

JSC “Ukrainian Railways” Strategy

for 2019-2023



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Executive summary

Objectives

This document outlines the strategic orientations, choices and priorities for JSC “Ukrainian Railways” (the “UZ” and/or the “Company”) and the envisioned process to implement them for the 5-year planning horizon, 2019-2023 .

Once the necessary support for the Strategy is secured from the stakeholders of UZ, and from the Shareholder in particular, the Company will develop in the ensuing few months an Implementation Plan with the requirements regarding resource, capacity and time-frame and monitor its implementation . This process will be ensured by the Supervisory board.

The Strategy is aimed at achievement of the following overarching objectives:

- Meeting Ukraine’s needs for rail transportation and logistics commensurate with its plans for economic development and mobility of its citizens.
- Achieving and maintaining a strong financial performance and position of the Company enabling the necessary investments in the Company’s core business.
- Ensuring safety of the railway for customers, employees and third parties.

- Increasing the satisfaction of the Company’s customers and employees.
- Implementation of modern and effective management practices and principles.
- Increasing transparency and compliance with the law towards elimination of corruption and malpractice.

Key challenges and constraints

There have been major changes taking place in freight transportation flows. This, combined with the following cross-cutting issues, represent the most important challenges and constraints to the realization of the present Strategy:

- scarcity of available financial resources for necessary investments;
- political and vested interest interference;
- ingrained ineffective geographic structural make up and practices
- general resistance to change.

Significant under-investment due not only to the poor financial and operational performance, but also to the non-market discretionary system of regulated tariff setup and lack of government

funding during last several years, led to the present poor condition of assets, and consequently the services. This situation was exacerbated by the lack of compensation for the loss-making passenger transportation services. UZ has also suffered from a lack of market orientation and deteriorating operational efficiency.

Upcoming liberalization of third party access to railway infrastructure can constitute both an opportunity and a threat for the Company. UZ faces an urgent need to significantly increase the level of labour productivity through modernization of equipment, optimization of processes and stimulation of operational excellence by introduction of modern incentive systems and increased dialogue.

Anticipated results

Satisfaction of Ukraine's transportation requirements both quantitatively and qualitatively.

Put the Company on sound financial basis through (i) reform of freight tariffs that shall cover Company's cost base timely reflecting market price dynamics (e.g. linking freight tariff to PPI index on quarterly basis) with additional limited margin so as to enable Company's to invest and keep its operating

assets in good shape, (ii) eliminating internal inefficiency by improving business practices to best international standards.

Significant improvement in asset productivity through long-term financial and investment planning and operational efficiency.

Establishing efficient, effective and modern process-oriented management systems.

Ensuring attractiveness of UZ as an employer through implementation of good working and compensation conditions and maintenance of high professional standards.

Ensuring implementation of Safety Management System according to the standards of the European Union and of modern practices for employee health and safety.

Transformation of UZ from a quasi-monopolistic enterprise into a "market-driven, competitive leader" with a transparent structure cleansed of corruption.

1

General part

1.1. Introduction

UZ is a rail infrastructure operator as well as a national freight and passenger carrier involved in performing a strategic function towards the economic development and security of Ukraine. Some parts of its operations constitute a natural monopoly.

Currently, the company provides 65% of transportation within the general structure of freight transportation by all modes of transport, and more than 35% of passenger transportation within the general structure of transport work performed by all modes of transport, not including municipal electrical transport. By volumes of freight transportations, UZ takes the fourth place on the Euro-Asian continent, after the railways of China, Russia and India.

UZ is one of the largest employers of Ukraine. Approx. 260 500 employees, or 1.6% of all employed in Ukraine, work in the Company. Up to 2.6% of Ukraine's GDP is produced by UZ.

The Company is the legal successor to all rights and obligations of the State Administration of Railway Transport of Ukraine as well as of subordinate enterprises and establishments which had a status of separate legal entities has started its business activities on 1 December 2015.

Evolving needs of the Ukrainian economy and the changes in the role of automobile, aviation and river transport necessitate qualitative changes in the Company to determine key lines of development in the mid-term perspective.

The purpose of the adoption of a new strategy for development of UZ for 2019 – 2023 (the "Strategy") is the definition of the Company's corporate-wide targets, which will be understandable to and accepted by its stakeholders, and to concentrate efforts to achieve them by implementing the necessary initiatives.

In developing the Strategy, a balanced and comprehensive approach is used to the definition of targets, in order to take into account the interests of UZ and its main stakeholders, namely the state, customers, suppliers, investors and Company employees, as well as strategic documents of the government (e.g. National Transport Strategy until 2030).

While achieving strategic objectives the essential role of the railway in the defence system of the country should be kept.

1.2. Mission, Vision and Values

1.2.1. Mission

To build a stable and prosperous business dedicated to support the development of Ukraine’s economy and the well-being of our employees by providing best-in-class quality, safe, reliable, efficient, competitive and customer-oriented railway transportation services.

1.2.2. Vision

- UZ is an undisputable leader in the transportation and logistics sector by providing high-quality and economically attractive services.
 - UZ efficiently performs the role of the lead carrier of passengers and freight and effectively manages the railway infrastructure satisfying the demand of the population and economy for transportation.
 - UZ is a leading socially responsible company attractive to employees, reliable and open partner for the society.
 - UZ reaches all the targets as described in the SP by 2023.
-

1.2.3. Expectations of main stakeholders

Freight/Logistics customers:

- Increase in the speed and punctuality of delivery of freights;
- Increase in reliability and availability of transportation by rail;
- Transparent rules of the game;
- Improve the service quality;
- Keep costs of delivery of freights by rail at competitive levels;

- Increase of the safety and security of rail transportation.

Passengers:

- Improve the value attractiveness;
- Punctuality and decrease in travel time;
- Improve comfort and cleanliness level;
- Increase the transport system integrity;

- Improve the level of safety.

Employees:

- Clear targets and definition of personnel functions;
- Closer correlation of remuneration to the achievement of results;
- Enhance the level of social protection;
- Opportunities for professional development and career growth;
- Increase the level of social dialogue.
- Sustainable development of UZ employees and solution of their social and economic issues through the social dialogue with labour unions.

Financiers/Investors:

- Transparent, easy-to-understand structure and financial profile;

- Investment security and reliability and timeliness in performing obligations;
- Adequate return on investments commensurate with risks;

State*:

- Contribution to the national economic welfare;
- Increase in the value of business as well as in receipts to the budget;
- Increase in availability of transportation by rail;
- Minimization of the environmental impact;
- Increase in employment and social responsibility;
- Implementation of the structural reform of UZ.

1.2.4. **Values**

Efficiency and Results Orientation.

We are efficient and effective in running our business with a focus on results, developing our personnel and supporting the economy of the country.

Quality. We strive to have high quality of our services and management of the Company.

Responsibility. We care for our employees, partners and society on the principles of unconditional priority of safety in carrying out our

activities, as well as obeying the laws of Ukraine, and expecting from all of our employees to follow the same principles.

Unity. We work as a united, coherent team for achieving our common goals and results.

Openness and Integrity. We are transparent in opening decision-making and processes to a wide dialogue and collaboration, and act with professional and personal integrity.

* As owner and regulator as well as representative of interests of broad strata of society

1.3. Analysis of Strengths, Weaknesses,

STRENGTHS	OPPORTUNITIES
<ul style="list-style-type: none">• the national leader in a quasi-monopolistic structure in the rail-way transportation and logistics market, providing 65% of cargo turnover and 35% of passenger turnover in the country;• the ripeness of the prospects for implementing new transport and logistics services;• the developed railroad network covering the whole country;• the own capacity for production, repair and modernization of rolling stock;• the railways-dependent structure of Ukraine’s industry;• the major employer across the country and many regions;• Strong tradition of a railwaymen culture and accumulated high technical competence;• the free pricing for the private wagon services.	<ul style="list-style-type: none">• the government’s prioritisation of the long-term development of the rail transportation sector;• the government policy in support of intended structural reforms and transformation of Company and its management approach;• the prospect of deregulation of the tariff’s “locomotive component”;• the implementation of service rating system for railway infrastructure access providing the maintenance, restoration and development costs recovery;• large demand of railway transportation due to significant density of the population and poor condition of roads;• the governmental support for loss compensation of suburban transportation by concluding service agreements with local authorities;• Initiative of the government to implement the compensation of losses of the long-distance passenger transportation from the State budget• the participation of the state and local authorities in financing the renovation of passenger rolling stock;• the participation of private inves-tors in the development of railroad complexes;• the increase in the volume of trade with the EU;• the increase of productivity and growth prospects for the iron ore and steel industry;• the increase in demand for the construction materials industry transportation.• the interest of the leading foreign manufacturers of rolling stock in entering the Ukrainian market;• the presence of domestic manufac-turers of wagons and passenger rolling stock• the increase in demand for interna-tional passenger transportation in the EU direction.• the excess of rail market demand over supply

Opportunities and Threats (SWOT)

WEAKNESSES	THREATS
<ul style="list-style-type: none"> widespread poor state of assets; and investment backlog; the high level of indebtedness; the failure to attract a sufficient private investment due to legislative restrictions, high political and financial and economic risks; the absence of the market-oriented state regulation of the railway transportation; the overcomplicated non-market driven bureaucracy; the high level of unreasonable social expectations; the high number of the administrative and other personnel; the large amount of social obligations (e.g. maintaining loss-making passenger transportation) in the absence of the governmental support; the lack of highly skilled personnel due to unsatisfactory salaries, poor educational and professional training; insufficient level of energy efficiency; the lack of sufficient funds, including investors' funds, and proper governmental support for capital renewals and implementation of priority investment projects; the internal and external resistance to implementation of effective policies and structural reforms; the range of unprofitable activities; the significant level of corrupt practices; the low level of purchasing power of the population, 	<ul style="list-style-type: none"> the reduction in total demand for high-yielding transit transportation; attempts to allow access to railroad infrastructure by third parties without a thorough, fair and coherent design and implementation of tariff system for this access, the locomotive component deregulation the lack of national manufacturers of traction rolling stock; the inefficient tariff setting mechanisms in the conditions of high inflation and national currency depreciation; the deficiencies in public procurement system from the Company's perspective; the failure to expand into new markets and attracting additional transportation load, including cargo in transit; the increase of competitive advantages of transportation by automobile, river and aviation transport; the staff loss to EU countries due to increase in employment opportunities in EU; the political uncertainties and frequent shift of development priorities, including adoption of regulations contradictory to the determined previously (e.g. railway land tax that was reduced in 2018 and returned back later that year); interjection of political, rather than economic, motivations into the issue of railway infrastructure optimization; the political influence on decision making process relating to the organization of unprofitable passenger transportation; the great social sensitivity to staff optimization, and labour productivity improvement measures; the lack of mechanisms to implement non-core assets divestments; the actual monopoly position of some suppliers of products used by the railways.

2

Market analysis

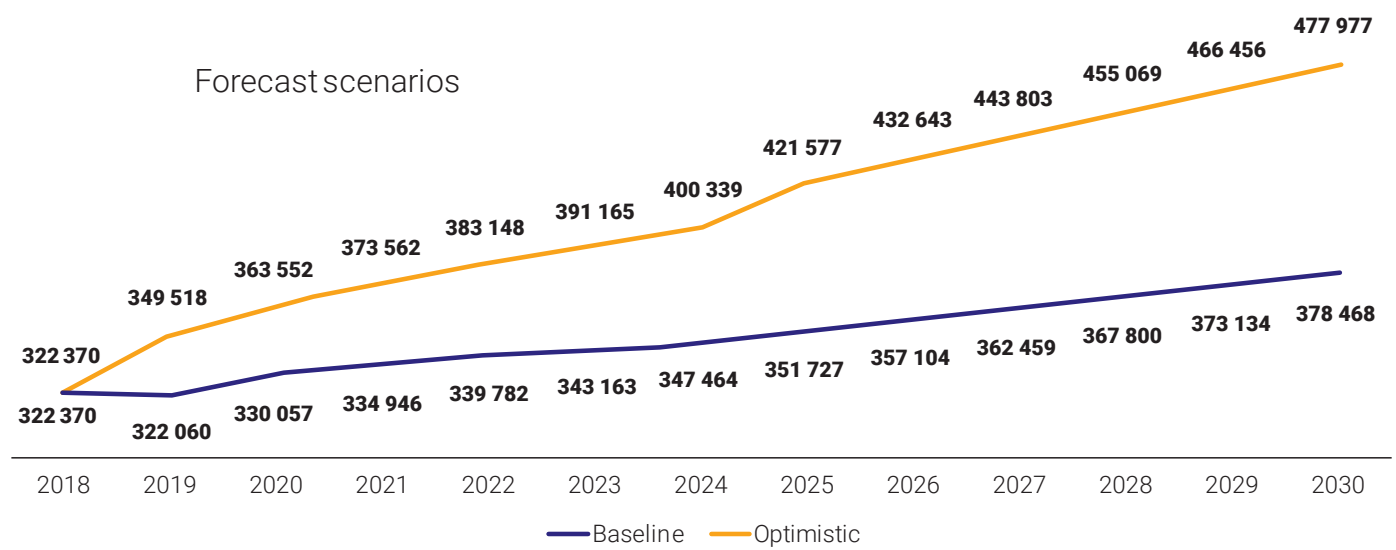
In order to forecast the freight traffic, a corresponding analysis of the market by connection and types of goods was carried out in two scenarios: basic and optimistic.

The forecast is made with the assumption that the structure of transportation by all modes of transport will remain unchanged.

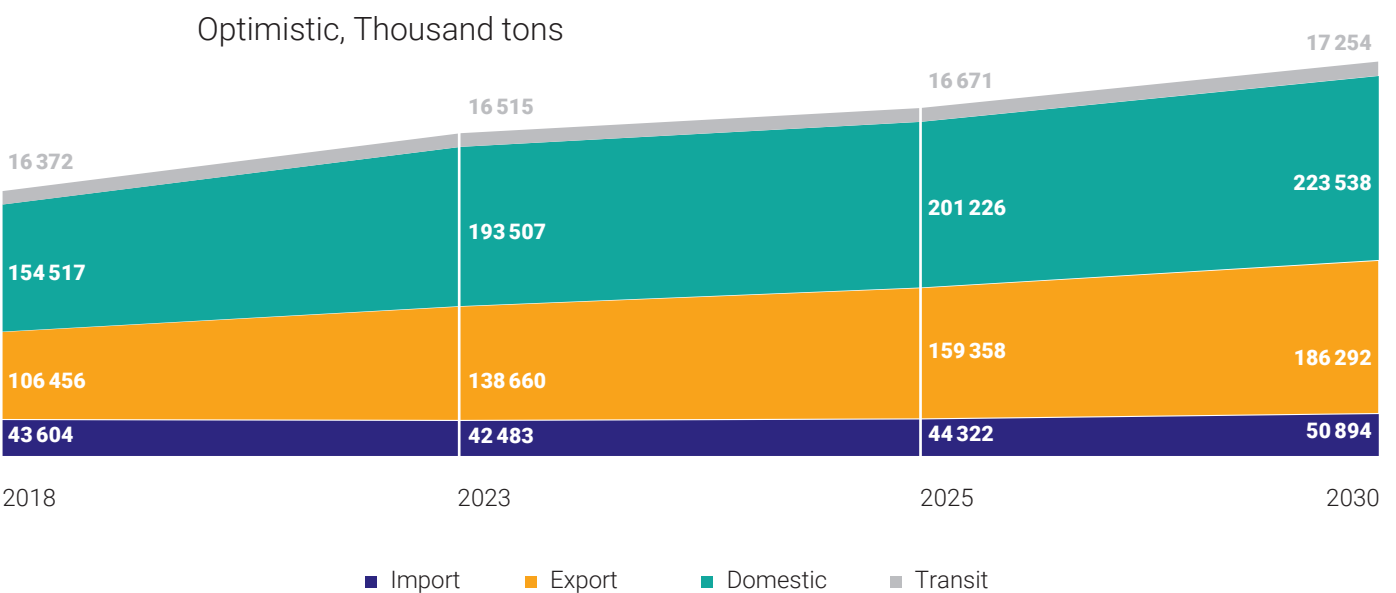
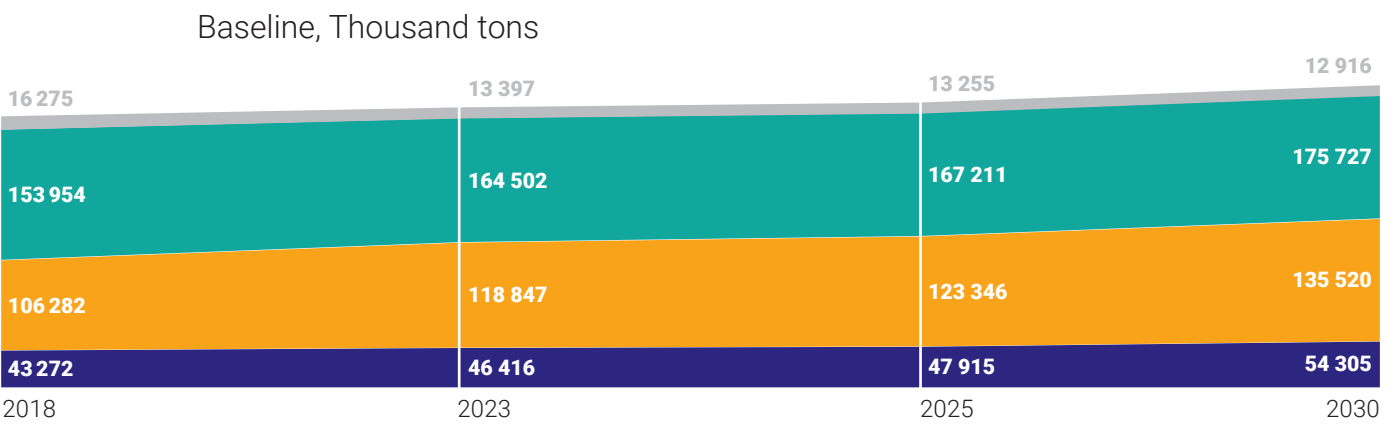
In case of the opening of the railway market, the forecast volumes will be distributed among the carriers. Open access to the infrastructure is not expected until 2022.

In order to satisfy increasing demand UZ will also increase the fleet of freight wagons in order to reach until 2023 share of freights that transported in wagons of UZ up to 50% (from 38% in 2018).

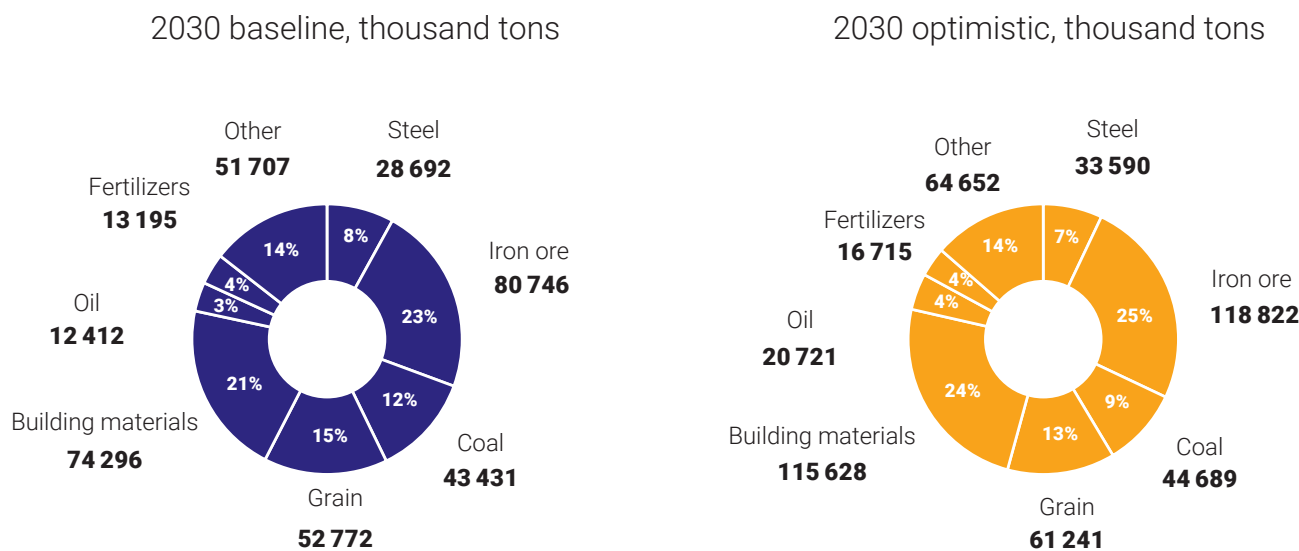
2.1. Demand forecast for rail transport



2.1.1. Forecast by the connection



2.1.2. **Forecast by the structure of goods**



2.2. **Forecast assumptions**

2.2.1. **Steel and iron ore**

The forecast for steel transportation was based on the OECD report “Steel Demand Beyond 2030”, which carried out an econometric model for the consumption of iron ores and metals.

Baseline scenario:

- 1,6% average annual growth for steel
- 0,4% average annual growth for iron ore

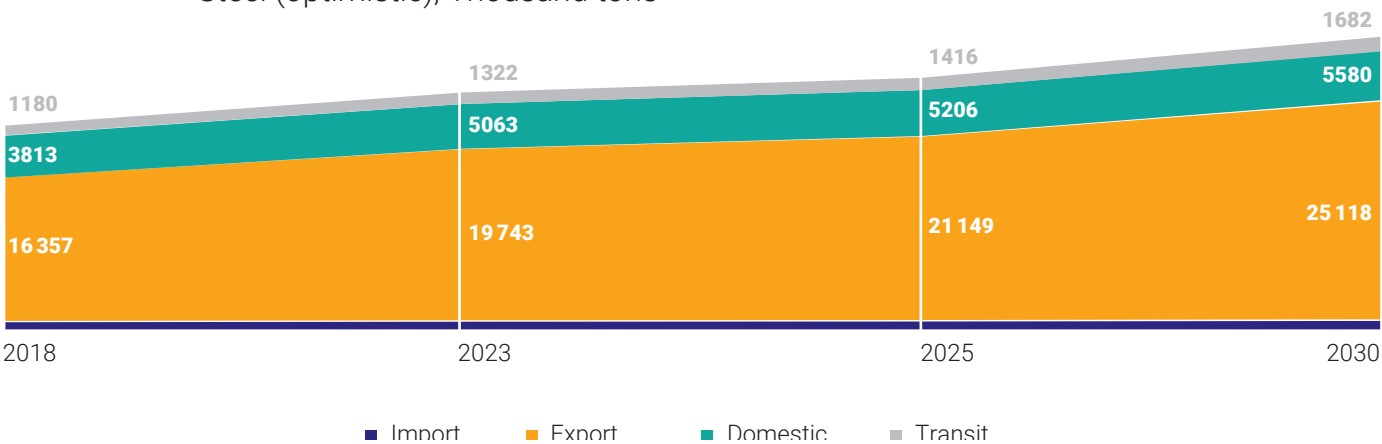
Optimistic scenario:

- 2,8% average annual growth for steel
- 3,4% average annual growth for iron ore
- Ferrexpo plans to double production until 2025 are considered.

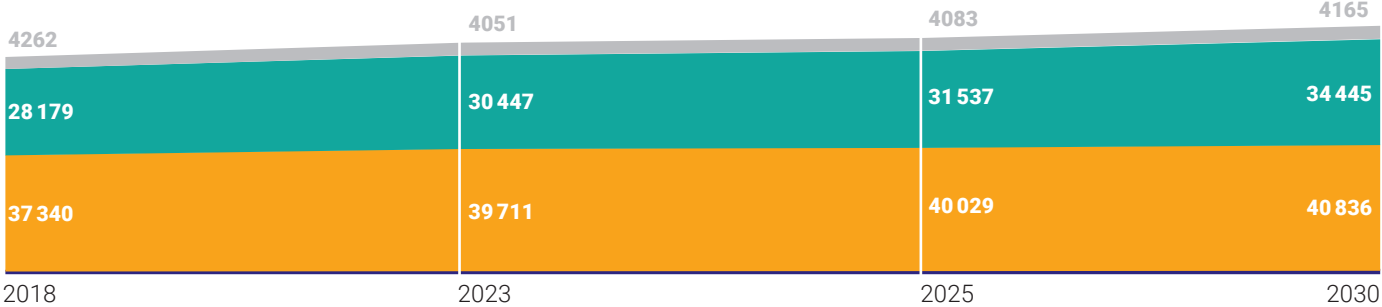
Steel (baseline), Thousand tons



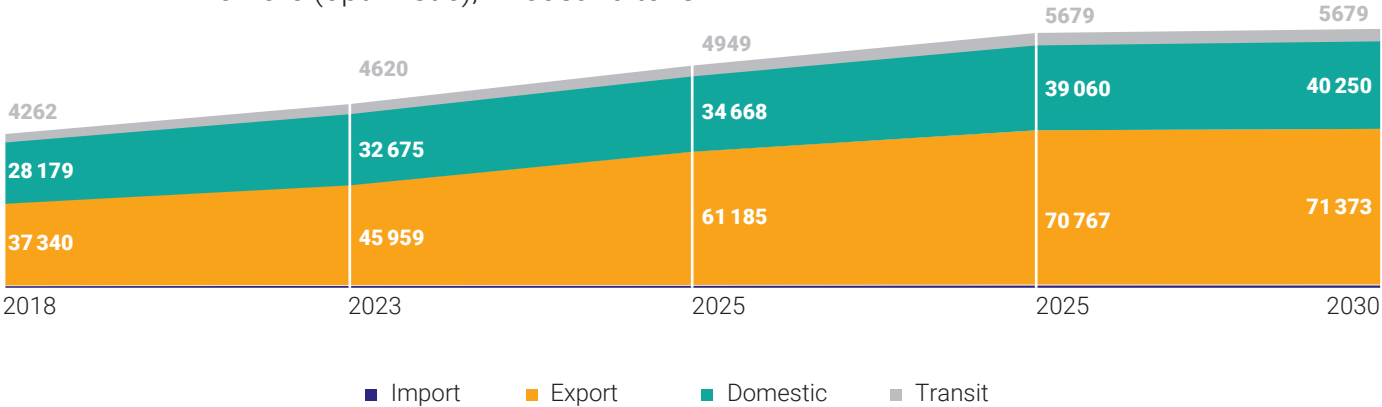
Steel (optimistic), Thousand tons



Iron ore (baseline), Thousand tons



Iron ore (optimistic), Thousand tons



2.2.2. Coal

The forecast includes «Energy strategy of Ukraine 2035»*.

Consumption of coal will decrease due to increase of efficiency of production and usage of alternative sources of electricity.

Baseline scenario:

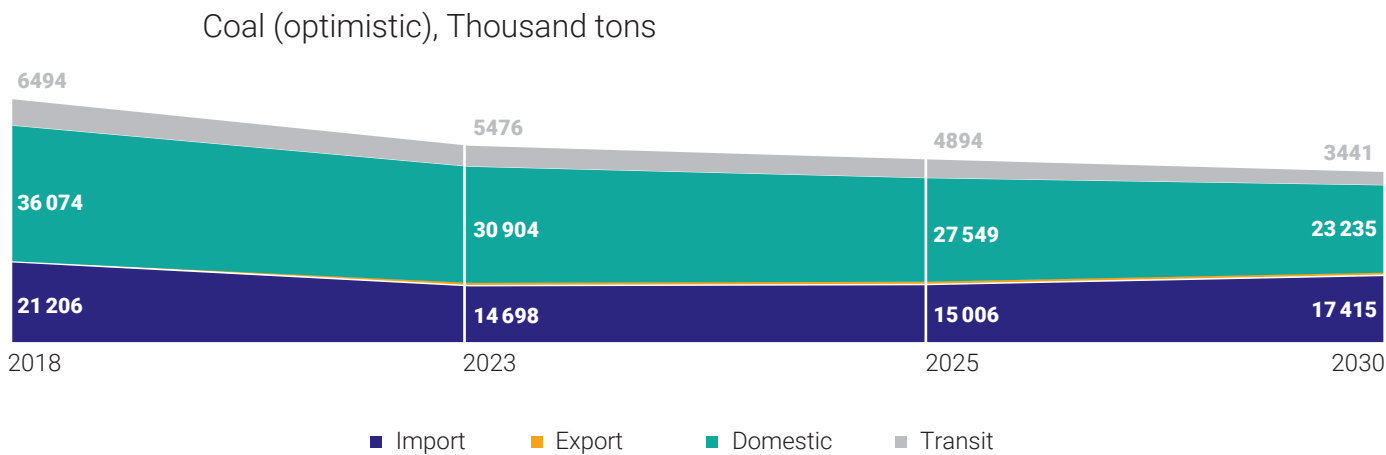
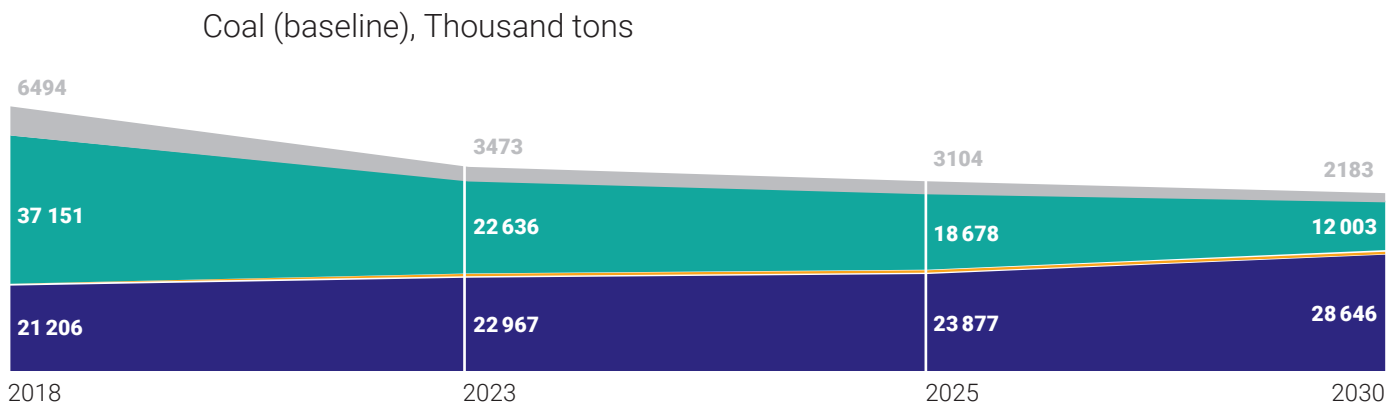
Continuous decrease of consumption

Coal is mainly imported

Optimistic scenario:

Continuous decrease of consumption

Domestic coal is used



* <http://zakon.rada.gov.ua/laws/show/605-2017-%D1%80>

2.2.3. Grain

Agriculture is one of the fastest growing sectors of Ukrainian economy. While not expecting large number of domestic consumption exports of grain and basic grain products (e.g. flour) will increase significantly.

Agricultural strategy of Ukraine 2020* is considered.

Baseline scenario:

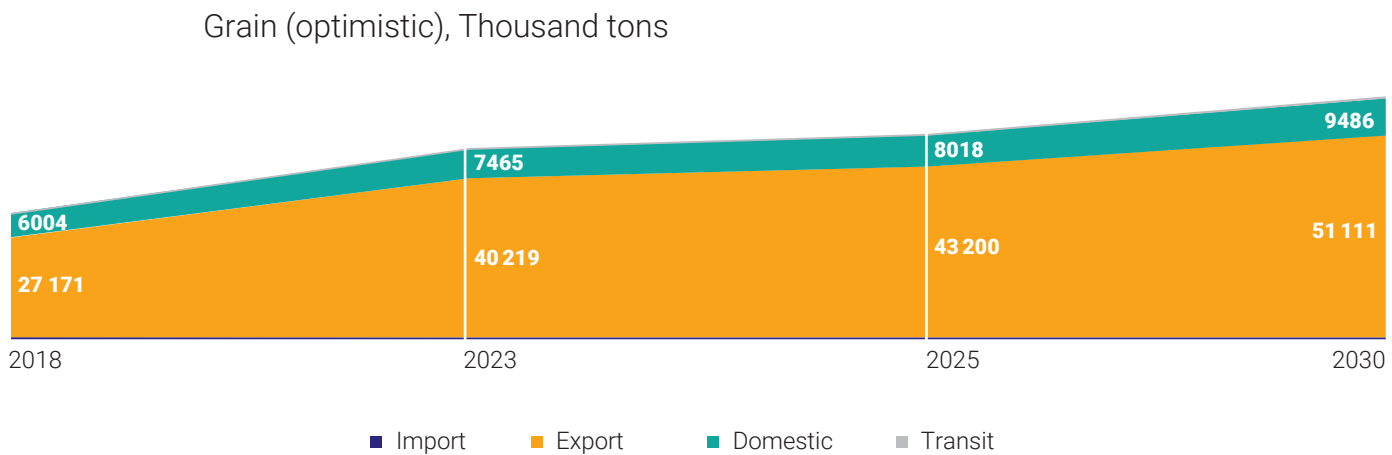
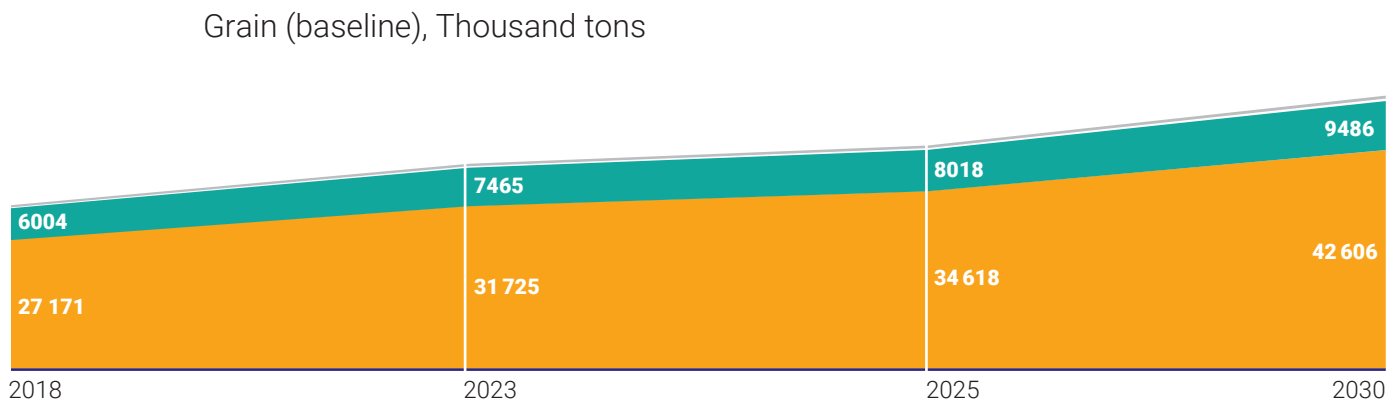
2019 yield will be slightly better than in 2018 (+5%)

Approx. 4,2% average growth per year

Optimistic scenario:

2019 yield will increase significantly (+10% to the level of 2017)

Approx. 6% average growth per year



* <http://zakon.rada.gov.ua/laws/show/806-2013-%D1%80>

2.2.4. Construction materials

Major part of transportation of crashed rock and sand depends on the activities of the State Road Agency.

Accordingly, the forecast of the budget of the State Road Agency has been made following the planned budget of road construction for 2019 with the increase in the future on the projected value of GDP growth in Ukraine.

For export GDP forecast for the key country partners (Italy, Russia) is used.

Baseline scenario:

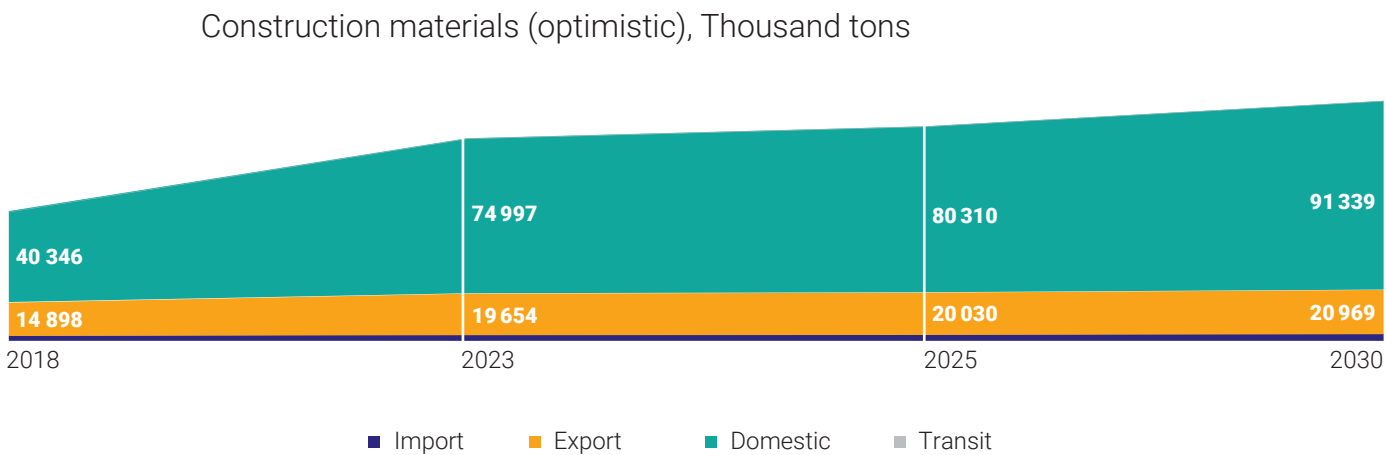
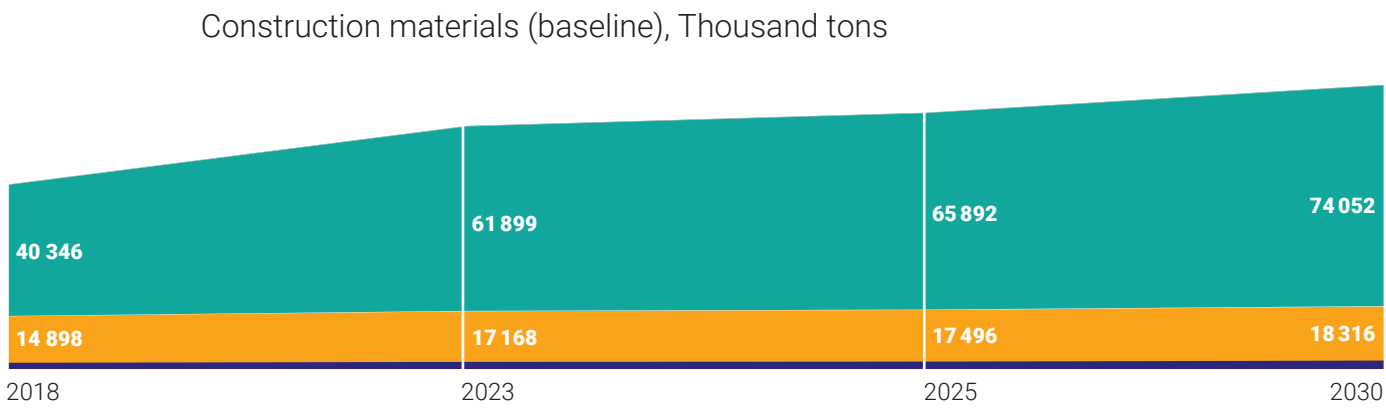
Realistic GDP and State Budget forecasts

3,7% average annual growth

Optimistic scenario:

Optimistic GDP and State Budget forecasts

5,5% average annual growth



2.2.5. Oil and oil products

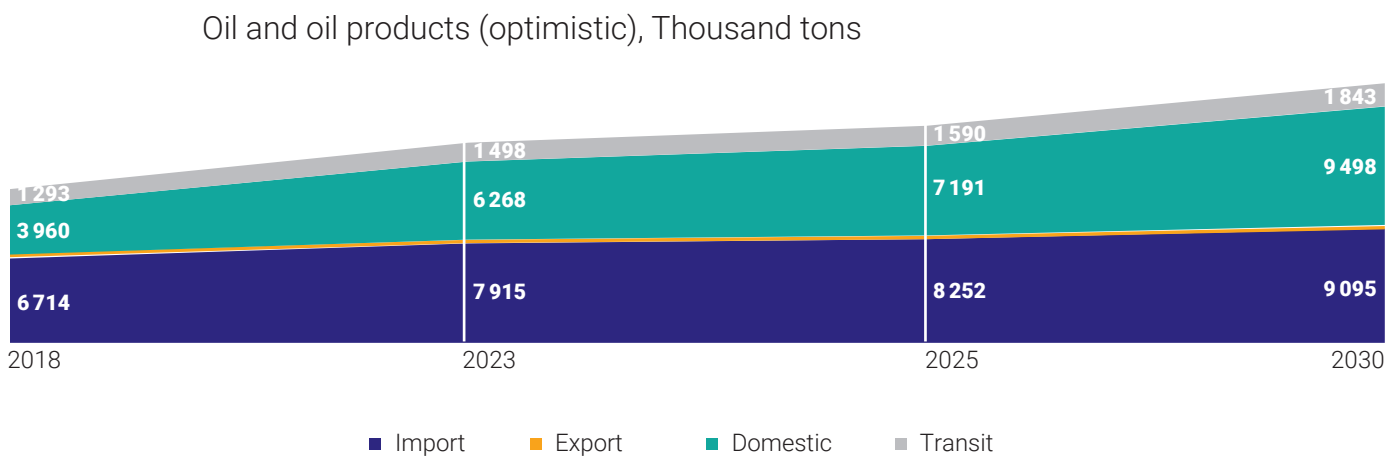
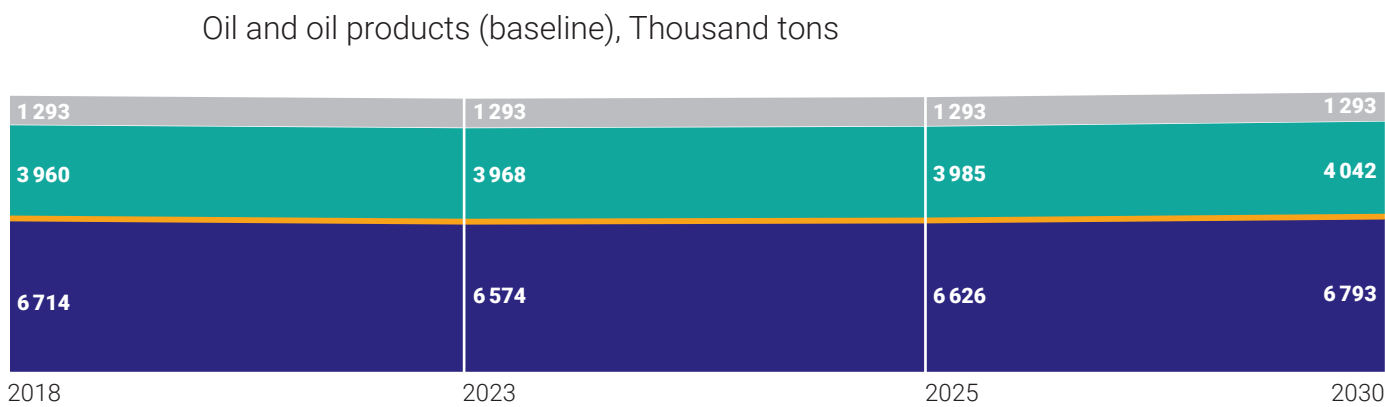
Current level of transportation of oil and products from oil is considered as a lowest possible level.

Baseline scenario:

Oil market stagnation with no new facilities and increased volumes.

Optimistic scenario:

Increase of consumption level and activation of Ukrainian oil refineries that will increase volumes of production, thus stimulating import and domestic transportation.



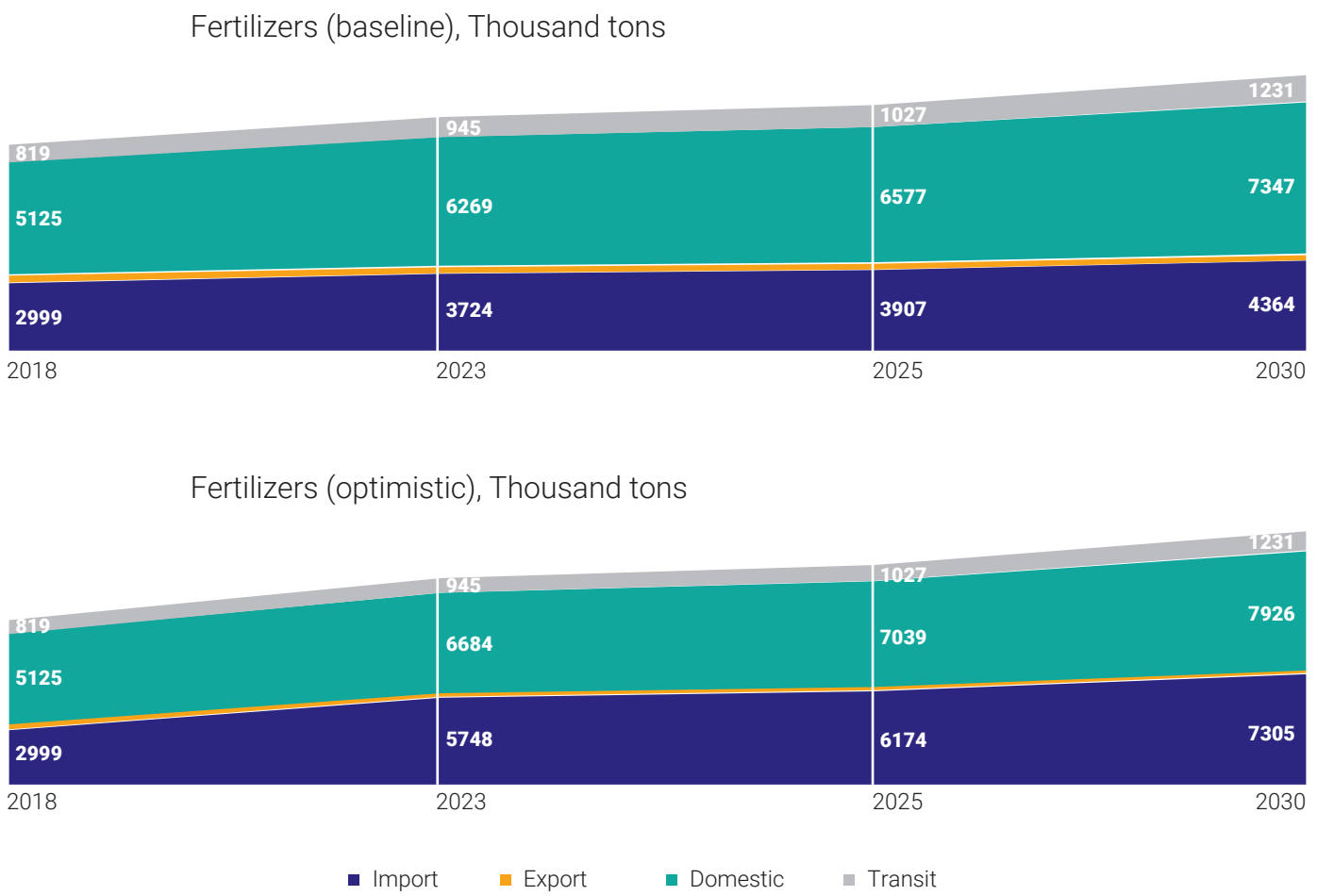
2.2.6. Fertilizers

It is assumed that the domestic production of the fertilizers will not increase significantly.

Thus, agricultural industry growth will be mostly secured by imported re-source.

Baseline and optimistic scenarios:

According to the development of the agricultural industry



2.2.7. Other goods

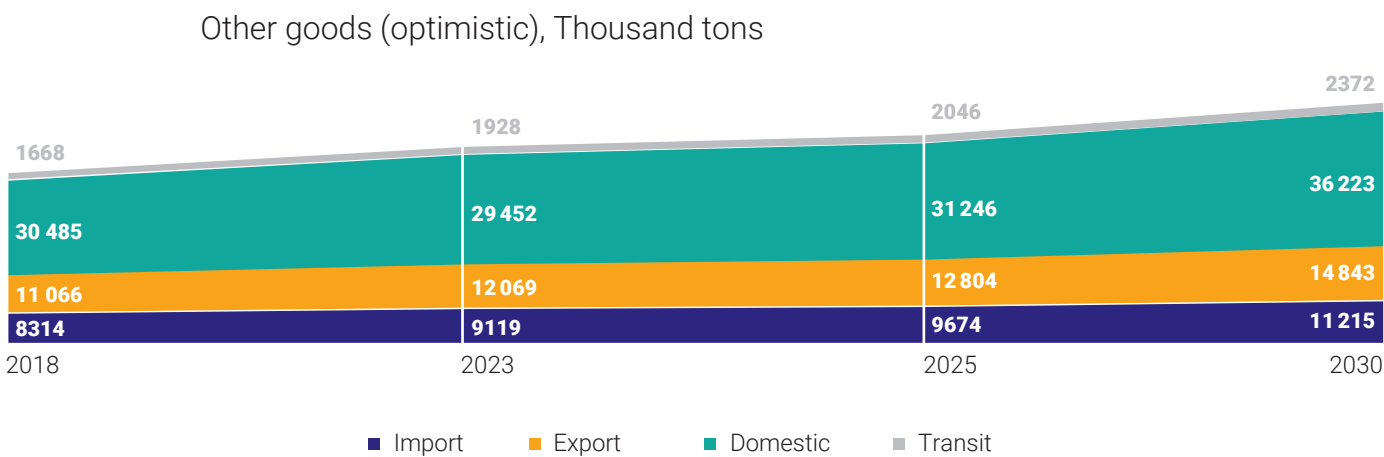
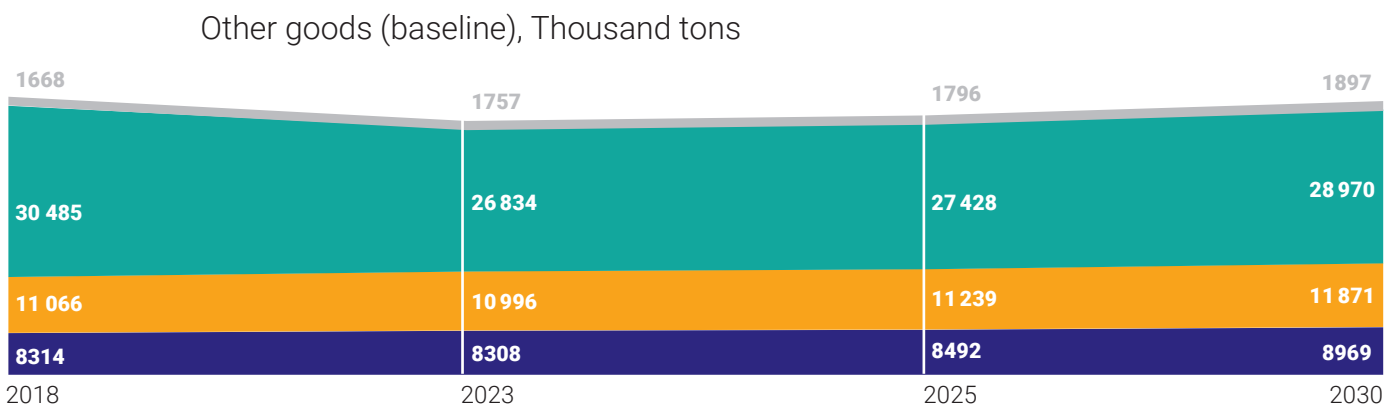
Volumes of transportation of the majority of goods in Ukraine in all connections (except transit) are highly correlated with the level of GDP.

Baseline scenario:

2% average GDP growth

Optimistic scenario:

3,5% average GDP growth



2.3. Other considerations

2.3.1. Business development in transit

One of key potential ways to increase the transit is to get the traffic that flows between Turkey and Scandinavian countries, Baltic countries and Poland.

Total value of goods traded by Turkey with these countries was USD 13,8B.

Trade with Scandinavia and Baltics (USD mn)

Top 5 exported goods			Top 5 imported goods		
Vehicles	25,6%	715,0	Iron and steel	20%	898,1
Textile and clothes	20,8%	581,0	Equipment and machinery	18%	808,3
Equipment and machinery	13,4%	374,3	Paper	12%	538,8
Iron and steel	10,7%	298,9	Oil	10%	449,0
Ships, boats	8,1%	226,2	Chemicals	8%	359,2
Total export		2 793,1	Total import		4 490,3

Trade with Poland (USD mn)

Top 5 exported goods			Top 5 imported goods		
Vehicles	26%	798,4	Equipment and machinery	39%	1343,9
Textile and clothes	24%	737,0	Vehicles	24%	827,0
Equipment and machinery	16%	491,3	Other	9%	310,1
Iron and steel	12%	368,5	Chemicals	8%	275,7
Chemicals	8%	245,7	Iron and steel	7%	241,2
Total export		3 070,8	Total import		3 445,9

Also, the promising direction of attracting additional transit traffic is the flow between the EU and China.

Current transit flow between China and EU by rail is up to 35 pairs of trains per week with only 2 of them running through Ukraine. With the expected increase of the flow that may double in the next 10 years there are opportunities to increase the transit that goes through Ukraine significantly.

Development of Intermodal traffic

Currently, UZ services 22% of container shipments to/from ports, the rest is mostly transported by road.

An important element in the development of rail transport is to increase the container transportation, which can be done by increasing the number of regular container trains.

In addition, the optimistic forecast considers the possibility of attraction of additional volumes of transit container transportation between the EU and China, Iran and India.

Consequently, the developed forecast of container transportation considers the increase in volumes of container transportation by attraction of new freight flows and switching of part of

cargoes from road transport to rail transport with the gradual increase of the share of transportation of containers from ports by rail.

The growth in the total volume of container transport was estimated in accordance with the targets of the National Transport Strategy of Ukraine for the period until 2030 (at least 1 million TEU in 2025 and 2 million TEU* in 2030).

It is planned to increase the container traffic by increasing the number of scheduled container trains and decreasing the number of single-unit container transportation. Assumed that by 2025 majority (more than 95%) of containers on rail will be transported only by scheduled containers trains.

Another possible way of increasing of the multimodal transportation is attraction of rail/road combined (con trailer) transportation. Most of European multimodal traffic is in trailers and swap bodies (continental multimodal). Such multimodal traffic is currently absent in Ukraine but might constitute a huge potential, namely in import and export. Such possibility should be precisely analysed and developed accordingly if there is a potential.

** Twenty-foot equivalent unit

Baseline scenario:

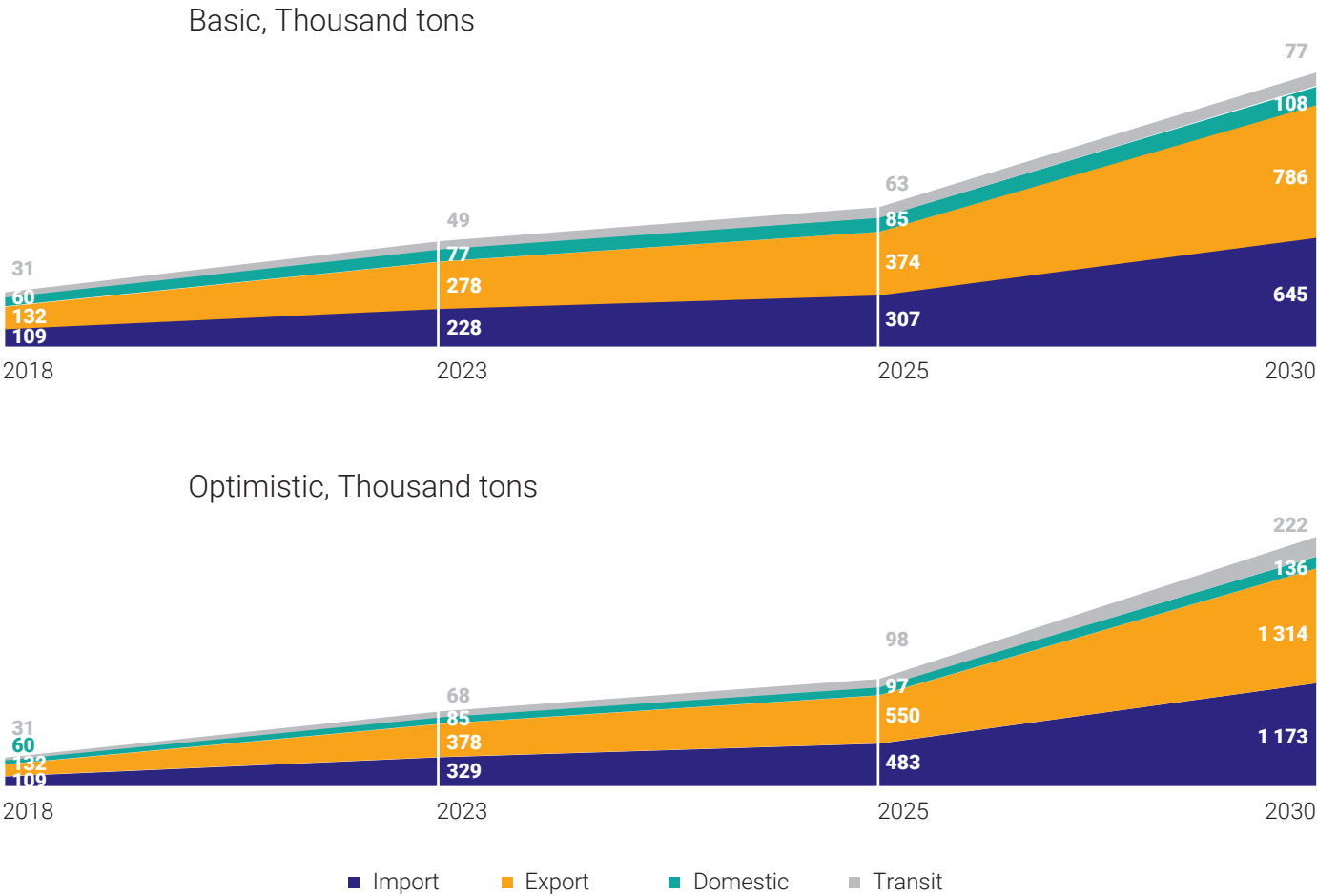
The share of transportation by rail to/ from ports in is expected to increase to 35% (2025) and 45% (2030) respectively.

Includes insignificant (up to 1 container train per day in 2025) additional volumes of transit traffic between the EU and China, Iran and India from 2021 through Ukraine.

Optimistic scenario:

The share of transportation by rail to/ from ports increases to 45% (2025) and 55% (2030).

Includes significant (up to 2 container trains by day 2025) additional volumes of transit traffic between the EU and China, Iran and India from 2021 through Ukraine.



2.3.2.

Restoration of the connection with some territories of Lugansk and Do-netsk regions

The possibility of restoring railway connections with Donetsk and Luhansk regions is taken into account in case that traffic may be restored with the Donetsk and Luhansk region within the period of validity if this Strategy. Key assumptions:

- The volume of cargo transportation in 2021 compared to 2016 (last year of transportation to the respective territories, the ban came into force in March 2017):

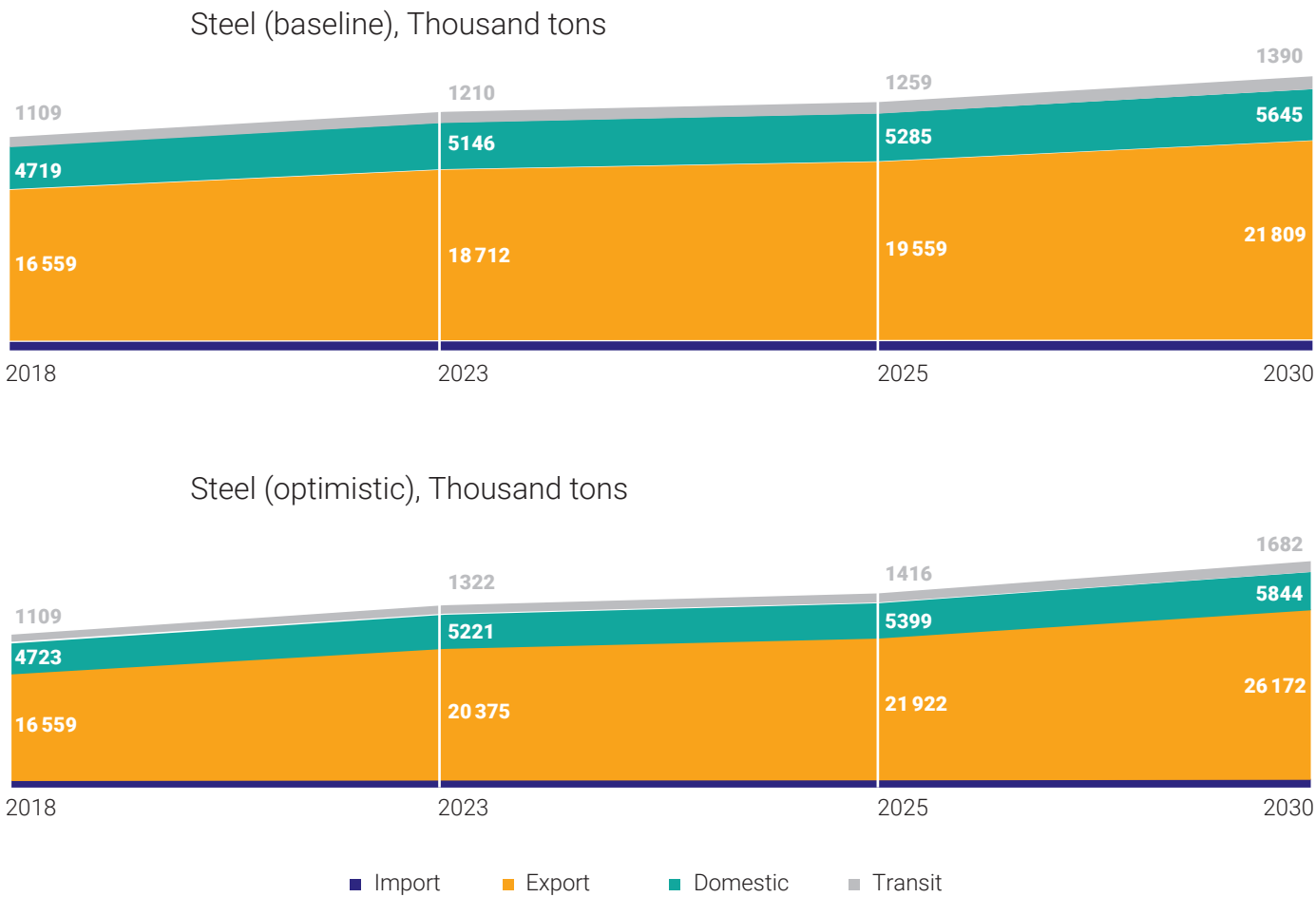
Coal – 40%

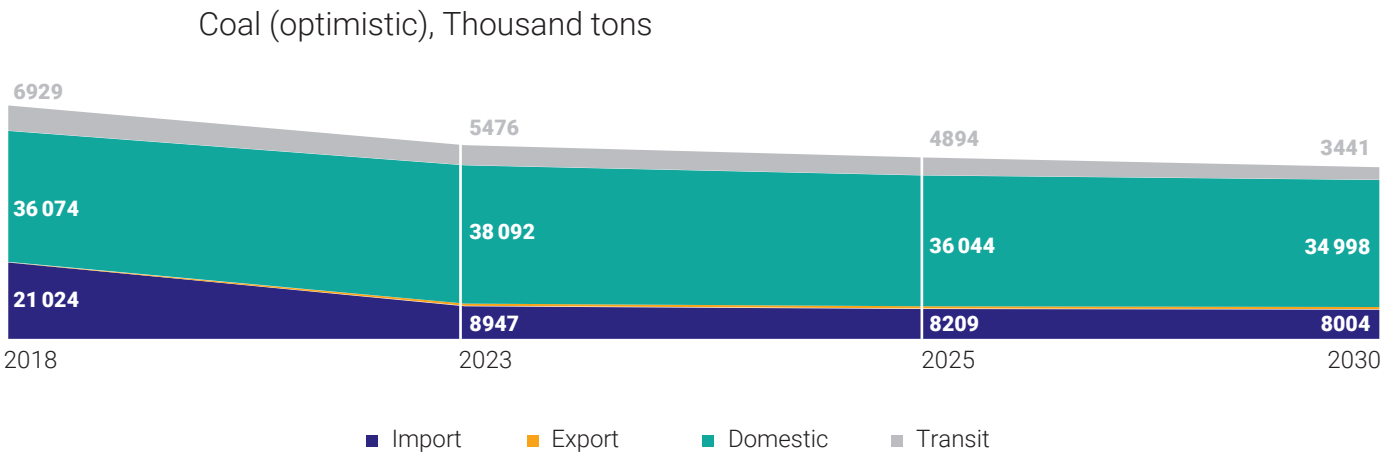
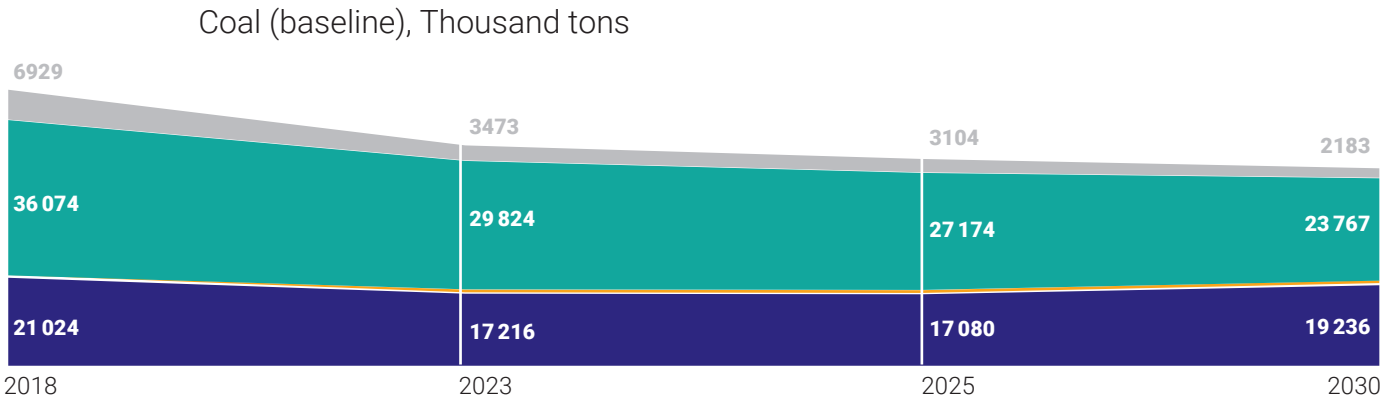
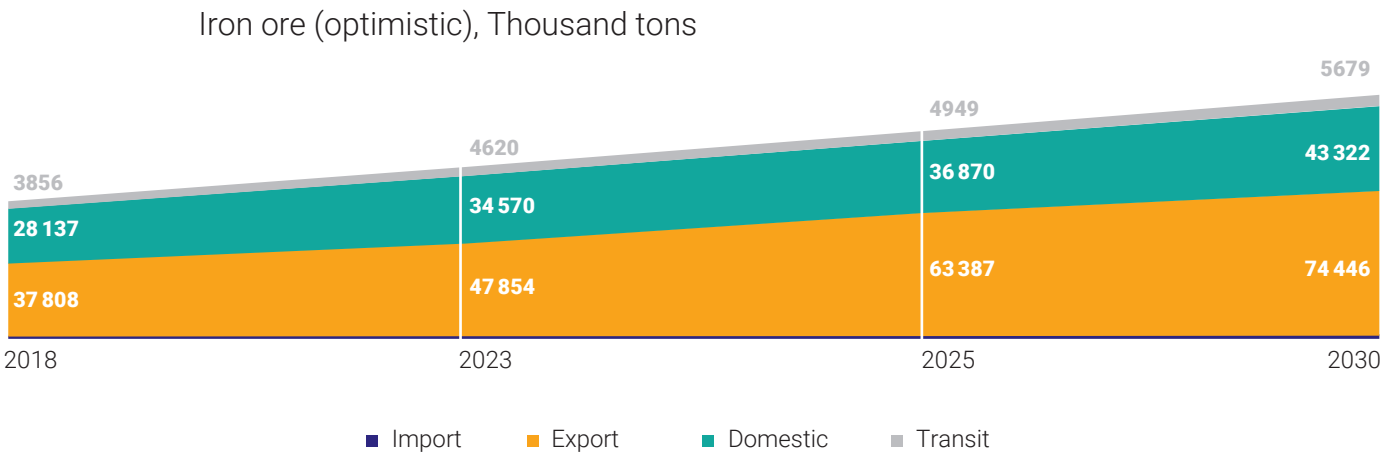
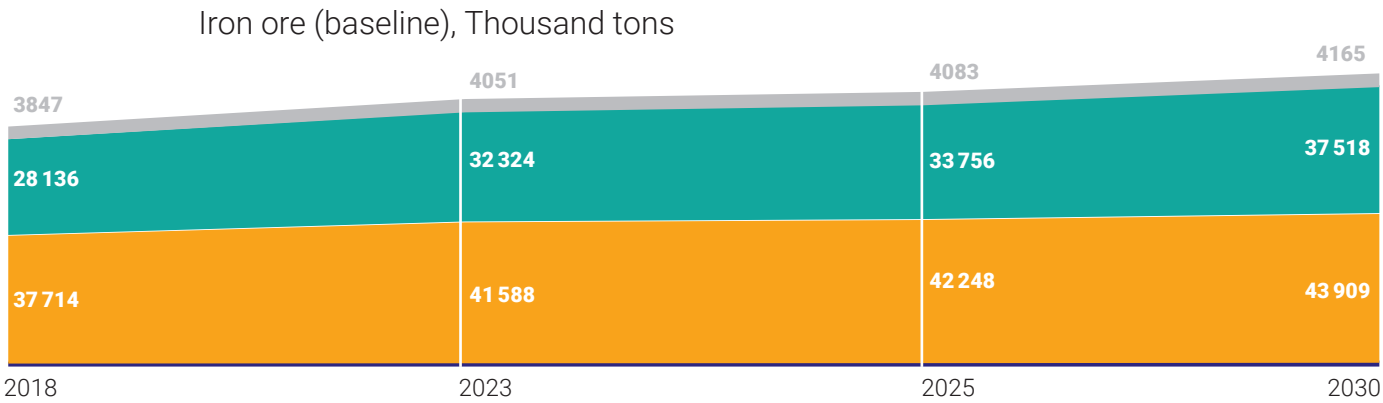
Iron ore – 30%

Steel— 15%

- By 2030, the volume will be doubled (compared to 2021).
- 50% of the additional volume of iron ore will be used in Ukraine, 50% exported.
- 80% of ferrous metals will be exported, 20% consumed in Ukraine.
- 80% of the additional volume of coal will replace imported coal, 20% additional internal consumption.

Forecast of change in the total volume of rail transport in case of renewal of the connection





3

Framework of objectives and targets

The Cabinet of the Ministers of Ukraine has adopted the State Ownership Policy (the “SOP”) for UZ which determines main purpose and expectation of the State . This Strategy dovetails from and defines strategic priorities in line with the SOP. Based on the State Ownership Policy (the “SOP”) for UZ, this SP defines strategic priorities and directions as laid out below.

3.1. Strategic objectives

The state has underlined six strategic objectives that govern decisions and actions in respect of UZ and the sector:

- Meeting the country's transportation requirements
- Improving UZ's financial and the sector's economic stability
- Investment in fleet modernization
- Increasing the safety level of rail transport and ensuring health, safety and security (HSS) of employees
- Increasing the attractiveness of Ukrzaliznytsia as an employer and meeting skilled and efficient staff requirements
- Improving UZ's governance and its operational management quality, transparency and readiness to open competitive markets of passenger and cargo transportation in the context of Ukraine's European integration (reform)

according to best practices

3.2. Key target indicators*

To evaluate the performance of the management of the Company on fulfilling the strategic objectives the following key indicators are established:

Meeting the transportation requirements

- Passenger customer satisfaction level (survey in accordance with EU methodology)

- Freight customer satisfaction level (survey, to be developed)

Improving financial and economic stability

- Operating ratio
- Financial leverage



Modernization and investment

- Average age of active fleet (separate by locomotives and wagons)
- Adjusted net tkm per employee

Increasing the safety level of rail transport and ensuring health, safety and security (HSS) of employees according to best practices**

- Number of accidents

Increasing the attractiveness of Ukrzaliznytsia as an employer and meeting the skilled and efficient staff requirement

- Employee satisfaction level
- Place of UZ in the Ukrainian Average Wage Rating

Improving the management’s quality, transparency and readiness to open competitive markets of passenger and cargo transportation in the context of European integration (reform)

- Corporate governance rating (evaluation by external consultant – to be done)

Values of target indicators will be approved by the supervisory board after the approval of the strategy.

* List of additional indicators is provided in Annex (p. 8.2).
** According to Common Safety Methods by European Union Railway Agency (4th railway package requirement)



4

Key strategic initiatives

Development of UZ requires a number of actions. Out of all strategic initiatives 10 key initiatives were emphasized:

1.

Establishing of viable tariffs (Tariffs) – 2019-2022.
2.

Reorganization of the Company from a regional structure into business segments (reorganization) – 2020-2022.
3.

Development and implementation of a long-term investment program (investments) – 2020.
4.

Rationalization of the network and production facilities of the Company (rationalization) – 2021.
5.

Customer-orientation and development of the product portfolio in core business (customer-orientation) – 2019.
6.

Reorganization and disposal of non-core assets (non-core assets) – 2022.
7.

Establishing of the new traffic management system (TMS) – 2021.
8.

Implementation of the Safety Management System (SMS) – 2022.
9.

Implementation of the PPP and budget-supported programs. (PPP and budget) – 2022.
10.

Fighting corruption through increased transparency (compliance) – 2020.

Actions required to implement initiatives are in p. 8.4.

Correspondence between strategic objectives and initiatives						
Strategic initiatives	Strategic objectives					
	Satisfaction of demand	Financial stability	Modernization and investment	Safety	Employees	Reform
Tariffs		✓	✓			✓
Reorganization	✓				✓	✓
Investments			✓	✓	✓	
Rationalization		✓	✓			
Customer-orientation	✓	✓			✓	✓
Non-core assets		✓	✓			
TMS	✓		✓			
SMS				✓		
PPP and budget	✓	✓	✓			
Compliance	✓	✓	✓	✓	✓	✓

4.1. Establishing of viable tariffs

Currently all tariffs in UZ are divided into 2 major groups: regulated and non-regulated. Nevertheless, both groups should rely on same principles:

- Cover maintenance, operation and renovation costs for the life cycle of fixed assets and intangible assets and a reasonable level of profitability.
- Be regularly reviewed based on the market fluctuations. Best approach for that purpose is to link tariff increases to Producer Price Index (PPI). This will also help depoliticise the process.

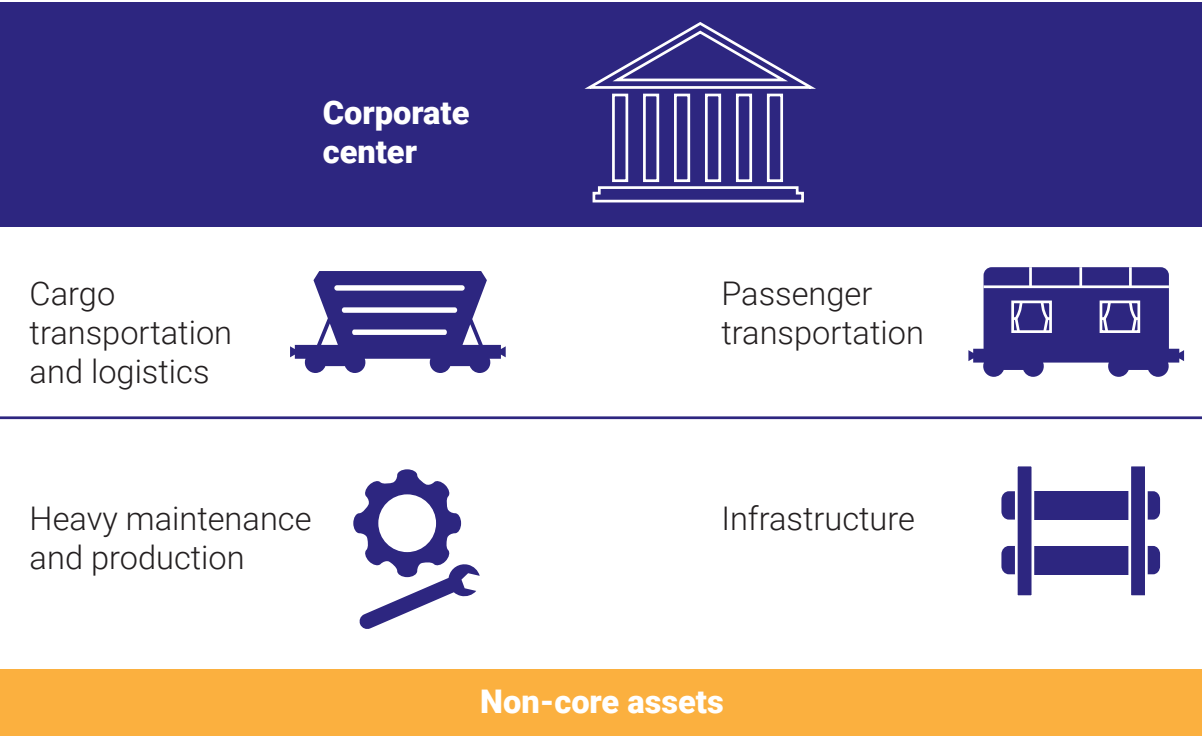
On the other hand, tariffs should not only be viable, but comprehensible and logical as well. Thus, it is necessary to reform the tariff system in accordance with the

EU Directives (separation of infrastructure access tariffs and carrier tariffs) and create a customer-oriented document that will be easy to use for all clients.

Prices of railway ticket for passengers are a socially important issue. Thus, train operators in the social segment should receive a full compensation of losses from the central and/or local government with Public Service Obligation (PSO) agreements and UZ will communicate to the government the need to include such obligations in the law.

All tariffs that are not a part of the natural monopoly, including the traction tariff after the implementation of the open access to the infrastructure, should be deregulated and established on market principles.

4.2. Reorganization of the Company from regional structure into business segments



Achieving the target structure of the Company requires creating vertically-integrated management structure, that will include:

- **Corporate centre**, that will form policies of the Company and control their implementation, as well as provide shared services.
- **Cargo transportation and logistics** vertical that will provide corresponding services.
- **Passenger transportation** vertical, that will provide passenger transportation services, including the execution of public service agreement on socially important transportation services in long-range transportation with the government and on sub-urban transportation with local authorities.
- **Infrastructure** vertical, that will maintain and service railway infrastructure and provide services on access to the infrastructure.
- **Heavy maintenance and production** vertical that will satisfy the demand of the company in renewal of fixed assets.
- Unit responsible for the **management of non-core assets** that will provide social services for employees of the Company and organization of non-core assets.

Cargo transportation and logistics together with the passenger transportation are core market-oriented businesses of the company. Infrastructure and heavy maintenance and production

are essential functions of the company business.

The reorganization will take into account its possible impact on employees and will aim to minimise it. Target of this reform is to increase the efficiency of processes to the increase productivity which in turn will also benefit employees.

Organizational separation should be implemented in parallel with the implementation of the separate accounting for each vertical.

Creation of the cargo and passenger carriers

UZ has to introduce the customer-oriented business model with centralized control over assets. It requires separate operations of the infrastructure (p. 5.4), but most importantly UZ has to create carriers for cargo and passengers that will be parts of cargo transportation and logistics (p. 5.1) and passenger transportation (p. 5.2) verticals that are able to survive the competitive environment after the implementation of the open access to the infrastructure.

Important element of the separation of operations of carriers from the infrastructure and opening of the access to the railway infrastructure is the establishment of transparent rules and proper compensation for loss making passenger services and other Public Service Obligations. Thus, the Network Access Code (Statement) should be developed.

4.3. Development of the long-term investment program

Assets of the railway are currently in poor condition. Considering the limitation on resources, public expect-

tations and need to increase transportation volumes, especially freight, the strategic program should include

priority direction for the investments.

The development of the railway requires modern and innovative solutions. Purchase of modern rolling stock, modernization of the signalling and safety systems, implementation of modern IT systems and other innovations will open the opportunity to increase the efficiency.

The investment program will be mostly targeted on key assets: infrastructure and rolling stock. Investments should achieve the following targets:

1. Dealing with the investment backlog in the railway infrastructure.
2. Increasing the quality and productivity of the rolling stock, especially traction.

3. Systems for efficient allocation and management of rolling to meet customer demand in the most cost effective and timely manner.

The investment program shall be discussed with suppliers and producers to ensure that UZ's transportation capacity is aligned with demand for transportation services. One element in securing such alignment should be entering into long-term framework agreements with key producers.

Another target of the investment program is to increase the quality of assets that will result in increasing workplace safety and labour productivity, thus leading to enhancing the level of social and employment security for employees.

4.4. Rationalization of the network and production facilities of the company

Ukraine's railway network was developed for needs of an economic model that is no longer relevant nor present. Current number of production facilities (wagon and locomotive depots, number of shunting yards etc.) has been developed to maintain three times as much volumes of transportation as country currently generates.

Target for the next 5 years is to configure these facilities that will be necessary to run UZ efficiently.

Moreover, either majority of railway tracks are currently low-active. It is required to analyse the market in order to determine

if there is a way to attract enough traffic to make such track viable or to compensate losses in a different way. Otherwise, the closure of parts of the railway or state funding of operations of such sections should be negotiated with the government.

Infrastructure strategy is described in the p 5.3.

Another important step will be to increase energy efficiency through improvement of operations and renewal of assets.

4.5. Customer-orientation and development of the product portfolio in core business

Traditionally railways in Ukraine were a monopoly that expected the customer (both freight and passenger) to approach the company and make efforts in order to receive the service.

One of key targets of the reform is to change the mentality of the Company into customer-oriented. In this sphere the following key actions are planned:

- Creation and development of the Key Account Management office that will serve major freight customers (about 80% of the market).
- Development of new services for passengers.
- Regular measurement of customer satisfaction both in freight and passenger business.

4.6. Reorganization and disposal of non-core assets

UZ has a large number of assets and activities. In order to decrease the total cost of operations and increase the efficiency of the core business all assets and activities should be evaluated in 2 dimensions:

1. Is this asset or activity critical for the core business?

2. Is it possible/worth to outsource such activity?

A more detailed approach to the non-core asset organization is described in p.6.2.

4.7. Establishing of the new traffic management system

Currently traffic management is not centralized and most of decisions are made in the Regions at different levels of the management. This creates a lot of inefficiency due to the lack of coordination between divisions of regional branches.

It is necessary to increase the efficiency by centralization of the traffic management function. It will happen in 2 stages:

1. Establishment of the central traffic control centre that will take command over regional traffic control centre (2019-2020).
2. Full transfer of traffic management functions to the traffic control centre (2020-2021).

4.8. **Implementation of a Safety Management System and improvement of labour safety**

UZ will aim to close the gap between its rail safety and HSE track record, and the track record of its neighbors in the European Union, as measured by the common safety indicators (CSI) of the European Railway Agency (ERA).

To achieve this goal UZ will:

- introduce Common Safety Methods (CSM), Safety Management Systems (SMS), Technical Standards for Interoperability (TSI) and the Entity in Charge of Maintenance (ECM) concept as established in European Union regulations and directives and further developed by the ERA,
- improve its Health, Safety and Environment (HSE) policies and practice towards international best practice.
- develop and implements systems to improve labour safety and introduce preventive measures in order to maintain healthy and safe working conditions, avoid production risks, increase the state of hygiene and work safety in order to sustainably decrease the number of accidents and employee casualties.

4.9. **Implementation of the PPP and budget-supported programs**

At the moment majority of capital investments are done with own funds of UZ, whereas a smaller part is financed by leasing / borrowing arrangements. However, international experience demonstrates that railways should not only rely on own revenues.

Firstly, UZ, with the support of the government, should start attracting private capital in the form of investments. It is a form of partnership that benefits to all stakeholders: UZ and investor receive profit, customers

get a new service, state and local communities – additional workplaces. This approach will also help setting benchmarks for UZ's performance of same or similar functions

Secondly, development of the socially and economically important infrastructure, that does not bring enough return on investments for the operator of the infra-structure, as well as development of the loss-making passenger transportation, should be financed from state and local budgets.

4.10. **Fighting corruption through increased transparency (compliance)**

Corruption is one of constraints of the development of the company that may be a major complication during the implementation of strategic initiatives. Only strict control over processes and their transparency will eliminate the risk of corruption.

Thus, it is planned to create a compliance office in accordance with the world best practices that will implement preventive system that will limit the possibility of corruption.

5

Core business strategy

5.1. Freight transportation and logistics

5.1.1. Analysis of the current situation

Current the railway transportation market is segments:

- 1. Transportation services (traction).** Until the adoption of the new edition of the Law of Ukraine "On Rail Transport", the Company will occupy a monopoly position in this market. The implementation of the EU Directives provides for the introduction of the transportation market, which necessitates the separation of transportation activities from infrastructure management activities.
- 2. Operator services.** Wagon fleet operations, including the possibility to provide operator services for other wagon owners.
- 3. Freight forwarding services/contract logistics.** Provision of services related to rail transportation on behalf of the consignor/customer of services.
- 4. Multimodal transportation.**
- 5. Terminal services.**

One of the key issues in the development of UZ is the lack of structural transformations and adaptation to market conditions in the past. Despite the experience of other railways over the world, modern management methods have not been introduced, or functional units for each type of business have not been established, additional services and international activities have not been developed.

In this connection UZ is poorly represented in some segments of the railway market and is gradually losing

market share, in which for a long time it has held a monopoly position.

Opportunities and strengths

UZ has a significant influence on the market of freight transportation and a significant share in the market of rail car operation.

Taking into account years of experience of the Company, the development of interstate partnership in the field of logistics, the lack of competition in the markets of railroad carriers of 1520 mm track in the EU and the competence of its employees, UZ has significant potential for business growth both in international markets and in the market for providing freight forwarding and terminal-warehouse services.

The main issues

- decreasing demand for freight transportation of high-priced goods, including transit transportation;
- physical and technical obsolescence and lack of traction rolling stock;
- reduction of the volume of traditional rail transportation within the transport and logistics market;
- reduction of the share of rail freight transportation in the total volume of freight transportation;
- the policy of the Customs Union with respect to third countries;
- a large number of intermediaries among consumers;
- problems with theft and sabotage;

- low level of trust of foreign counterparties to Ukrainian companies;
- a significant amount of subsidization of loss-making activities of the company at the expense of the profitable ones;

The main threats

- continuation of negative tendencies in the spheres of economy in which there is the greatest demand for rail freight transportation;
- limitations for entering new markets and attracting additional volumes of transportation, including transit cargo;

- Entry of powerful foreign carriers, which already have locomotives of a wide track, into the Ukrainian market;
- requirement to continue subsidizing unprofitable business activities at the expense of the profitable ones;
- increase of competition from private owners of rolling stock;
- increase of competitive advantages of freight transportation by road and river transport;

5.1.2. Strategic Business Initiatives

To achieve strategic goals, a number of structural changes and measures to ensure the development of both traditional transportation and new products and services of the logistics segment are necessary.

General business vertical initiatives:

- 1.** Formation of a business vertical, which will include relevant branches, supporting business linkages that will specialize in various functions of cargo, commercial and logistics at the central, regional and international levels.
- 2.** Development of new transport products.
- 3.** Renewal and modernization of freight cars locomotives and wagons.
- 4.** Creation of the cargo carrier – key service provider in all segments of railway transportation market.

Separation of the carrier

Currently in Ukraine infrastructure and carrier services are not separated organizationally and financially. One of key targets of reform is to separate those services and open the access to the railway transportation market that requires significant preparation in order to create a competitive carrier.

Taking into consideration the fact that low-profitable segment of the market is not enough to ensure sustainability, the carrier has to be able to withstand the competition from private carriers and guarantee the number 1 market position.

Key market for the national carrier is transportation of bulk cargo (coal, ore, metals, grain, chemicals) in domestic, export-import and transit connections. UZ Cargo has to guarantee high service levels, develop assets and form significant competitive advantages that will allow to increase volumes of transportation with the traction he operates.

Key tasks and functions of the carrier:

1. Traction of trains, improving of the operating efficiency in cargo transportation
2. Centralized management and operation of the traction and wagon fleet.
3. Implementation of the payment settlement between business units of UZ.
4. Implementation of the “point of contact / one stop shop” for customers.
5. Transition from “traditional transport services” to “satisfying of the logistic needs of the customer with the decrease of costs and increase of profitability” proposition.
6. Development and regular actualization of the list of services and their quality according to the need of customers.
7. Development and implementation of the customer and product management IT systems as well as for effective transportation operations.

5.2. Passenger transportation

5.2.1. Analysis of the current situation

Passenger transportation represents a significant potential for development and can become a financially viable business segment. Moreover, it is also important for reinforcing a positive image for the Company.

Functioning of the vertical highly depends on the state policy since current level of tariffs are unprofitable. Future legislation shall include compensation of losses of the passenger transportation from the government.

Opportunities and strengths

UZ occupies a significant place in the passenger transport market, where there is steady high demand. This is in part due to the unsatisfactory condition of high-ways, UZ’s extensive rail network, its experience in the sector and low transportation costs.

The introduction of a visa-free travel regime with the EU has given impetus

to the development of rather profitable “East-West” transportation, which saw the volume of transportation increased almost twice in 2018 compared to 2017.

Gradual increase in population mobility, increased radial (capital-region) and rapid growth of diametric (region-region) passenger flows in the absence of adequate competition from aviation transport represent an opportunity to attract additional passenger traffic flow.

Gradual transition of passengers to day trains, while night trains will still remain an important part of the Ukrainian travel culture in the upcoming years.

The main issues

- unprofitability of suburban and some types of passenger transportation;
- gradual loss of the share of rail passenger transportation in the overall structure of the passenger transportation market;

- underdeveloped segment of additional passenger services;
- low disposable income of the population;
- lack of adequate state support including reduction of the percentage of government compensation for privileged passenger transportation;
- lack of structural transformations and adaptation to market conditions.

Main threats

- perseverance of the losses of suburban and passenger transportation without the possibility to properly subsidize them from other activities;
- increase of the competitive advantages of passenger transportation by road and air transport, especially development of low-cost airline carriers.

5.2.2. **Strategic Business Initiatives**

General business initiatives which are contemplated are:

1. Formation of the business vertical, which will include relevant branches, supporting business enterprises that will perform the functions of passenger transportation and provision of services, provide repair, maintenance of passenger rolling stock, equipment and preparation for departure.
2. Operation of the passenger rolling stock, including traction.
3. Division of socially important and commercial segments of long distance transportation:
 - public transportation is determined by the central executive authorities, and its organization is provided by government orders, which must compensate the costs at the level that will provide maintenance, operation and renewal costs during the life cycle of fixed assets and intangible assets, regardless of the cost of travel;
4. The formation of a system of agreements on socially-important transportation (public service obligations) with local authorities to organize transportation in suburban traffic. According to such agreements local authorities will pay the carrier the cost of organizing the suburban traffic, the level of which will ensure the costs of maintaining, functioning and restoration during the life cycle of fixed assets and intangible assets, and establish the desired level of ticket prices, revenues from which will be transferred to local budgets or credited as part of the payment for the implementation of transportation.
5. Development of the existing and

introduction of new products on the market: transportation of cars by car-carriers, transportation by salon cars, transportation by luggage cars and tourist trains.

6. Renewal of the fleet of passenger and motor-vehicle rolling stock, including the participation of state and local budgets as well.
7. Prepare for the implementation of the quality management system in accordance with Regulation (EC) 1371/2007.
8. Development of transport services and expansion of the route network, rail buses, organization of multimodal transportation in cooperation with bus and other means of transport.
9. Participation in the state projects that are targeted on development of new passenger connections, such as High-speed rail, as well as providing of the institutional support for such projects.
10. The development of a client-oriented interface for ticket sales system and route planning.
11. The development of sales channels with maximum automation, on line services and trip planning flexibility with inclusion of intermodal options including full connection of UZ European and global railway tickets sale systems.
12. Establishing of the B2B (business to business) sales system.

5.3. Infrastructure

5.3.1. Analysis of the current situation

The infrastructure vertical provides the management and uninterrupted operation of railway tracks, engineering structures, automation and telecommunication devices, local and technological electrical networks directly used to ensure the process of cargo and passenger transportation, organization and improvement of train traffic control.

The infrastructural vertical includes the following divisions: railways, signaling and communications, electricity, transportation, buildings and structures.

Opportunities and strengths

There is an extensive railway network that covers all regions of Ukraine and

provides an opportunity to attract a significant amount of cargo and passengers for transportation.

The existence of a developed system of an electrified railway network, which provides about 90% of freight traffic at a lower cost compared to diesel traction. An extensive system of local electrical networks that provide transmission of electricity for both the own needs of railways and for third-party transport consumers is present.

The increase of the number of high-speed passenger trains by dividing tracks into predominantly freight and passenger traffic.

Highly skilled engineering staff, structural subdivisions in UZ, which

carry out reconstruction, technical re-equipment, repairs and current maintenance of railway infrastructure objects are available.

The main issues to be solved

- critical wear and tear of basic technical equipment, primarily engineering structures, contact networks, traction substations, special rolling stock and transmission lines;
- limited throughput capacity of individual directions, there is no possibility of significant increase of speeds of passenger trains with combined traffic without investments from the State budget. Much of the rail infrastructure requires various types of repairs (more than 2000 km), has many speed limits for trains (almost 350), which increases operating costs and reduces the capacity of the network ;
- combined traffic of freight and passenger trains, which restrains the development of high-speed passenger trains, that may be solved with the right investments from the State
- improper planning and preventive system of maintenance and repair of fixed assets increases the life cycle cost of infrastructure objects that doesn't consider forecasted volumes;

- the lack of a clear definition of the transportation tariff components for infrastructure maintenance and repair and allocation of it in full for these purposes;
- worn-out repair and maintenance equipment and use inefficient technologies, as a result – low labour efficiency (e.g. in UZ there are almost 35% of employees in infrastructure maintenance of the total number of employees related to the transportation, while in developed railways – 15%);
- unproductive costs to service a significant number of railway tracks.

The main threats

- impossibility to maintain the necessary qualitative parameters of the infrastructure work due to its long-term lack of financing and, consequently, delay in the delivery of the declared volumes of freight transportation,
- failure to enact the necessary changes in the tariff system,
- rising prices for fuel, electricity, personnel and materials at rates higher than tariff indexing for infrastructure services.

5.3.2. Strategic Business Initiatives

1. The proper formation and implementation of the integrated business infrastructure vertical.
2. Investments in modernization and repair, as well as infrastructure renovation and development in order to resolve bottle-necks and increase the quality of service.
3. Investments in the modern track inspection equipment, automation of level-crossing protection, centralized traffic control, automation of station work in order to increase the productivity.
4. Optimization of the coverage and usage of the infrastructure network

based on analysis of traffic, possibility to increase it and possibility to receive state funding of socially important, but low active, sections of the network.

5. Development of the infrastructure services based on the requirements to the railway network of the government in accordance with EU directives.
6. Modernization and development of investment attractive passenger stations and hubs with the target to provide the best quality service for passengers.
7. Allocation of the infrastructure tariff on the basis of reasonable expenses for support and necessary investments in the infrastructure complex.
8. Transition to the system of efficient mutual settlements within UZ.
9. Cooperation with the government in order to get external funding (e.g. from EU) of the railway infrastructure development.
10. Consider implementation of the infrastructure development projects with the external funding (i.e. complete Zaporizzhya – Mariupol electrification, increase of the maximum speed of trains over existing limits, etc.).
11. Achieve exemption of the land tax for railway.
12. Develop the Network Statement in accordance with the European and Ukrainian legislation.

5.4. Heavy maintenance and production

5.4.1. Analysis of the current situation

UZ owns a number of enterprises and units whose tasks are to meet the needs of the Company in restoring the main means of production, the manufacturing and commissioning of a new rolling stock to increase labour productivity and safety of the railroad traffic, to improve the quality of services and reduce the cost of transportation.

Opportunities and strengths

- Availability of production facilities and qualified personnel to manufacture and repair the rolling stock.
- The possibility to organize rolling stock repairs based on the technical conditions and transition to the method of service on the extended warranty shoulders of traffic.
- Optimization of the rolling stock repair system with the introduction of maintenance of rolling stock throughout the life cycle.
- Involvement of world leaders in the production of rolling stock to form strategic partnerships for modernization and in the future to establish production of traction rolling

stock on the territory of Ukraine.

The main issues

- planning and preventive system of maintenance and repair of rolling stock increases life cycle costs;
 - the current management structure is not divided by type of activity into service and heavy repair;
 - the lack of structural transformations and adaptation to market conditions (UZ owns higher number of production facilities that required for the existing traffic);
 - inefficient resource planning and procurement systems;
 - rising costs of fuel, electric power, personnel and materials.
-

5.4.2. Strategic business initiatives

- 1.** Formation of business vertical, which will include relevant branches supporting enterprises that will specialize in performing capital repairs of traction rolling stock, as well as rolling stock upgrading.
- 2.** Optimization of the rolling stock repair system by specializing production units for the repair of certain spare parts and increasing of the time between overhaul.
- 3.** Introduction of services for maintenance of rolling stock during the life cycle.
- 4.** Analyze the possibility to involve investors and form strategic partnerships with world leaders in the production and modernization of traction rolling stock.

6

Non-core business strategy

6.1. Social block

6.1.1. Analysis of the current situation

In the structure of UZ there is a large number of institutions providing services that are part of the social benefits package of the employees. These comprise: health care institutions, a centre for professional development, boarding houses, sanatoriums, preventive health centres, children's health camps, children's railways, sports clubs, recreational facilities, housing stock and other social and cultural facilities.

Social responsibilities and the need to maintain attractiveness of UZ will be taken into account in the making of decisions regarding the level and organization of non-core assets. The objective is to identify those social services and facilities that are most important for the employees and provide them in a sustainable and most efficient way.

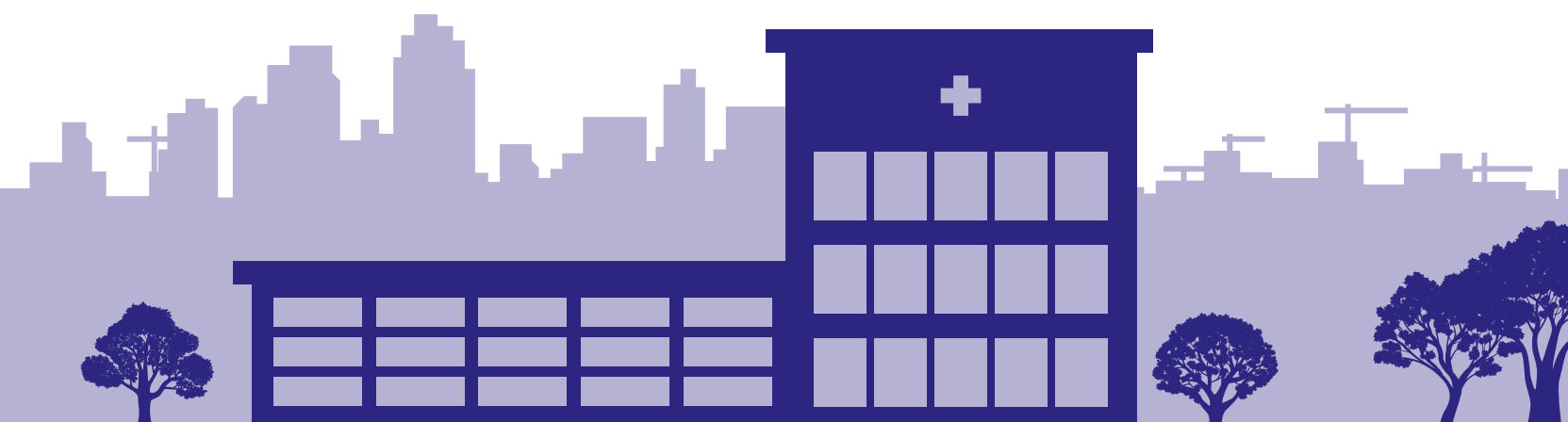
Decisions in this regard will be the subject of social dialogue with labour unions.

6.1.2. Strategic initiatives of the social block

To carry out strategic goals, it is necessary to execute a number of structural transformations and take a number of measures in order to:

1. Social benefits package will aim to keep the level of support for employees and their families at appropriate and sustainable levels and

include ensuring of proper health care access and support including preventive medicine programs, professional training and other social facilities essential for employee and retiree well-being. Employee well-being is an essential part of operational safety in the UZ.



2. Develop measures to improve housing and living conditions of employees with the participation of trade unions.
3. Develop a program to increase the profitability of the social package, including investment programs, optimizing the activities of social objects, the sale of inappropriate property.
4. Seek possibilities for creation of a public organization for joint development with potential donors and investors of social infrastructure objects.

6.2. Non-core asset organization program

UZ has a large number of assets and activities that are not directly part of the transportation process, and their reduction is key to cost optimization.

During the implementation of the strategy, an organization program for non-profile assets will be developed, which will include:

- criteria to assign assets and activities to non-core ones;
- assessment of the importance of this asset or type of activity to ensure the company's activity;
- the method of making a decision on the lease, sale or write-off of non-profile assets and the development of criteria to assess economic efficiency in case of refusal to own a certain asset or execution of this activity or alternative to the acquisition of the goods or services.





Implementation of the strategy

Publication and discussion of the strategy

After the approval of the Strategy a presentation of the main principles and directions will be published and presented to key groups of stakeholders. During the presentation purpose and key targets of the development of the Strategy will be discussed, as well as general overview and detailed presentation of parts that stakeholders are the most interested in.

One of the key targets of the strategy discussion is to increase the level of the social dialogue. Internal communication should be enhanced in order to ensure that employees understand and support the implementation of the strategy, as well as suggest required actions to achieve targets in the best possible way.

Implementation plan

According to the approved Strategy, targets, key indicators and timeline will be developed and approved by way of an implementation plan. Implementation plan will be developed by the Management Board and approved by the Supervisory board.

Key elements of the implementation plan:

- Assessment of the needed human, financial and technical resources, and the extent of their availability from within and outside UZ.

- Actions and timetable to implement the strategy, including its investment program with responsible employees
- List of Key Performance Indicators (KPI) for each unit

Monitoring of the Strategy implementation

Implementation plan, scenario conditions and assumptions are monitored regularly:

- Report of the CSO on the progress of implementation of the implementation plan to the Strategy and Finance Committee of the Supervisory Board: every 3 months, after approval of the report by the reform committee*.
- Management Board report on the implementation of the Strategy to the Supervisory Board: as frequently as it sees fit, but no less than semi-annually, on the next SB meeting after the January 20 and after July 20; the latter meeting shall also be used to review strategic assumptions and directions as basis for establishing the framework and a sound basis for the (financial) planning and budgeting.
- Strategy Department public communication of result of the implementation of the strategy: every 6 months, in 15 days after the approval of the report by Strategy and Finance Committee of the Supervisory Board.

* Reform committee is a body established by the executive management. Key target of the reform committee is to analyze suggested actions and results for the implementation of strategy itself before it goes for the review of the Management board and Supervisory board.



Annex

8.1. Other target indicators

Meeting the transportation requirements

- Freight customer pre-planning satisfaction rate
- On-time performance of passenger trains

Improving financial and economic stability

- Net profit
- EBIT
- Free Cash Flow (cash flow from operations less net cash flow from in-vestments)
- Financial rating
- Revenue per tkm
- Revenue per wagonload
- Revenue per pas-km
- Net-tkm per employee
- Pass-km per employee
- Net-tkm per employee in freight business (new)
- Pass-km per employee in passenger business (new)

Modernization and investment

- Availability of active fleet (separate by locomotives and wagons)
- Wagon cycle time (freight)
- Locomotive productivity (gross-ton-km) / installed power in active fleet

(g-tkm/installed kW)

- Section speed (km/h)
- Track kilometres under slow orders (km)
- Average freight train speed (km per train per day)
- Fuel consumption per gtkm for freight mainline locomotive
- Energy consumption per gtkm for freight mainline locomotive
- Fuel consumption per train-km for passenger mainline locomotive
- Energy consumption per train-km for passenger mainline locomotive
- Fuel consumption per 1 hour of operations of the shunting locomotive
- Yard & terminal dwell (new)
- Trip plan compliance (new)

Increasing the safety level of rail transport* and ensuring health, safety and security (HSS) of employees according to best practices

- Number of serious injuries and fatalities per accident
- Number of serious injuries and fatalities to passengers
- Number of serious injuries and fatalities to railway workers
- Railway accidents involving dangerous goods

* According to Common Safety Methods by European Union Railway Agency (4th railway package requirement)

- Number of level crossing accidents
 - Number of serious injuries and fatalities per level crossing accident
 - Introduce Safety Management System according to Common Safety Methods with relevant set of indicators (new)
-

8.2. **Key assumptions for the strategy implementation**

Forecasted volumes of transportation deviated for no more than 3% from the actual transportation volume (in 5 years cumulatively).

Internal transformations of the JSC «Ukrainian railways» in terms of increasing in internal efficiency by means of cost optimization and growth in revenues from implementation of new profitable services are supported. The system of management of the Company is improved, the transition to cost accounting by types of business activities and mutual settlements between them is completed.

From 2019, the transfer of out-of-class freights to class 1 and unification of tariffs on transportation of empty wagons are made.

Until adoption and enactment of an updated Law of Ukraine “On Railway Transport”, the indexation of tariffs on transportation of freights and passengers is conducted at the PPI level (except tariffs on freight transportation in terms of the Wagon component and tariffs on passenger transportation by Intercity+ class 1 trains).

After enactment of an updated Law of Ukraine “On Railway Transport”, from:

2020, public service obligations (PSO) with local authorities, by which delivery of services of suburban railway transportation on the break-even condition for a carrier is provided;

2021, tariffs on access to infrastructure on the conditions of 100% cover of costs for its maintenance and development according to approved investment plans;

2021, after opening railway transportation market, free pricing on freight rail-way transportation is implemented;

2021, a state order for long-distance passenger transportation on their break-even condition for a carrier is set.

Capacities of industries and product suppliers are sufficient to deliver required goods and services in time to implement the investment plan.

8.3. Approaches to management and formation of corporate policy

The management of the company will be based on a process approach. UZ's top management will define and approve unified corporate policies and business processes for the company.

To form a process approach in the company, it is necessary to describe existing processes and review them to optimize, eliminate the duplication of functions, and identify those responsible for those functions that are currently not provided.

The process approach will be integrated into the automated system, which will provide the description of processes and electronic document flow in the company.

In accordance with the identified processes Key Performance Indicators (hereinafter referred to as KPIs) will be determined for each unit within the framework of the strategy implementation.

UZ's top-management will also provide control over the implementation of functional policies to provide shared services to business verticals: legal, accounting, HR, IT, financial and economic planning, etc. A detailed list of shared services and the principles of their provision will be formed during the implementation of the Strategy.

As a part of the development of the management structure the lean management should be introduced as one of key principles of the business process design.

Financial and credit policy

Currency risk balancing will be implemented by introducing a quasi-currency risk hedging mechanism (introduction

of automatic indexation of prices and tariffs for the level of industrial producer prices).

Ensuring the possibility of attracting credit funds in foreign financial markets to invest in the rolling stock and infrastructure.

Introduction of liquidity management of the company for the next 12 months by involving revolving credit lines or overdraft.

Continuous balancing of assets and liabilities, revenues and expenses in order to achieve a long-term liquidity of the company.

Introduction of a three-year financial planning system.

Implementation of the system of annual budgeting of income and expenditures with its further development to ensure three-year budgeting.

Centralization of payments, creation of a single payment centre of the company including cash pooling.

Implementation of the control system of expenditures at all levels of the company.

Automation of the statistical information collection.

Investment Policy

Implementation of a communication system with potential investors and projects that they propose to implement, as well as mechanisms for the implementation of such investment projects.

Implementation of the investment project evaluation system in order to deter-

mine their effectiveness, economic feasibility, risks and prioritization.

Formation of investment projects pools with their distribution by funding sources.

Establishing of the stable cooperation with international financial institutions, international railway producers, other institutional investors.

Implementation of the scoring system for investment projects.

Implementation of the investment project monitoring, post-control and back-testing.

Marketing policy

Ensuring regular market research.

Introduction of forecasting and transport modelling systems.

Creation of a unified system to assess the level of satisfaction with the quality of services implemented by the company in accordance with European practices.

Introduction of the service development and promotion system.

Development of a unified advertising policy of the company.

Establishment of the key cargo transportation customer office.

Strengthening the customer-oriented approach of the company and introduction of a regular assessment of satisfaction with the level of the services provided.

Sales pricing policy

Formation of non-regulated prices and tariffs for the sale of goods and services that will cover maintenance, operation and renovation costs for the life cycle of fixed assets and intangible assets and a reasonable level of profitability.

Ensuring the formation of separate tariffs to access railway infrastructure and transportation in accordance with the requirements of the EU Directives, which will cover maintenance, operation and renovation costs for the life cycle of fixed assets and intangible assets and a reasonable level of profitability.

Introduction of automatic indexation of all prices and tariffs at the level of the index of producer price index (PPI).

Elimination of the differentiation of the cost of transportation in freight and empty trips by freight tariff classes, as well as other prices and tariffs, the level of which unreasonably depends on the type of cargo.

Analyse possibility to implement separate tariffs for block-train transportation.

Deregulation of prices and tariffs that are not related to the services of a natural monopoly.

Expansion of the practice to sell goods and services through electronic auctions.

Establishing of internal prices (sale of goods and services between units) on the same principles as for external prices.

Property policy

Introduction of a modern property management system.

Development of the method of assigning assets to core and non-core.

Development of a policy and a regulation for making decisions on disposal of property (lease, sale, write-off).

Corporate Management Policy

Introducing corporate management standards in accordance with OECD practices.

Regular assessment of the corporate management quality by an independent consultant.

The introduction of the KPI system for companies, 100% of shares of which are owned by UZ in accordance with the Strategy.

Determination of the demand for services of companies, 100% of shares of which are owned by UZ, taking into account the level of investment required to increase production capacity, and the specialization of such industries in providing services to the company.

Policy for Accounting services

The introduction of mutual settlements between business verticals and the distribution of actual costs by type of activity.

Centralization of accounting and tax function.

Improvement of the central database in order to form a balance of the company in the central office.

Involvement of internal audit in KPI development and control.

Improvement of the management accounting system for a detailed cost and revenue accounting.

Technical policy and quality management

Implementation of modern technologies.

Stimulation of the production of new goods for the railway transport in order to diversify procurement through activation of the dialogue with producers, development of long-term plans and executing of long-term agreements.

Increasing the productivity of assets.

Optimization of the repairs and maintenance system.

Implementation of the standardization system in UZ, introduction and maintaining of the system of normative documents.

Development of metrological standards for all units of UZ.

Development of the technical inspection system of the infrastructure and rolling stock.

Introduction of the Quality Management System

Improvement of the input and output control system.

Organization of scientific, technological and constructing services and development of processes targeted on improvement of the technological processes of the railway transport, construction of the rolling stock and infrastructure, increasing of the efficiency of the railway transport.

Safety Management Policy

Introduction of a risk management system.

Introduction of a safety management system in accordance with the requirements of the EU Directives.

Partnership with the European Railway Agency to support the implementation of European safety management practices.

Environmental policy

Minimization of the negative impact on the environment.

Implementation of environmental management system in accordance with international standards ISO 14000.

Diagnostic audit of the company (assessment of the existing ecological management system).

Increase of financial and economic efficiency of introduction of effective system of ecological management.

Procurement policy

Centralization of the procurement function and professionalization of procurement.

Implementation of the category strategy.

Implementation of the total cost of ownership model in the procurement decision process.

Certification of the procurement system according to the methodology of the Chartered Institute of Procurement and Supply.

Implementation of the process approach and automatization in supply and procurement.

Introduction of inventory management system.

Social policy and human resources management

Implementation of the KPI system for all structural subdivisions.

Implementation of the model of com-

petence, scoring and development of employees.

Improvement of the training system and regular training of employees.

Salaries are expected to grow on the basis of improved labour productivity, as the result of the negotiated industrial agreements. Implementation of the single collective contract and securing of social guarantees of employees.

Communication policy

Improvement of the internal and external communication system to manage relations with key stakeholders.

Introduction of the regular publication system of key performance indicators of the company.

Introduction of a company's reputation management system.

Creation of a brand management system.

Anticorruption policy

Establishment of a system aimed at identifying and reducing corruption and corruption risks.



Introduction and improvement of corruption prevention and corruption risk management system.

The transition from investigations of violations to the preventive system.

Principle of no tolerance for corruption and corrupt practices with consequences of termination of labor contract/dismissal.

Strengthening cooperation with law enforcement agencies to prosecute perpetrators.

Information Technology

Provision of management of JSC "Ukrzaliznytsia", its structural subdivisions and branches with a complete, reliable information for analysis, planning and realization of the current activity, making of managerial decisions.

Management of the IT Strategy of the Company and formation of the IT Project Map.

Usage of the modern IT for automatization of the business processes and digital transformation of the company.

Assurance of the efficiency of IT.

Transformation of the IT role to the service organization.

Optimization of costs for development and maintenance of IT systems and implementation of the unified technical policy during the systems lifecycle.

Usage of the corporate standards in the sphere of unification and integration of technological, soft- and hardware support of IT systems.

Guaranteeing of the information security and data publicity.

Legal support

Definition of approaches to the organization of the legal support system, including contractual and claim work, taking into account the possibility of outsourcing such services.

Improvement of the system of internal normative acts.

Introduction of the system of accounting and control of contracts, court cases and law enforcement proceedings where the company is a party.



8.4. Actions to implement strategic initiatives

Nº	Action	Deadline
Establishing of viable tariffs		
1	Review of regulated and non-regulated prices and tariffs according to market conditions	Quarterly
2	Assisting MIU in development of the methodology for calculation of the infrastructure tariff	2020-2021
3	Development of the methodology for calculation of the carrier tariff	
4	Implementation of separate tariff for infrastructure and liberalized pricing for carriers	2022
Reorganization of the Company from regional structure into business segments		
1	Decision on target corporate structure of UZ (number of legal entities, their subordination)	2020
2	Organizational separation of business verticals (cargo transportation, passenger transportation, infrastructure, heavy maintenance and production)	2022
Development of the long-term investment program		
1	Implementation of 5-year investment planning	2020
2	To follow the approved long-term investment program	Annually after 2020
Rationalization of the network and production facilities of the company		
1	Develop the methodology for the categorization of the infrastructure segments	2019
2	Negotiate possibility to compensate losses of low-active infrastructure with local governments	2020
3	Submit to the government proposal for closure of low-active tracks considering social impact and national security	2020
4	Restructurization of production facilities of UZ (locomotive and wagon depots, shunting stations, etc.) in order to correspond with current transportation volumes and existing fleet	2020-2021

Nº	Action	Deadline
Customer-orientation and development of the product portfolio in core business		
1	Creation of Sales and Key Account Management function for freight customers	2019
2	Implementation of the regular customer survey system (both for passenger and freight)	2019
Reorganization and disposal of non-core assets		
1	Development of the methodology for categorization of non-core assets	2019
2	Categorize non-core assets based on their social and economical importance	2020
3	Creation of the list of non-core assets for disposal	2020
4	Disposal of non-core assets	2020-2023
Establishing of the new traffic management system		
1	Establishment of the central traffic control centre that will take command over regional traffic control centres	2020
2	Full transfer of traffic management functions to the traffic control center	2021
Implementation of a Safety Management System and improvement of labour safety		
1	Fully implements Health, Safety and Environment policies in accordance with EU requirements	2022
Implementation of the PPP and budget-supported programs.		
1	Create the list of possible PPP projects	2019
2	Run the pilot PPP project	2020
Fighting corruption through increased transparency		
1	Creation of the compliance office and appointment of the compliance officer	2019
2	Development of the compliance policy of the company	2019-2020
3	Implementation of the compliance function in accordance with best world practices and Ukrainian law	2021-2022

