mitigation methodology involves understanding the political and economic uncertainties of the operating environment and the risks faced in our business operations. The Group's compliance and legal teams constantly monitor changes in legislation and report them to the Group's management and Board of Directors while the finance and business teams monitor economic developments and do the same. The counterparties, banks and transactions of the Group are constantly reviewed by the Group's compliance and legal teams to ensure full compliance with all applicable legislation. Risk managers have direct access to the Group's key management.

The Group maintains a balanced fleet as one of the cornerstones of its business model. A balanced fleet (between universal gondola cars, adaptable to the demand for the transportation of various bulk cargoes, and rail tank cars, which are used for the transportation of oil products and oil) enables the Group to adapt to market conditions and reduces its dependence on any one cargo flow. In addition, the Group has entered into long-term Service Contracts with several large clients.

Management assesses the possible impairment of the Group's tangible assets by considering the current economic environment and outlook.

Management believes that it is taking all necessary measures to support the sustainability and development of the Group's business in the current business and economic environment. Management is closely monitoring the implications of recent sanctions imposed on the Russian Central Bank and various Russian businesses and individuals and of the global outbreak of COVID-19 and acts depending on the development of the situation. The Group constantly evaluates and implements options for distant work for its workforce to mitigate risks of spreading and catching COVID-19 illness.

Regulatory Risk and Relations with Government Authorities and State-owned Enterprises

Description

The Group is subject to regulatory risks relating to the operation of the Russian railway transportation market and railway industry reform. Any changes to the regulatory environment of the Russian railway transportation market or in other markets where the Group operates, including, but not limited to, railway tariff regulations and technical requirements for fleet operation and maintenance, could negatively impact the Group's business, its profitability and prospects for further business growth. Government authorities have significant influence over the functioning of the Russian railway transportation market. Any deterioration in the Group's direct or indirect relationship with government authorities at either the local or federal level could result in greater government scrutiny of the Group's business and how it conducts its operations or less effective access to services dependent upon government authorities.

Risk Management

In addition, the Group relies on its relationship with and the services (including maintenance and repairs), infrastructure and information provided by RZD, an entity controlled by the state. While the Group has enjoyed a good relationship with RZD, there is no assurance it will always continue to do so in the future or that RZD will not increase its charges for such service provision and infrastructure use. Railway transportation regulations in countries bordering Russia may change, limiting the access of the Group's rolling stock to certain territories.

Controls and mitigating factors

Management of the Group regularly monitors changes to the regulatory regime of the railway transportation market in the countries in which it operates. The Group has a diversified portfolio of service providers (e.g. for rolling stock repair services), which allows it to use private repair depots (including three in-house repair facilities) to ensure less dependence on RZD-owned depots, obtain higher-quality service and minimise the costs of that service. RZD remains the only provider of infrastructure and locomotive traction services, although the Group does operate its own locomotives in the form of block trains (cargo or client specific Group-operated block trains all going in the same direction) on some routes. The Group also continues to monitor market liberalisation reforms to ensure that it can take advantage of any opportunities when they arise. The Group monitors Federal Antimonopoly Service ("FAS") initiatives regarding railway tariff regulation and also seeks to minimise its exposure to adverse changes in RZD's regulated tariffs for the usage of infrastructure and locomotive traction by providing that these changes are adequately passed on to the Group's customers where possible.

Regulatory Risk, Risks of Banking System and Risk of Termination of Listing of the Company's GDRs on the London Stock Exchange ("LSE") and Admission to Trading, Sanctions

Description

Since late February 2022, the Russian economy and the Group's operating environment have been negatively impacted by the escalated military and political conflict between Russia and Ukraine and the associated international sanctions against a number of Russian institutions, companies, banks and individuals. These events have drastically changed the business environment of the Group and changed the regulation of business processes in a number of European countries, the US, Russian Federation and Ukraine. On 3 March 2022, the LSE suspended the trading of the Company's GDRs and as at the date of publication of this Annual Report this suspension is still in place. There is a risk that the admission of Company's GDRs to trading on the LSE will be cancelled due to a potential change in the listing rules of the LSE. In this case, the Company's GDRs may be converted into ordinary shares of the Company. The major clearing systems, Euroclear and Clearstream, have, as at the date of publication of this Annual Report, suspended the instructions for transfers and settlements of accounts connected to the Russian Federation. In addition, an increasing number of Russian banks have been banned from SWIFT, the global messaging system for financial transactions. The conversion between the Russian rouble and other currencies is, as at the date of publication of this Annual Report, not possible in most cases.

Following the sanctions, imposed by the EU on NSD, the major clearing systems Euroclear and Clearstream block the amounts payable through NSD, thus holders of GDRs traded on the Moscow Exchange may have difficulties with receiving dividends, if such dividends are paid through Euroclear and Clearstream clearing systems.

Controls and mitigating factors

Management is closely monitoring the situation with the assistance of legal and tax consultants and is ready to act depending on the developments. In addition, management will seek to maintain an open and constructive dialogue with any regulators to discuss any developments as they arise.

Constraints and Risks to Growth Strategies

Description

Business growth can be constrained by an increase in prices for new rolling stock and spare parts, underproduction of rolling stock, partial scrappage of the Group's rolling stock due to expiration of its useful life, sanctions imposed on Russian Federation and some Russian industrial groups, a limited supply of long-term funding, an increase in the cost of borrowing and/or adverse market conditions that can have a negative impact on the return on any investments.

Although the Group takes a conservative approach to investments, any deterioration in the market environment may negatively impact the profitability and payback period of investments in rolling stock, thus limiting the Group's return on its investments and ability to expand its business. Alongside pursuing organic growth strategies, the Group has expanded its operations through acquisitions in the past and may pursue more in the future if appropriate opportunities arise. The pursuit of an acquisition strategy entails certain risks, including problems with integrating and managing such new acquisitions. The expiry of long-term Service Contracts with its key customers may also limit the Group's growth opportunities as these may result in volatility in logistics, a reduction in the Group's business volumes and/or profitability of its operations.

Controls and mitigating factors

Any acquisition of rolling stock is matched against projected demand for railway transportation and the economically viable expected payback period for such investments. The Group cooperates with numerous rolling stock producers in Russia and other CIS countries without placing too much reliance on any particular supplier. The Group is also focused on the diversification of its business. Any valuation of an acquisition target is subject to review by external advisers, and fairness opinions are normally provided by reputable appraisal companies to the Group's Board of Directors when a transaction is considered.

Risk Management

Competition and Customer Concentration

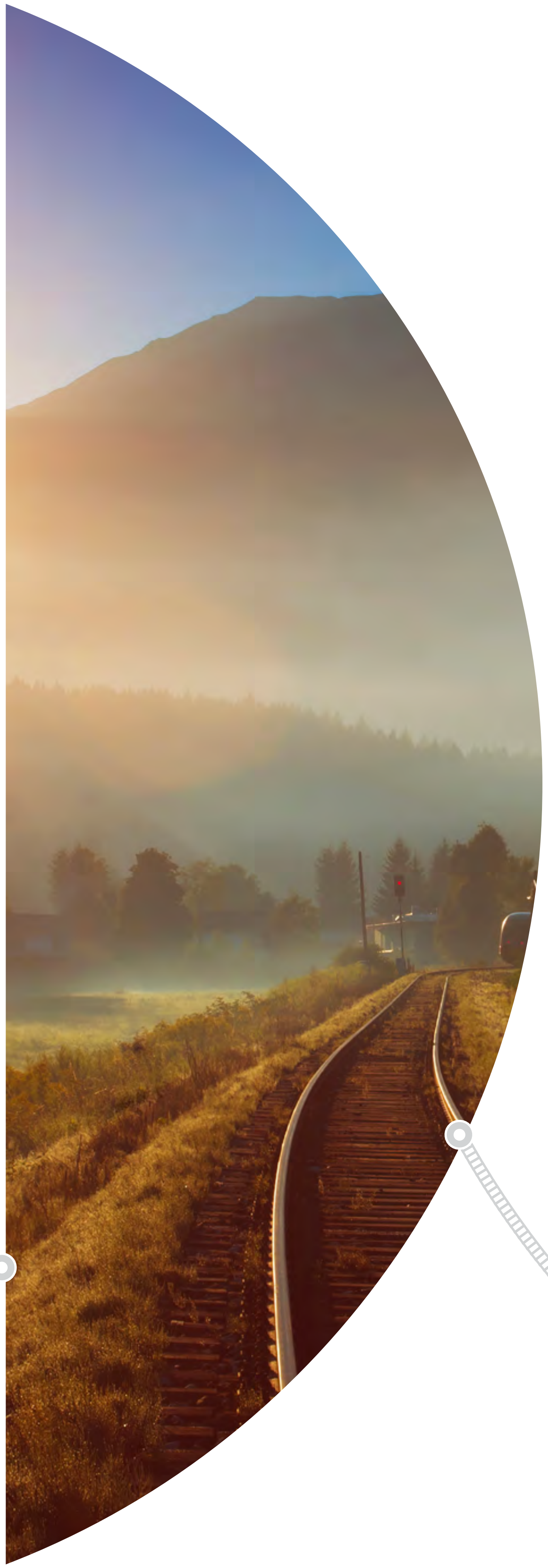
Description

The Russian freight rail transportation market is highly competitive in terms of unregulated operators' services tariffs. The ongoing market consolidation may lead to greater price competition. The risk of an irrational supply of railcars on the market by railcar producers and/or irrational behaviour of competitors (including new market entrants) may place additional pressure on the profitability of railcar operations and thus negatively impact the Group.

Competition between railway transportation and other means of transportation, including, but not limited to, oil product and oil transportation by pipeline, river and road, may negatively impact the Group's business volumes and profitability. The Group's customer base is characterised by significant concentration: the business is heavily dependent on a few large industrial groups and their suppliers, with its top 10 customers and their suppliers accounting for about 67% of the Group's Net Revenue from Operation of Rolling Stock in 2022. While the Group has long-term Service Contracts with several key customers, failure to extend and/or maintain the current Service Contracts or for such customers to no longer have the volume requirements they have had in the past may have a negative impact on the Group's operational results and financial performance.

Controls and mitigating factors

Globaltrans has significant competitive advantages that mitigate some of the risks of competition. These advantages include its strong reputation for high-quality service and reliability; its independent status; its long-term partnership with customers; its sophisticated operating capabilities; and its modern fleet. The Group has long-term, established relationships with its key customers and their affiliates and suppliers. In most cases, Globaltrans has become an integrated part of their operations. About 59% of the Group's Net Revenue from Operation of Rolling Stock in 2022 was covered by long-term Service Contracts with several large clients. Such contracts provide additional stability and greater certainty regarding transport volumes for the Group. Globaltrans continues its focus on expanding business with small and medium companies to further diversify its customer base. In 2022, the share of small and medium companies amounted to about 33% of Net Revenue from Operation of Rolling Stock (2021: 32%). Furthermore, the Group's marketing function regularly monitors competitors' business strategies, their use of technology, their price strategies and industry trends.



Locomotive Traction and RZD Authorisations

Description

The Group is dependent on RZD to issue permits allowing it to operate locomotives and to approve its use of locomotives for particular routes. If those routes are not in demand by the Group's clients, their utilisation could be lower. Furthermore, there is uncertainty about the prospects for, and the timing of, further deregulation of locomotive traction.

Controls and mitigating factors

The Group has a competitive advantage in providing freight rail transportation services to some clients, as it operates its own locomotives for the traction of block trains dedicated to particular routes. By assembling full trains composed only of its own railcars, the Group increases the speed and reliability of transportation for its clients. The Group has established controls to obtain the timely renewal of locomotive operation licences and the respective permits from RZD. The Group regularly monitors the progress of the reform relating to continued deregulation of locomotive traction. In addition, the Group's management actively participates in the development of the required regulation through various dedicated industrial organisations and partnerships.

Heightened Risk of Shareholder Activism

Description

GDRs of Globaltrans have been listed on the Main Market of the LSE since May 2008 (although trading has been suspended by the LSE since 3 March 2022) and on the Moscow Exchange since October 2020 with a free float of over 50%. Publicly traded companies are often subject to shareholder activism, and the Company's shareholders may seek to advocate for changes to corporate governance practices, social issues, or for certain corporate actions or reorganisations via media campaigns or other activities. Responding to these campaigns can be costly and time consuming and may have an adverse effect on the Group's reputation or ability to execute its business plan. In addition, the current geopolitical environment surrounding Ukraine and Russia may heighten the likelihood of these risks.

Controls and mitigating factors

The Group has an active shareholder engagement programme and seeks to maintain a constructive dialogue with the Company's major shareholders. Feedback from shareholders is provided to the Company's Board of Directors.

Risk Management

OPERATIONAL: RISKS THAT INFLUENCE THE GROUP'S OPERATIONAL EFFICIENCY

Current State and Quality of Infrastructure

Description

The rail network and physical infrastructure in Russia, owned and operated by RZD, as well as the networks and infrastructure of other countries on which the Group depends to operate its rolling stock, like Kazakhstan, Ukraine and other neighbouring countries, largely date back to the Soviet era. In some cases, these rail networks have not been adequately maintained, which could negatively affect the condition of the Group's rolling stock, performance and business. In addition, the oversupply of rolling stock, inefficient logistics at local destinations as well as maintenance and modernisation of rail infrastructure undertaken from time to time by RZD could negatively impact the average speed of transportation and therefore affect the operational performance of railcars. RZD tariffs for the use of the railway network and the provision of locomotive services are regulated by the FAS and are in principle "pass-through" items for the Group and other private freight rail operators. Meanwhile, RZD tariffs for the traction of empty railcars are in most cases a direct cost to the Group and other private freight rail operators. Significant upward changes in the regulated tariffs, whether as a result of annual indexation or changes in the tariff-setting methodology, could have an adverse effect on the Group's business. The railway infrastructure in Ukraine may also be partially damaged/destroyed following the military and political conflict between Russia and Ukraine.

Controls and mitigating factors

With immaterial exceptions, all of the Group's rolling stock is insured against damage. Moreover, as a freight carrier on the railway network, RZD bears full responsibility for third party losses caused by accidents on the network. The Group monitors its rolling stock through its dispatch centre on a 24/7 basis and plans its routes accordingly to optimise logistics and minimise the risks of disruption. The Group monitors FAS initiatives to detect possible changes in tariff-setting methodology and tries to reflect relevant changes in contracts with customers.

Risks to Operational Performance, Including Inflationary Pressures

Description

Rising inflation in Russia and an increase in prices for spare parts and railcar repair works may increase the Group's costs and maintenance CAPEX, while the Group may have limited opportunities to increase tariffs to customers.

Controls and mitigating factors

Among the Group's key objectives are to increase operational efficiency and to focus on controlling and reducing costs. The Group seeks to diversify and control its supply chain to maintain cost efficiency.

Employees

Description

The Group's future success will partly depend on its ability to continue to attract, retain and motivate key employees and qualified personnel, in particular an experienced management team and logistics and railway experts. Competition in Russia for such personnel with relevant expertise is intense due to the small number of qualified individuals with suitable practical experience in the rail industry.

Controls and mitigating factors

Adequate remuneration packages, which are in line with or above market levels, are offered to all employees and key managers and the remuneration of key managers is linked to the Group's financial results. The human resources function regularly monitors salary levels and other benefits offered by competitors to ensure that the Group's remuneration packages are appropriate.

Customer Satisfaction

Description

Customers rely on the Group for the provision of high-quality freight rail transportation and other related services and expect the Group to be commercially responsive to their needs. These include the timely collection and delivery of cargo and availability of rolling stock, which is not always within the direct control of the Group because it is dependent upon RZD for locomotive traction and maintenance of infrastructure. Accordingly, timely delivery of cargo is highly dependent on a third party whose performance could be unsatisfactory to the Group's customers.

Controls and mitigating factors

The Group has a strong reputation for delivering good quality, reliable and flexible freight rail transportation services to its customers. Customer satisfaction is one of the key metrics that the Group's management monitors. Each customer is assigned an account manager responsible for the day-to-day relationship with that customer. Customer feedback is analysed and appropriate follow-up actions are taken. The Group has a track record of high customer retention and the majority of key customers stay with the Group for many years. In addition, the Group serves several key clients on a long-term basis and has recently added new contracts and extended others. The Group will also continue to monitor its third party service providers to ensure satisfactory performance standards are being met.

IT Availability/Continuity

Description

The Group uses specialised rail transport and logistics software to ensure the efficiency and effectiveness of its logistics, dispatching and rolling stock tracking services. These systems are either licensed to the Group and then customised to the Group's needs or delivered to the Group and maintained for its needs by third parties under service agreements.

Due to recent sanctions imposed by the US, the European Union, the United Kingdom and a number of other countries, a number of IT solutions used by the Group will no longer be maintained by American, British and European Union suppliers.

Risk Management

The Group may potentially face risks related to access privileges, audit trails, authentication, authorisation, backup procedures, business continuation, change management (software and hardware), data integrity, disaster recovery, infrastructure, information/data security and cyber-attacks. The Group may lose access to IT products if third party providers do not renew commitments under existing or expiring service agreements. Further systems and products that the Group uses could cease to be maintained by third party service providers, requiring the Group to adopt new systems or products.

Controls and mitigating factors

Local IT specialists have introduced solutions to maintain the availability and proper licensing of IT services and ensure their recovery in case of disruption. Where applicable, the Group is working to identify and engage alternative suppliers of IT solutions. The IT function and internal audit function monitor all IT-related activities and performance for compliance with IT policies and procedures as well as regularly reviewing and maintaining business continuity plans and procedures.

Risks of Terrorist Attacks, Natural Disasters or Other Catastrophic Events Beyond the Group's Control

Description

The Group's business operations could be adversely affected or disrupted by terrorist attacks, natural disasters (such as earthquakes, floods, tsunamis, hurricanes, fires or typhoons) or other catastrophic or otherwise disruptive events — including changes to predominant natural weather, sea and climatic patterns, piracy, sabotage, insurrection, military conflict or war, riots or civil disturbance, radioactive or other material environmental contamination, an outbreak of a contagious disease or changes to sea levels — which may adversely affect global or regional trade volumes or customer demand for cargo transported to or from affected areas, or lead to denial of the use of any railway, port, airport, shipping service or other means of transport and disrupt customers' logistics chains. In addition, the Group may be exposed to extreme weather conditions such as severe cold periods and icy conditions that disrupt activities in ports that are destination points for customer cargoes. Furthermore, many of these events may not be covered by the Group's insurance or any applicable insurance may not adequately cover any resulting losses.

The Group's rolling stock could be adversely affected by unlawful acts in Russia or neighbouring countries. The occurrence of any such events may reduce the Group's business volumes, cause idle time for its rolling stock or disruptions to its operations in part or whole, subject the Group to liability, impact its brand and reputation and otherwise hinder normal operations. This could have a material adverse effect on the Group's business, results of operations or financial condition.

Controls and mitigating factors

The Group's rolling stock is insured against damage, and the responsibility for third-party losses caused by accidents on the network lies with RZD. The Group consistently monitors any disruptive events and applies a business continuity policy to:

- Ensure the safety of employees and human life;
- Maintain continuity of time-critical services;
- Minimise disruptions to clients and partners;
- Minimise the operational, financial and reputational impact.

COMPLIANCE: RISKS THAT INFLUENCE THE GROUP'S ADHERENCE TO RELEVANT LAWS AND REGULATIONS

Pending and Potential Legal Actions

Description

The Group is involved in legal actions from time to time. Such actions may have an adverse effect on the Group. The ambiguity of the law in Russia and CIS countries creates regulatory uncertainty and could result in claims from government authorities not expected by the Group.

Controls and mitigating factors

The Group runs its operations in compliance with tax, currency, sanctions, labour, customs, antimonopoly and other applicable legislation and constantly monitors any changes in the regulatory environment. The Group monitors its compliance with the terms of its agreements. Standard forms of agreements are used for transportation services, and various controls are in place to ensure that the terms of agreements are adhered to. All contracts are subject to rigorous review by all of the Group functions concerned and to a formal approval process prior to execution.

ESG Risks

Description

ESG risks include those related to climate change impacts mitigation and adaptation, environmental management practices, environmental protection and duty of care, working and safety conditions, respect for human rights, gender equality, supporting a culture in which all relevant stakeholders are valued and respected, compliance with relevant laws and regulations and ensuring compliance with regulations governing the protection of human rights, operational and occupational health and safety, and ESG practices in the jurisdictions in which we operate.

Controls and mitigating factors

Although rail is one of the greenest modes of transport, the Group is committed to the protection of the environment by seeking to reduce the environmental footprint of its business and develop a sustainable supply chain. The Group aims to ensure compliance with regulations governing the protection of human rights, operational and occupational health and safety, and ESG practices in the jurisdictions in which the Group operates. The Group promotes high ethical standards and respect for human rights. In January 2021, the Group formally adopted an ESG policy and also established the ESG Committee of the Board of Directors. The main purpose of ESG Committee is to oversee the development and implementation of the corporate environmental and social responsibility initiatives of the Group, monitor and review activities, and make recommendations to the Board of Directors of the Company on actions needed to address any issues identified or to make improvements where desirable.

More information on climate-related risks is available in the Sustainability Report on pages 94 to 99.

Risk Management

Compliance with Regulations and Sanctions

Description

The Group functions in several jurisdictions, including Cyprus, Russia and Ukraine. In addition, the Group has its GDRs listed on the LSE (although the LSE suspended trading of the Group's GDRs on 3 March 2022 and such suspension remains in place) and the Moscow Exchange. Thus, the Group is subject to the laws and regulations of those countries in which it is active, the regulations of stock exchanges on which its securities are traded and any applicable sanctions legislation, all of which may change from time to time. As a result of the situation in Ukraine, the United States, the European Union, Ukraine, the United Kingdom and a number of other countries have imposed heightened sanctions and restrictions on numerous Russian businesses, banks and individuals.

Controls and mitigating factors

The legal and compliance teams of the Group together with the external lawyers engaged by the Group monitor the applicable requirements in each of jurisdiction in which it is active and stock exchanges on which its securities are trading, including monitoring US personal and sectoral sanctions (SDN OFAC, SSI OFAC and CAATSA), EU and UK sanctions lists, special regulations imposed by the Russian authorities and the appropriate controls are in place to ensure that all subsidiaries of the Group comply with applicable regulations.

Fiscal Risk from Evolving Legal and Tax Regimes

Description

Local tax, currency and customs legislation, especially in Russia, other emerging markets and Cyprus, may be subject to varying interpretations, inconsistencies between federal laws, regional and local laws, rules and regulations, frequent changes and a lack of judicial and administrative guidance on interpreting legislation. Any increase in applicable tax rates, as well as introduction of new taxes in the countries where the Group is active, may reduce the profitability of the Group.

Controls and mitigating factors

The Group has controls in place, including highly qualified and experienced personnel, to monitor changes in legislation and determine the appropriate action needed to minimise the risk of a challenge to such treatments by the authorities. For complex matters, the Group engages and cooperates with external consultants and law firms.

Impact of Brexit and Takeover Regulations

Description

From 1 January 2021, as a result of the end of the transitional period following the United Kingdom's exit from the European Union, as a company organised under the laws of Cyprus, the Takeover Panel no longer exercises shared jurisdiction over transactions involving the Company which would otherwise be subject to the Takeover Code, including takeover bids, merger transactions, or schemes of arrangement resulting the change or consolidation of control over the Company. In addition, from 1 January 2021, the LSE (where the Company's GDRs are admitted to trading) is no longer a regulated market as defined in Directive 2014/65/EU of the European Parliament and of the Council on markets in financial instruments; as a result, the legislation in Cyprus regulating takeovers, including those requiring mandatory takeover offers in certain situations, no longer applies to the Company.

Controls and mitigating factors

The absence of Takeover regulations applicable to the Company allows existing significant shareholders, or persons acting in concert, to increase their holdings (or new significant shareholders, or persons acting in concert, to acquire more than 30% of the outstanding share capital of the Company) without being obliged to make a mandatory tender offer to other shareholders. The Group monitors developments in applicable regulations, making appropriate disclosures of any relevant new regulations and will make all required notifications of significant shareholdings (or changes in respect of such shareholdings) in the Company.

Risk Management

FINANCIAL: RISKS THAT INFLUENCE THE GROUP'S FINANCIAL PERFORMANCE

Currency Risks

Description

Currently, the Group has neither borrowings nor lease liabilities denominated in US dollars and therefore does not have formal arrangements for hedging foreign exchange risk with the exception of hedging foreign currency risk associated with dividend payments that are considered highly probable and the associated dividends payable that are declared in Russian roubles and paid in US dollars until their settlement. The Group may however keep bank balances in US dollars and other currencies. The Group therefore has limited exposure to the effects of currency fluctuations on bank balances between the US dollar and the Russian rouble.

Controls and mitigating factors

A large proportion of the Group's revenues and expenses are denominated and settled in Russian roubles. At present, the risks related to liabilities denominated in foreign currency are not material and are partly compensated for by assets and income denominated in foreign currency. The Group has refinanced all of its liabilities denominated in US dollars with long-term debt denominated in Russian roubles. Since 2008, the Group has taken action to mitigate currency risks and adjusted the profile of the borrowings in its credit portfolio. As of 31 December 2022, all of the Group's debt was denominated in Russian roubles.

Interest-rate Risks

Description

The Group's income and operating cash flows are exposed to changes in market interest rates. These arise mainly from floating rate lease liabilities and borrowings. An increase in market interest rates in Russia may negatively influence the Group's profits.

Controls and mitigating factors

The Group enters into long-term borrowing and leases with financial institutions to finance purchases of rolling stock and acquisitions of subsidiaries. The Group borrows at current market interest rates and does not use any hedging instruments to manage the interest-rate risk. Management monitors changes in interest rates and takes steps to mitigate these risks as far as practicable by ensuring that the Group has financial liabilities with both floating and fixed interest rates as appropriate. As of 31 December 2022, all of the Group's debt was at fixed interest rates. Management also considers alternative means of financing.

Credit Risk

Description

Financial assets that potentially subject the Group to credit risk consist principally of trade receivables, cash and cash equivalents. Furthermore, the Group's business is substantially dependent on a few large key customers, including their affiliates and suppliers. Its top 10 clients accounted for about 79% of the Group's trade and other receivables as of 31 December 2022 and about 67% of the Group's Net Revenue from Operation of Rolling Stock in 2022.

Controls and mitigating factors

The Group has policies in place to ensure that sales of goods and services are made to customers with an appropriate credit history. Substantially all of the Group's bank balances are held with reputable banks. The Group also continues to explore opportunities to diversify its customer and supplier base.

Liquidity Risk

Description

The Group's business is capital-intensive. The current situation in Ukraine and the resulting increased and intensified sanctions imposed by the United States, the European Union, the United Kingdom and numerous other countries on Russia have had a negative impact on the Russian financial markets and have limited the Group's access to international sources of funding. Any lack of available funding and potential increases in market interest rates could have a negative impact on the Group's ability to obtain financing for the settlement of its liabilities or cash to meet its financial obligations.

Controls and mitigating factors

The Group has a budgeting policy in place that allows management to control current liquidity based on expected cash flows. These include, among other things, operating cash flows, capital expenditure needs, funds borrowed from financial institutions and funds raised from listed debt instruments. Management continues to monitor the current environment and its potential impact on liquidity.