

Financial risks

FINANCIAL RISKS

The Company's financial risks include:

- Market risk
- Credit risk
- Liquidity risk

MARKET RISKS

Aeroflot considers the following market risks to be the most substantial:

Price risk, which refers mainly to prices for aviation fuel, which are linked to world oil prices. Aviation fuel accounts for more than 30% of total Company expenditures, and an increase in aviation fuel prices by 1% per year on average increases Aeroflot's total expenditure by almost RUB 500 million. The Company hedges a part of its fuel price risks. At the end of 2012 prices for about 20% of the total monthly consumption of aviation fuel were hedged.

Currency risk, which arises due to exchange rate fluctuations and can have material impact on financial results of the Company, since the Aeroflot sales network consists of agencies located in different countries, which carry out settlement in different currencies. At the end of 2012 exchange rates were in favour of the Company (strengthening of the euro, weakening of the dollar). The Company hedged a substantial share of its foreign currency income in 2012.

Interest-rate risk is the risk of exchange rate changes, which can lead to increase in the cost of borrowing (increase of Company spending on interest payments). In order to reduce its exposure to interest-rate risks, the Company carried out an interest-rate swap transaction in 2011 for transfer of a floating LIBOR rate to a fixed rate. The instrument currently covers about 30% of the Company's total leasing portfolio. The impact of interest-rate risks on Company business is judged to be minimal, but the risks of interest rate increases remain in force for 2–3 years.

CREDIT RISK

Credit risk arises in situations when counterparties are unable to meet their financial obligations to Aeroflot.

Aeroflot minimizes its risks associated with air transport sales by using a systematic approach to credit risk management based on methods for identification of potential credit risk, which have been developed by the Company. These include:

- methods for calculating the amount of financial security in sales of transportation services and for calculation of Aeroflot's credit risk;
- methods for calculating limits for credit institutions, which provide a service to Aeroflot and which issue guarantees for the Company;
- methods for rating of agents, which sell passenger transportation services in Russia.

These methods are consistently applied to Aeroflot's entire agent network and may also be applied with respect to electronic sales through agents using the Transport Clearing Chamber and BSP sales systems, who make bilateral settlements or carry out settlement through the IATA clearing center.

The Company constantly monitors the financial situation of agents in order to ensure efficient management of credit risks. Forms of financial security used in sales of air transportation services through the agent network include bank guarantees and deposits.

LIQUIDITY RISK

Liquidity risk refers to possible inability by the Company to perform its obligations to counterparties.

Aeroflot's financial departments follow a carefully planned schedule of cash inflow and outflow in order to identify shortfalls in advance and rectify them through short-term borrowing from the Company's partner banks.

Aeroflot carried out a number of measures during 2012 in order to enhance liquidity:

- limits were increased on credit, deposit and conversion transactions with financial institutions;
- more banks were added to the list of institutions, with which short-term credit, deposit and conversion transactions can be executed using the Reuters Dealing system;
- the financial activities of Aeroflot offices in Russia were centralized, and payments through offices abroad were centralized to the maximum possible extent.