JOINT-STOCK FINANCIAL CORPORATION
SISTEMA

SISTEMA PJSFC

Annual report
2017

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1. RESPONSIBILITY STATEMENT

JOINT-STOCK FINANCIAL CORPORATION
SISTEMA

To whom it may concern

23 April 2018

Responsibility Statement

To the best of my knowledge (a) the consolidated financial statements, prepared in accordance with IFRS, give a true and fair view of the assets, liabilities, financial position and profit or loss of Sistema PJSFC and the undertakings included in the consolidation taken as a whole; and (b) the management report includes a fair review of the development and performance of the business and the financial position of Sistema PJSFC and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Yours sincerely,

Andrey Dubovskov

President and Chief Executive Officer
Sistema PJSFC

2. PROFILE OF SISTEMA

2. **Profile of Sistema**

Overview

Sistema PJSFC ("Sistema" or the "Company" or the "Corporation", together with its subsidiaries, "the Group") is one of the largest private investors in Russia's real economy. Sistema's investment portfolio is dominated by Russian companies in various sectors including telecommunications, consumer retail, paper and packaging, agriculture, high-tech, real estate, healthcare, financials and hospitality. Sistema holds controlling interests in most of its portfolio companies.

Sistema's strategic goal is to create long-term growth of shareholder value by boosting returns on investments in existing assets and reinvesting available cash in new investment projects to diversify its portfolio and increase overall return on investment.

Sistema's specialises in improving the operational efficiency of the assets it acquires by restructuring and by working with industrial partners to enhance expertise and mitigate financial risks.

Sistema's shares trade on Moscow Exchange (ticker: AFKS) and on the London Stock Exchange in the form of global depositary receipts (ticker: SSA). One GDR represents 20 ordinary shares.

Key highlights 2017, RUB bn

Revenue	*704.6*
Cash inflows from investments[1]	68.1
Investments[2]	130.5
Adjusted OIBDA[3]	199.5
Adjusted OIBDA margin	28.3%

Sistema's fastest growing assets[4]

Asset	*Revenue growth in 2017*
Hotel assets	54.5%
Medsi	24.0%
Agroholding Steppe	22.2%
Detsky Mir	21.9%
Binnopharm	21.8%

[1]Cash flows from investments at the Corporate Centre level (based on management accounts) include dividends and cash returns from Sistema's portfolio companies of RUB 34.0bn and proceeds from asset monetisations of RUB 34.1bn.
[2]Investments include total Group Capex of RUB 104.4bn based on Sistema's consolidated financial statements and investments at the Corporate Centre level of RUB 26.1bn (based on management accounts).
[3]See Attachment A on page 92 for definitions and reconciliation of adjusted OIBDA to IFRS financial measures.
[4]Revenue growth in 2017 YoY.

3. MANAGEMENT REPORT

3.1 Main events

Legal dispute and settlement agreement with Rosneft and Bashneft[5]

In May 2017, Rosneft and Bashneft filed a legal claim with the Arbitration Court of the Republic of Bashkortostan against the Corporation and its 100% subsidiary Sistema-Invest seeking damages in the amount of RUB 106.6bn allegedly incurred by Bashneft as a result of its reorganisation in 2014. Later, the Ministry of Land and Property Relations of the Republic of Bashkortostan joined the claim, which was increased to RUB 170.6bn.

At the beginning of December 2017, Rosneft and Bashneft filed a second lawsuit against Sistema and Sistema-Invest seeking damages in the amount of RUB 131.6bn allegedly suffered by Bashneft due to payment of dividends to its shareholders.

On 22 December 2017, Sistema signed an amicable settlement agreement with Rosneft, Bashneft and the Republic of Bashkortostan under which the parties were to drop their lawsuits and withdraw all mutual claims. Sistema undertook to pay Bashneft RUB 100bn before 30 March 2018.

In 1Q 2018, Sistema fully fulfilled its liabilities under the agreement by making payments totalling RUB 100bn to Bashneft. The parties withdrew all legal claims against each other, and all interim restrictive measures imposed on Sistema's assets were lifted. The settlement agreement was therefore executed in full.

Completion of merger between SSTL and RCom[6]

In October 2017, Sistema completed the merger of the telecoms business of Sistema Shyam TeleServices (SSTL) with Reliance Communications (RCom). SSTL received a 10% equity stake in RCom following a new share issue by the Indian operator. If the Department of Telecommunications and the courts of India confirm that SSTL's spectrum can be used to deploy 4G networks without any additional payments, SSTL may be entitled to an earn-out payment from RCom.

Detsky Mir's IPO[7]

In February 2017, Detsky Mir listed its shares on Moscow Exchange. The company's market capitalisation at the start of trading was about RUB 62.8bn. Following the IPO, Sistema's stake in Detsky Mir amounted to 52.1% + 1 share.

Launch and successful implementation of MTS's share repurchase programme[6]

In 3Q 2017, MTS launched a share repurchase programme totalling up to RUB 20bn to create additional returns for shareholders. As of the end of March 2018, MTS had repurchased RUB 19.8bn worth of shares from its shareholders, including Sistema.

Appointment of new president and election of new Management Board[8]

In March 2018, Sistema's Board of Directors approved the appointment as President of Sistema of Andrey Dubovskov, the former president of MTS. Andrey Dubovskov took office on 13 March 2018.

Also in March 2018, the Board of Directors elected a new Management Board effective from 2 April 2018.

EVENTS AT PORTFOLIO COMPANIES

MTS and MTS Bank: launch of MTS Money Wallet

At the beginning of 2017, MTS in cooperation with MTS Bank launched a new service, MTS Money Wallet, which offers quick and convenient access to financial services offered by MTS. The new service brings together several

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[5] See also Note 5 of the Financial Statements
[6] See also Note 6 of the Financial Statements
[7] See also Note 9 of the Financial Statements
[8] For other subsequent events see also Note 40 of the Financial Statements

payment tools, including the MTS e-wallet account, subscribers’ personal accounts and bank cards. The service is available to both individuals and corporate customers.

Segezha Group: commissioning of a new paper-making machine at Segezha PPM

In 4Q 2017, Segezha Pulp and Paper Mill launched paper-making machine No 11 with capacity of 110,000 tons. It is a unique machine with a high level of automation. Investments in the project amounted to EUR 80 mn. The machine was built by an international team of engineers and technologists from Germany, Russia, China, Finland, Brazil, Croatia and the Czech Republic. Following its launch, Segezha PPM became the world's biggest producer of unbleached sack paper.

Agroholding Steppe: successful expansion of land bank

In 2017, Agroholding Steppe expanded its land holdings by 65,000 ha to 380,000 ha by acquiring new assets with high growth potential in the Stavropol and Rostov regions.

Detsky Mir: opening of a new distribution centre in the Urals

Detsky Mir opened a new distribution centre in the Urals to ensure more efficient deliveries in the Urals, Siberia, the Volga region and Kazakhstan. In September 2017, the company signed a lease agreement for a class A distribution centre with an area of 46,000 sq m at the Yuzhnouralsky transportation and logistics centre in the Chelyabinsk region. Under the agreement, which was signed for 10 years, the leased area may be expanded to 82,000 sq m. The company will start using the new centre in 2Q 2018.

OZON: appointment of a new CEO

In December 2017, Alexander Shulgin was appointed CEO of online retailer Ozon. Before joining Ozon, Alexander Shulgin worked for seven years at Yandex – from 2010 as CFO involved in preparing the company's listing on the NASDAQ stock exchange and from 2014 as CEO. Alexander Shulgin replaced Danny Perekalsky, who had been Ozon's CEO since 2014.

Medsi: new acquisitions in regions

Medsi continues investing in the expansion of its business in Moscow and other regions. In August 2017, it acquired the Medem clinic to enter the St Petersburg market. The 6,800 sq m clinic consists of 28 departments. In September 2017, Medsi acquired Medlife, a leading healthcare chain in Perm, consisting of five clinics and a sports and recreation centre with a total area of over 6,400 sq m.

3.2 Strategy

MISSION

Sistema’s mission is to build an investment company with multi-industry expertise and a strong track record in managing shareholder and third-party funds. Investments focus primarily on new and innovative industries, with no restrictions on geography or industry.

VALUE CREATION MODEL

Sistema's investment company model envisages monetisation of the portfolio through incoming dividends and asset sales, as well as:

(1) investment in new, high-potential investment projects capable of generating high returns on invested capital;

(2) distribution of profit to Sistema's shareholders through dividends;

(3) investment in the development of existing assets to increase their value.

SISTEMA'S STRATEGIC FOCUS

- Maximising total shareholder return (TSR) and reducing the discount to net asset value (NAV)
- Raising and managing outside capital to expand available resources for investment, and receiving income from management of assets
- Reducing the Corporate Centre's debt within 1-2 years
- Focusing on investments in high-potential technologies

BASIC PRINCIPLES OF THE INVESTMENT STRATEGY

Direct investments from Sistema's Corporate Centre

- Investments in controlling stakes of large assets, including distressed/undervalued businesses, or in large tech companies
- Value creation via active management of acquired assets with potential engagement of a financial partner
- Asset type: mainly mature businesses
- Geography: mainly Russia
- Industries: no restrictions, but in order of priority: consumer segment, B2B segment with export potential, and real estate
- Deal size: starting from USD 100 mn; stake: starting from 50%+1; required IRR: more than 25% in rubles
- Acquisition of assets with acceptable debt levels (Debt/OIBDA of the acquired asset less than 3.0), or higher debt levels if there is a plan for reduction to the acceptable level within two years

Direct investment through own funds (PE/VC)

- Investments in promising future technologies, e.g., companies developing technologies and solutions that create new industries or disrupt existing sectors
- Investments will be made through own funds with mandatory participation of outside investors as financial partners (share of outside partners: at least 20%)
- Geography: no restrictions
- Target fund size: starting from USD 100 mn; required IRR: more than 20% in USD
- Deal sizes, stakes and stages of financing will be determined in the funds' investment theses
- Market principles of income distribution and incentives for the team

Investments of portfolio companies that require investment from Sistema

- Investments in portfolio companies to increase their market share or enter adjacent/synergistic business segments
- Involvement of strategic and financial partners as needed
- Geography: in accordance with the approved strategy for portfolio companies
- Industries: companies' industries and adjacent/synergetic industries
- Required IRR: higher than weighted average cost of capital (WACC) with discounted payback period (DPBP) of 3-10 years (WACC and DPBP are approved for each asset annually)

Principles of managing Sistema's assets

- Introduction of a partnership management model that allows key executives of the Corporation to share the risks and returns from investment activities with the shareholders
- Managing of assets across sector verticals led by Managing Partners
- Managing Partners have responsibility for implementing the investment strategies of portfolio companies
- Boards of Directors of portfolio companies provide control, coordination and support for management in decision-making in key functional areas (strategy, key deals, budget planning, HR and internal audit)
- Engagement of industrial experts as members of the Boards of Directors of portfolio companies
- Incentives of Managing Partners is designed to: (1) increase Sistema's capitalisation, (2) maximise the value of assets under management and monetise this value, (3) raise outside capital for management

3.3 Shareholders' equity

STRUCTURE OF SHAREHOLDERS' EQUITY

Sistema has 9,650,000,000 ordinary shares outstanding with a nominal value of RUB 0.09 each. Its authorised capital is RUB 868,500,000.

Sistema held an initial public offering in 2005. Its shares trade on the London Stock Exchange in the form of global depositary receipts (GDRs) under the ticker SSA. One GDR represents 20 ordinary shares. The Corporation's ordinary shares are also listed on Moscow Exchange in the first listing level under the ticker AFKS. The GDRs traded on the London Stock Exchange represent about 17.6% of Sistema's equity, while the shares traded on Moscow Exchange represent 14.8%.

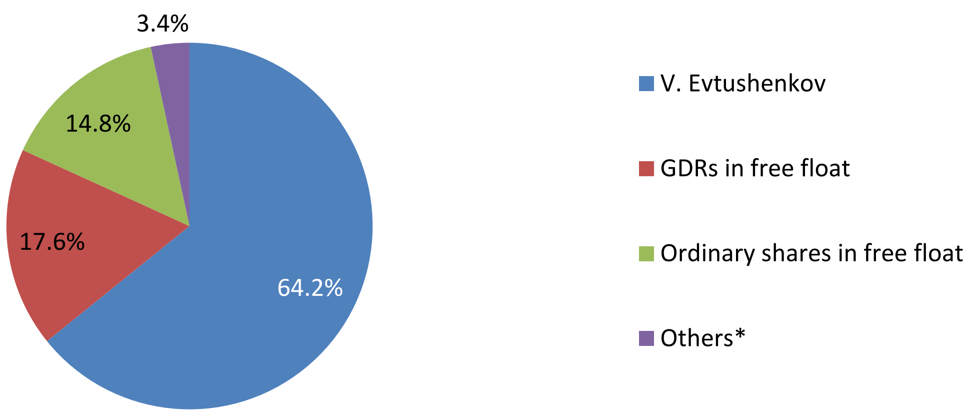
Sistema's shares are included in Moscow Exchange's two key indices, the MOEX Russia Index (formerly MICEX) and RTS, as well as its Broad Market Indices[9].

Shares of MTS, a Sistema subsidiary, trade on Moscow Exchange under the ticker MTSS and on the New York Stock Exchange (NYSE) in the form of ADRs under the ticker MBT.

Shares of Detsky Mir, a Sistema subsidiary, began trading on Moscow Exchange in February 2017 under the ticker DSKY in the first listing level.

Sistema's principal shareholder is its Chairman Vladimir Evtushenkov, who owns 64.2% of the Corporation's equity.

Sistema's shareholding structure[10]



** Ordinary shares and GDRs owned by Sistema Group companies, members of the Board of Directors and the management of Sistema.*

CHANGES IN SISTEMA'S GDR AND ORDINARY SHARE PRICES[11]

In 2017, Sistema's share price fell by 47.8% and the price of its GDRs by 53.7%, mainly due to investors' reaction to claims made by Rosneft, Bashneft and the Republic of Bashkortostan against the Corporation throughout the year (the claims were settled in December 2017).

[9] Broad Market Indices of the Moscow Exchange include top 100 securities selected based on the criteria of liquidity, capitalisation and the number of shares in free float and form the bases for calculation of the Moscow Exchange's other indices. The calculation bases include the shares whose free float coefficient is at least 5%.

[10] As of 31 March 2018

[11] Source: Bloomberg

On the first trading day of 2017, the closing price of one GDR on the London Stock Exchange was USD 9.0, corresponding to Sistema’s total market capitalisation of USD 4,342.5mn. On the last trading day of the year, the closing price was USD 4.17, with Sistema's total market capitalisation standing at USD 2,012.0 mn.

The closing price of GDRs reached a record high of USD 10.0 on 24 January 2017, and the ordinary shares peaked at RUB 25.1 on 20 January 2017. The lowest closing GDR and ordinary share prices were recorded on 18 December 2017 at USD 3.0 and RUB 9.0, respectively. Average daily trading volume on the London Stock Exchange in 2017 was 775,715 GDRs, and on Moscow Exchange 21,592,735 ordinary shares.

3.4 Dividends

DIVIDEND POLICY

In April 2017, the Board of Directors of Sistema approved a revised dividend policy. In accordance with the policy the amount of dividends recommended by the Board for each reporting year will be the higher of either an amount equivalent to a dividend yield of at least 6% or RUB 1.19 per ordinary share. The Corporation has set itself the goal of paying dividends twice a year, based on the results for the first nine months of a reporting year and for a full reporting year.

DIVIDENDS DISTRIBUTED FOR THE FIRST NINE MONTHS OF 2017

On 3 November 2017, an Extraordinary General Meeting of Sistema's shareholders (Minutes No.2-17) approved a distribution in the form of interim dividends of 6,562,000,000.00 (six billion five hundred and sixty-two million) rubles, or 0.68 (zero point sixty-eight) rubles per ordinary share in Sistema.

As of 31 December 2017, the total amount of interim dividends for 9M 2017 paid was 2,121,721,383.40 rubles (the total amount of dividends paid to nominee shareholders and custodians being professional participants of the securities market who are registered in the shareholders register).

DIVIDENDS NOT PAID TO SHAREHOLDERS

As of 31 December 2017, the total amount of outstanding dividends due for payment by that date according to applicable laws and regulations was RUB 1,032,976.28, including:

- dividends payable in 2017 – RUB 149,006.16;
- dividends payable for previous years – RUB 883,970.02;

The reason for non-payment of the declared dividends due by 31 December 2017 was the absence of information required for making payments due to shareholders entitled to dividends.

After 31 December 2017, the amount of dividends unpaid by the dates set forth by applicable laws and regulations increased by RUB 4,213,003,660.24. Reasons for non-payment of the indicated amount of dividends include a written application of a shareholder and absence of conditions required for paying dividends.

	Total amount of declared dividends, RUB	Dividend per share, RUB	Declaration date	Payment date
2012	2,702,000,000	0.28	30/06/2012	24/08/2012
2013	9,264,000,000	0.96	29/06/2013	26/08/2013
2014	19,879,000,000	2.06	28/06/2014	31/07/2014
2015	4,535,500,000	0.47	27/06/2015	29/07/2015
2016 (for the full year 2015)	6,465,500,000	0.67	25/06/2016	27/07/2016
2016 (for 1H 2016)	3,667,000,000	0.38	23/09/2016	20/10/2016
2017 (for the full year 2016)	7,816,500,000	0.81	24/06/2017	28/11/2017
2017 (for 9M 2017)	6,562,000,000	0.68	28/11/2017	22/12/2017[12]

[12] Date of payment of dividends to the nominee shareholders and custodians being professional participants of the securities market who are included in the shareholders register.

3.5 Financial review

REVIEW OF THE FINANCIAL PERFORMANCE OF SISTEMA GROUP

(RUB mn)	**FY 2017**	**FY 2016**	**Change**
Revenues	704,551	680,864	*3.5%*
Adjusted OIBDA[13]	199,549	184,800	*8.0%*
Operating income	91,222	82,169	*11.0%*
Loss attributable to Sistema	(94,603)	(11,759)	-
Adjusted (loss)/profit attributable to Sistema[12]	*4,119*	*1,481*	*178.1%*

In 2017, Sistema's consolidated revenues increased by 3.5%, mainly due to strong like-for-like[14] sales growth and the ramp-up of new stores at Detsky Mir, solid mobile revenue growth from MTS's Russia business as well as successful expansion and higher capacity utilisation at Medsi.

Group selling, general and administrative expenses (SG&A) for the full year 2017 remained under control, increasing by 1.6% year-on-year to RUB 154.5bn. Growth of SG&A expenses at Detsky Mir driven by the company's robust and cost-efficient expansion in Russia (with 104 new stores opened during the year) was largely offset by a decline of SG&A expenses at the Corporate Centre due to lower management incentive payments.

Group adjusted OIBDA increased by 8.0% in 2017, reflecting stronger operating performance at MTS, MTS Bank's return to profitability due to lower provision charges, as well as improved efficiency at Detsky Mir and Medsi and lower SG&A costs at the Corporate Centre. The adjusted OIBDA margin 28.3% for the full year, a year-on-year increase of 1.1 percentage points.

The adjusted profit attributable to Sistema was RUB 4.1bn in 2017, up 2.8 times against the result for 2016, thanks to solid bottom-line performance at MTS and the turnaround at MTS Bank.

REVIEW OF THE FINANCIAL POSITION OF SISTEMA GROUP

Group adjusted consolidated financial liabilities[15] amounted to RUB 638.8bn as of 31 December 2017, representing an increase of 24.2% versus RUB 514.4bn as of 31 December 2016. This increase was driven primariliy by the recognition of the liability under the settlement agreement with Rosneft, Bashneft and the Republic of Bashkortostan, as well as by borrowings at MTS and the Corporate Centre.

As of 31 December 2017 Group cash and cash equivalents amounted to RUB 60.0bn, remaining largely flat as compared to the end of 2016.

Net financial liabilities at the Corporate Centre level amounted to RUB 213.4bn as of 31 December 2017, as compared to RUB 119.8bn as of 31 December 2016. The 78.1% increase in net financial liabilities during 2017 was mainly attributable to the liability under the settlement agreement with Rosneft, Bashneft and the Republic of Bashkortostan. Cash position[16] at the Corporate Centre level as of 31 December 2017 amounted to RUB 13.6bn as compared to RUB 13.5bn as of 31 December 2016.

Group adjusted consolidated financial liabilities can be reconciled to the Group's borrowings as follows:

[13] See Attachment A on page 92 for definitions and reconciliation of adjusted OIBDA and adjusted profit attributable to Sistema to IFRS financial measures.
[14] Like-for-like (LfL) growth in RUB terms. LfL growth includes only DM stores in Russia that have been in operations for at least twelve full calendar months.
[15] Group consolidated financial liabilities include financial liabilities at the Corporate Centre level of RUB 227.0bn (based on management accounts) and total borrowings at the Group's portfolio companies of RUB 411.8bn in accordance with IFRS.
[16] Including highly liquid deposits and liquid financial investments, based on management accounts.

(RUB mn)	4Q 2017	4Q 2016
Borrowings	**535,719**	**478,126**
Liabilities to Rosimushchestvo and RUSNANO	23,028	36,291
Liability under the Settlement Agreement	80,000	-
Adjusted consolidated financial liabilities	**638,747**	**514,417**

Net financial liabilities at the Corporate Centre level can be reconciled to the indebtedness of Sistema's Corporate segment as follows:

(RUB mn)	4Q 2017	4Q 2016
Indebtedness	**123,974**	**97,025**
Liabilities to Rosimushchestvo and RUSNANO	23,028	36,291
Liability under the Settlement Agreement	80,000	-
Cash and cash equivalents	(13,298)	(7,100)
Liquid deposits and financial instruments	(271)	(6,380)
Net financial liabilities	**213,433**	**119,836**

For details on Sistema's financial risk management objectives and policies, as well as Sistema's exposure to price risk, credit risk, liquidity risk and cash flow risk please see Note 31 of Sistema's Consolidated Financial Statements as presented in this report.

SEGMENT FINANCIAL RESULTS OVERVIEW

The table below summarises main performance metrics of Sistema's key portfolio assets.

(RUB millions)	Revenues		Adjusted OIBDA		Adjusted profit/(loss) attributable to Sistema	
	FY 2017	FY 2016	FY 2017	FY 2016	FY 2017	FY 2016
MTS	442,910	435,692	178,358	167,647	29,926	25,377
Detsky Mir	97,003	79,547	10,664	8,203	2,871	2,775
Segezha Group	43,725	43,018	7,081	8,655	81	1,961
Agroholding Steppe	10,210	8,358	4,019	2,857	1,130	871
Medsi	11,670	9,409	1,968	592	837	(720)
MTS Bank[17]	18,106	18,268	923	(2,345)	169	(2,616)
Real Estate[18] (Leader Invest, Business-Nedvizhimost)	15,267	12,810	5,960	5,237	2,452	2,877
RTI[19]	50,579	52,628	6,626	5,809	(2,563)	(4,730)
Bashkirian Power Grid Company (BPGC)	17,671	16,052	5,259	5,636	2,369	2,706
Binnopharm	2,363	1,939	482	415	14	11
Hospitality assets	4,318	2,794	849	487	(517)	(252)
Corporate[20]	2,640	2,852	(12,103)	(13,864)	(21,495)	(18,720)

[17] Excluding results of East-West United Bank (EWUB) and the result of the divestment of a 47% stake in EWUB
[18] In this table Leader Invest results for 2017 are presented in accordance with IFRS 15. 2016 results are presented in accordance with IAS 18.
[19] RTI's financial results in this table are presented in accordance with IFRS 15 standards. In the consolidated accounts of Sistema Group, RTI's financial results are presented in accordance with IAS 18 standard
[20] The Corporate segment comprises companies that control and manage Sistema's interests in its subsidiaries.

KEY PORTFOLIO ASSETS

MTS

PJSC Mobile TeleSystems is a leading telecom operator in Russia and the CIS. MTS Group has more than 106.5m mobile subscribers in Russia, Armenia, Ukraine and Belarus. The company also provides fixed-line telephony, broadband Internet, cable and satellite television, digital, mobile application and e-commerce services in Russia, as well as additional GPON-based services in Moscow (MGTS). MTS has about 5,700 retail outlets in Russia.

Sistema's stake: 50.25%[21]

Leadership

- President, Chairman of the Management Board: Alexey Kornya[22]
- Chairman of the Board of Directors: Ron Sommer

Industry overview for 2017

According to analytical agencies[23], in 2017 the Russian telecoms market grew by +1.3% year-on-year, vs a decline of -0.6% in 2016. The market size was RUB 1.6tn, of which mobile communications accounted for RUB 0.9tn (growth by +1.5%). The number of mobile subscribers was down by 180,000, from 255.6m in 2016 to 255.4m in 2017. All Big 3[24] operators experienced this drop as they shifted focus from increasing the number of new connections to attracting and retaining high quality subscribers, as well as due to changes in their retail strategies and a reduction in price competition.

Markets for fixed-line telephony and inter-operator services continued falling year-on-year, by 9% and 7% respectively.

In 2017, the market for fixed-line broadband Internet continued growing both in terms of income (+3.7%) and subscriber numbers (+4.3%).

Markets for additional services increased at a faster pace. The Russian Internet of Things (IoT) market in 2017 grew by 22% to RUB 9.3bn.[25]

Significant changes were made to communications legislation in 2017. Two bills on cancelling internal roaming in Russia were submitted to the State Duma. MTS already has tariff plans and tariff options that allow its subscribers to use communications services at home-region prices while travelling within the country.

The anti-terrorism package on storage of information (text, images, audio and video) transmitted via communication networks signed by the President of Russia in July 2016 (to enter into force on 1 July 2018) was widely discussed by all market players in 2016-2017. The final document is expected to be approved in 1H 2018. In order to comply with the law, MTS has already started construction of module data processing centres in Nizhny Novgorod and other Russian regions.

Revenue of the mobile business, RUB bn

	2014	2015	2016	2017
MTS	290.4	296.2	295.0	304.0
Vimpelcom (Veon)	221.4	219.0	218.5	224.2
Megafon	265.5	265.1	259.0	260.0
Big 3 in total	**777.3**	**780.3**	**772.5**	**788.2**

[21] As of 31 December 2017
[22] As of 31 December 2017 and until 13 March 2018: Andrey Dubovskov
[23] TMT Consulting (www.tmt-consulting.ru, December 2017, February 2018), AC&M Consulting (ComNews.ru 2 April 2018)
[24] MTS, VEON (VimpelCom Ltd.), Megafon
[25] According to preliminary data from AC&M Consulting

Business development in 2017

As the leading Big 3 operator in terms of revenue and OIBDA, in 2017, MTS continued developing its networks, optimising costs, increasing operational efficiency and implementing its digital transformation strategy[26]. In 2017, MTS Russia extended its lead over its competitors in terms of revenue from mobile business and OIBDA and ensured the smallest outflow of subscribers (10% per quarter on average).

In 2017, MTS continued constructing networks in all spectrums, mainly 4G, and tested a 5G network in partnership with Ericsson in Q3 2017. In addition, MTS is implementing projects for joint use of infrastructure and spectrum with Veon and Megafon. Joint use reduces capital expenses per base station by half.

MTS is the leader in the Russian M2M/IoT market. In December 2017, MTS opened the first permanent IoT laboratory in Russia under the aegis of the Global System for Mobile Communications (GSMA) international association, presenting to its customers and partners pilot solutions based on Narrow Band IoT (NB-IoT) technology that can be used at home, in security systems, in city infrastructure and utility services.

In September 2017, MTS started providing services for cloud processing of big data – Big Data as a Service (BDaaS) – using its own data centres. First Cargo Company, Sberbank and BAT Russia became the first users of the virtual data centre.

Acquisition of LiteBox, a cloud retail software developer, gave MTS an opportunity to expand its ecosystem of financial products and strengthen its B2B platform.

In 2017, MTS acquired e-sports club Gambit Esports, which has one of the top teams in the world, thus entering the e-sports market.

Business development strategy

- “3D: Data. Differentiation. Dividends” strategy was transformed into “3D: Data. Digital. Dividends”. The Digital segment envisages introduction of digital technologies into the company's main operations and active development of digital products.
- MTS’s operational strategy focuses on development of basic mobile and package services, fixed-line services and digital products. MTS will strengthen the convergence of services and expand its multiservice portfolio.
- The 2018-2020 investment programme envisages implementing digital services and VoLTE (Voice over LTE) projects, increasing the capacity of optic fibre lines for new services and products, and preparing networks for commercial use of the 5G spectrum in Russia.
- In April 2016, the Board of Directors of MTS approved a new dividend policy for 2016-2018, under which MTS intends to pay dividends in the amount of RUB 25-26 per ordinary share and RUB 50-52 per ADR with a guaranteed minimum payout of RUB 20 per ordinary share and RUB 40 per ADR per calendar year. To ensure additional shareholder returns, the Board of Directors of MTS also approved a programme to buy back MTS's own shares and ADRs in the amount of up to RUB 30bn within 3 years. As a result of the first (4Q 2016) and second (1Q 2017) tender offers MTS purchased 35,121,665 ordinary shares worth RUB 10bn in total. In 3Q 2017, MTS launched a share buyback programme for up to RUB 20bn. As of the end of March 2018, MTS purchased shares worth RUB 19.8 from Sistema and minority shareholders.

2017 financial performance

(RUB mn)	**2017**	**2016**	**Change**
Revenue	442,910	435,692	*1.7%*
Adjusted OIBDA[27]	178,358	167,647	*6.4%*
Operating income	94,671	86,065	*10.0%*

[26] See Business development strategy for more detail.
[27] Including share in MTS Bank's net income / (loss)

Adjusted net income attributable to Sistema	29,926	25,377	*17.9%*

In 2017, MTS achieved strong results and continued to deliver on its digital strategy. Amid an improved operating environment and higher usage of data services, the company posted 1.7% growth in revenues.

Adjusted OIBDA increased by 6.4% in 2017, while the adjusted OIBDA margin rose by 1.8 percentage points for the full year. In addition to revenue growth, factors affecting OIBDA and the OIBDA margin included a decline in SIM-card sales in Russia, higher gross margins on handset sales and a 12.4% decrease of MTS's retail network during the year to 5,696 stores at year-end 2017.

Detsky Mir

Detsky Mir Group is the largest children's goods retailer in Russia, comprising the Detsky Mir and ELC chains.[28] It offers toys, apparel and footwear, stationery, arts and crafts kits, sporting goods, and baby and pregnancy products.

The Detsky Mir chain has 578 stores in 207 cities and towns in Russia and 12 cities and towns in Kazakhstan, while the ELC chain has 44 stores in Russia[29]. The total selling space of the group's stores is 688,000 sq m.

Sistema's stake: 52%

Leadership

- CEO: **Vladimir Chirakhov**
- Chairman of the Board of Directors: **Christopher Baxter**

Industry overview for 2017[30]

The Russian children's goods market can be divided into five categories: toys, clothes, footwear, baby products, and stationery and other products for children aged 0 to 12. The size of the children's goods market in Russia in 2017 amounted to RUB 525bn, compared with RUB 396bn in 2011. The market's CAGR over the past 7 years was 4.8%. Analysts project that the market will grow by an average of about 1% per year and will reach RUB 547bn by 2021.

The children's goods market is highly resilient to crises (along with FMCG). In 2016-2017, some specialised players left the market, while other national and regional chains lost traffic and closed stores, with a significant decrease in like-for-like sales. Nevertheless, specialised retailers remain the main sales channel for children's goods, along with hypermarkets and supermarkets (39.8% and 39.7% market share, respectively, in 2017).

E-commerce is an increasingly popular sales channel, with an average annual growth rate in 2011-2017 was 24.5%. Online sales of children's goods in 2017 amounted to RUB 53.1bn.

Clothing and footwear traditionally account for a substantial part of the children's goods market, with total share in 2017 of 38.5% (28.8% and 9.7%, respectively). Baby products and toys have 29.9% and 19.0%, respectively. Baby products are growing at a faster rate: in 2017, this category reached RUB 157bn in revenue compared with RUB 89bn in 2011.

Business development in 2017

[28] Detsky Mir Group consists of PJSC Detsky Mir, LLP Detsky Mir Kazakhstan and LLC Kub-Market (ELC brand)
[29] As of 31 December 2017
[30] According to data from Ipsos Comcon and Detsky Mir Group

In 2017, Detsky Mir continued its robust development by opening 104 new stores. The company opened a record 62 new stores in the fourth quarter of 2017.
Detsky Mir continued its expansion in Kazakhstan by opening 10 new supermarkets, almost doubling its retail chain in the country to 22 stores in 12 cities. In 2017, like-for-like sales in tenge increased by 25%.

In addition to retail stores, Detsky Mir Group offers all of its products for purchase online. Since its launch in 2011, the online segment has been the company's fastest growing sales channel (CAGR in 2011-2017 of 121%). One of the key drivers of turnover growth in this segment in 2017 was the launch of in-store pick-up.

A unique feature of Detsky Mir's e-commerce is using sources of free traffic. The company has no significant expenses on promoting its online store, but remains profitable, and thereby more operationally efficient than its competitors.

A strategic area for Detsky Mir is the development of private labels. On average, private labels accounted for 26.7% of Detsky Mir's entire product mix in 2017.

In 2017, Detsky Mir continued to improve its operating efficiency by reducing operating costs, primarily rental and personnel costs, and by optimising labour productivity and improving commercial terms with lessors.

Automation of business processes and introduction of new software helped cut transaction times and reduce the labour intensity of business processes. As a result, the average number of employees per store decreased from 26 in 2013 to 18 in 2017.

A key element of the company's strategy is the development of its logistics infrastructure. To optimise logistics costs, the company introduced a comprehensive transport management system in 2017.

In March 2017, Detsky Mir updated its loyalty programme, adding competitive advantages. Now bonuses can be used to pay for up to 100% of the purchase; the only exceptions are gift cards and services. As of the end of 2017, the loyalty programme had 18m participants.

IPO results

In February 2017, Detsky Mir held an IPO on the Moscow Exchange. Trading commenced on 10 February 2017 under the ticker symbol DSKY. The placement price was RUB 85 per share, giving a market cap of RUB 62.8bn. The company attracted bids for 2.1x the number of shares offered. The EV/EBITDA multiple was 9x. The successful IPO confirmed Detsky Mir's status as a highly attractive asset.

- ✓ The first IPO of a Russian non-food retailer over the last 10 years
- ✓ The IPO book was 2x oversubscribed; more than 90% of the final offering went to foreign investors
- ✓ Since the IPO, the price has risen by 13% (as of the end of March 2018)

Vladimir Chirakhov, CEO of Detsky Mir

"We are delighted by the strong market interest in our offering, and are pleased now to move forward with a high-quality and geographically diverse shareholder base. The IPO caps off an extremely successful year for Detsky Mir."

Business development strategy

The company plans to further consolidate the children's goods market through its unique and highly diversified product mix, affordable prices and digitalisation of sales. Detsky Mir sees additional potential to expand in Russia and Kazakhstan and plans to open at least 250 stores in the medium term.

Detsky Mir continues to develop omni-channel sales, in which buyers are not tied to any channels but can choose whichever is most convenient. The same prices, the same product mix and the opportunity to pick up an order in a retail store create synergy.

The level of service in 2018 will improve in-store pick-ups. The project "Perfect In-Store" sets an ambitious target: 90% of orders must be ready within 1 hour. After making an order online, the customer will be able to pick it up in the nearest store in just one hour.

2017 financial performance

(RUB mn)	**2017**	**2016**	**Change**
Revenue	97,003	79,547	*21.9%*
Adjusted OIBDA	10,664	8,203	*30.0%*
Operating income	8,024	6,620	*21.2%*
Adjusted net income attributable to Sistema	2,871	2,775	*3.5%*

In 2017 revenue at Detsky Mir increased by 21.9% year-on-year, thanks to the roll-out of new stores and the strongest growth in like-for-like sales among Russia's publicly traded retailers (+7.2% for the full year). E-commerce continued to be the fastest-growing sales channel. Online sales accounted for 4.8% of total sales in 2017.

Detsky Mir posted an adjusted OIBDA margin of 11.0% in 2017 as a result of continued improvements to operational efficiency on the back of stronger labour productivity and strict control of rental costs. The adjusted SG&A/revenue ratio declined by 0.9 percentage points year-on-year to 22.8% in 2017.

Segezha Group

Segezha Group is a fast-growing Russian forest holding with a vertically integrated structure and a full cycle of logging and advanced wood processing. Segezha Group includes Russian and European producers of high-quality unbleached sack paper, paper sacks, birch plywood, sawn timber and pre-fabricated glulam houses. Segezha Group's products are sold in 12 countries. The group's companies employ 13 thousand people.

Sistema's stake: 100%

Leadership

- President: Mikhail Shamolin[31],
- Chairman of the Board of Directors: Ali Uzdenov

Industry overview for 2017[32]

Sack paper

In 2017, the largest producers of sack paper increased their production output by 4.6% amid high demand in most markets and significant growth of prices for paper (up to 10%).

The global paper market is estimated at 6,900 t, while projected global consumption CAGR until 2020 is 2.3%. This growth will mostly be driven by demand in the Asian market.

[31] As of 31 December 2017 – K. Zakirov.
[32] Source of industry data: Indufor, Poyry

Paper sacks

According to expert estimates, the size of the European paper sacks market did not change significantly in 2017 year-on-year, at 5.5bn items. There were no substantial year-on-year changes in prices for paper sacks. The annual average growth rate of the market until 2021 is projected at 1%.

In 2017, consumption of paper sacks in Russia decreased to 742m items (-9.6% vs 2016) on the back of the continued fall in real household incomes and a rainy construction season. As the ruble strengthened against the euro in the first half of 2017, importers managed to partially substitute Russian producers of paper sacks (imports as a share of the market increased by 6% year-on-year and reached 26%). Prices for paper sacks in Russia fell by an average of 5%.

The availability of the group’s own high-quality raw materials allows Segezha to control the production cost of paper sacks and successfully compete with European producers both in Europe and Russia.

Birch plywood

The birch plywood market is estimated at 4.8-5m cu m. Russia is the world's largest producer of birch plywood, accounting for 71% of the global market (3.5m cu m). The CAGR of global birch plywood consumption is estimated at 2-2.7%. The world's largest consumers of plywood are Europe and Russia, which together account for 67% of the market.

In 2017, plywood output in Russia was approximately 3.68m cu m. Exports fell by 3% to 2.46m cu m due to decreased demand in the European market. Exports accounted for 67% of Russian plywood output.

In 2018, production of birch plywood is expected to grow by 4.2% globally and by 4.5% in Russia.

Sawn timber

The global market of sawn softwood timber grew by 1.5% year-on-year in 2017, reaching 337m cu m. Average annual growth of consumption in Segezha Group’s key markets is forecast at 1.6% through 2022.

Output of sawn softwood timber in Russia grew by 6% year-on-year in 2017, to 36.5m cu m.

Business development in 2017

Birch plywood

In 2017, Segezha Group was the world’s seventh biggest producer of large-size birch plywood, with output increasing by 4% year-on-year. Exports accounted for 78% of plywood sales, up from 74%. Segezha Group's key strategic markets are Germany, Benelux, the United States, France, Italy, Finland, South Africa, Spain, the Czech Republic and Denmark. In 2017, the company started deliveries to Algeria. In 2017, Segezha Group sold its plywood to 53 countries in total (compared to 57 in 2016).

Indicator	**2017**	**2016**	**%**
Plywood sales, K cu m	95	92	+3.2%

In 2017, Segezha Group continued the construction of a new plywood mill in Kirov (at the Vyatka Plywood Mill) with production capacity of 86K cu m. The new production facility will enable Segezha Group to enter new markets with long-grain plywood and expand production of short-grain plywood. The Kirov plywood mill will be commissioned in the first half of 2018.

Sack paper

Segezha Group is the world's fourth biggest producer of unbleached sack paper. Segezha Pulp and Paper Mill (Segezha PPM) is a leader in Russia for production and export of unbleached sack paper. Exports account for 92% of Segezha Group's paper sales.

High quality raw materials and low costs enable Segezha Group to increase the production output of sack paper by substituting products made by less competitive market players.

In 2017, Segezha PPM's sack paper sales (including intra-group supplies) totalled 298,000 tonnes, increasing by 8% year-on-year due to the launch of a new paper-making machine (No.11) produced by the Germany's Voith. The new machine is expected to reach full capacity in 2018, making Segezha Group the world's second biggest producer of kraft paper.

Segezha Group's paper is sold in 60 countries and successfully competes with the products of market leaders. Segezha Group is the world No 1 in terms of production cost of kraft paper.

Indicator	**2017**	**2016**	**%**
Sack paper sales, thousand t	204	170	+20.1%

Paper sacks

The sales of paper sacks decreased in 2017 as sales fell in Russia due to stronger competition and a temporary drop in demand. Segezha Group's share in the Russian paper sacks market did not change significantly, and stood at 51% at the end of 2017. Segezha Group strengthened its leading positions in the European market with sales growing by 9% year-on-year. The Group also substantially increased its export to Africa, the Middle East and the US.

Indicator	**2017**	**2016**	**%**
Paper sack sales, m items	1,191	1,270	-6.2%

Innovations: Integrated packaging solution

In 2017, Segezha Group developed an integrated packaging solution jointly with Mikron (a Sistema Group company): a smart sack with an embedded RFID tag enabling quick and accurate product identification. The technology makes it possible to improve customers' internal logistical processes and keep track of a product's location and final destination. The first commercial batch of smart packaging was produced in September 2017.

Sawn timber

In 2017, Segezha Group accounted for 2.5% of the total sawn timber output in Russia. About 47% of sawn timber produced by Lesosibirsk Woodworking Plant No.1 was sold to China and about 46% to countries in the MENA region: Egypt, Iraq, Lebanon and Syria. Sales to European countries totalled approximately 6%.

Indicator	**2017**	**2016**	**%**
Sawn timber, thousand cu m	894	912	-2.0%

Prefab houses

According to expert estimates, the total production of prefabricated glulam houses in Russia was about 104,000 cu m. Segezha Group's share in this market is roughly estimated at 20%.

The Sokol Woodworking Plant, part of Segezha Group, continues strengthening its leadership in the Russian market. In 2017, the plant reached record production volumes of laminated beams and prefab glulam houses, at more than 67,000 cu m.

The glulam houses manufactured by Segezha Group meet European standards EN 14081 and FSC, and may be classified as a business-class product.

Segezha Group is planning to increase the production of pre-fabricated glulam houses by 10% and enter new markets in the Baltic region and Scandinavia (Estonia, Sweden and Norway).

Innovations: systems for analysing forest reserves
In cooperation with Kronstadt Group (a Sistema Group company), Segezha Group is developing solutions for the forest industry that ensure more accurate and effective planning of forest resources. The company is planning to use the latest product developed by Kronstadt Group: a scalable cloud service with ready-made desktop solutions for cartographers and geoportal solutions. In future, the company will use drones to monitor forest reserves and produce detailed reports, with no need for field inspections. The first stage of the project will be completed by the end of 2018. This project will make it possible to significantly improve long-term planning for logging, construction of forest roads and management of the logging fleet, and to reduce the cost of logging.

Business development strategy

Segezha Group's strategy is aimed at creating an industry leader in terms of production efficiency using a vertically integrated and diversified business model. The Group is developing as a major forest holding with strong competitive advantages in the global market. Segezha Group produces quality and sought-after solutions and seeks to increase the share of high value-added products.

Investment programme

Segezha Group's investment programme focuses on:

- modernisation;
- improving efficiency;
- reducing environmental impact;
- improving product quality;
- increasing production output in key segments.

Segezha Group is committed to continuous improvement of efficiency at its production facilities. The Group constantly looks for opportunities to increase its production capacity by increasing the effectiveness of business processes, debottlenecking, automating production, and other methods.

Capacity of the Segezha's production facilities

	thousand t	thousand cu m	mn sq m	thousand cu m	thousand cu m	thousand cu m
Segezha Pulp and Paper Mill (PPM)	360					
Sokol PPM	19					
Vyatsky Plywood Mill		192	25			
LDK[33]				100		
Onega LDK				220		
Sokol PPM				115	58	37
Lesosibirsk LDK			25	600		

[33] LDK – "Sawmill"

Financial results in 2017

(RUB mn)	**2017**	**2016**	**Change**
Revenue	43,725	43,018	*1.6%*
Adjusted OIBDA	7,081	8,655	*(18.2%)*
Operating income	3,132	5,165	*(39.4%)*
Adjusted net income attributable to Sistema	81	1,961	*(95.9%)*

Revenue at Segezha Group increased by 1.6% in 2017, mainly due to higher sales of sack paper (on the back of strong growth of demand globally) and plywood.

During the year revenue was impacted by lower sales of paper sacks in Russia due to increased competition and a temporary decline in demand in the Russian sack market, as well as the strengthening of the RUB versus key currencies (69.6% of Segezha Group's revenues are denominated in foreign currencies).

During 2017, Segezha implemented a plan to reduce the adverse impact of external factors by tightening procurement expense controls, as well as reducing shipping and administrative costs. The decrease in adjusted OIBDA and profit for the year was mainly due to FX-rate pressures as well as inflation of logistics and raw material costs.

Revenue and OIBDA structure in 2017 by business units (RUB bn)

	Revenue	Adjusted OIBDA
Paper and Packaging	24.1	4.9.
Wood processing	13.4	1.6
Plywood and wood boards	5.9	1.8
Other	0.4	-1.3

Sales

Product type		**2017**	**2016**	**%**
Laminated wooden structures	thousand cu m	43.4	21.9	98.3%
Prefab glulam houses	thousand cu m	19.0	30.3	-37.4%
Fibreboards	mn sq m	48.2	49.3	-2.2%
Round timber production	thousand cu m	3,921.3	3,827.7	2.4%
Share of own logging	%	63.1%	63.0	-1.3 p.p.

Agroholding STEPPE

Agroholding Steppe is a major diversified agricultural player in Russia with a portfolio of assets in four key segments: crop farming, dairy farming, fruit growing and vegetable growing.

Located in southern Russia, Steppe's assets are in the most favourable regions for climate, crop yields and logistics. Agroholding Steppe owns 50% of RZ Agro, a major producer of grain and oil crops in southern Russia jointly controlled by Sistema and the Louis-Dreyfus family.

Sistema's stake: 91%

Leadership

- CEO: Andrey Neduzhko
- Chairman of the Board of Directors: Ali Uzdenov

Industry overview for 2017[34]

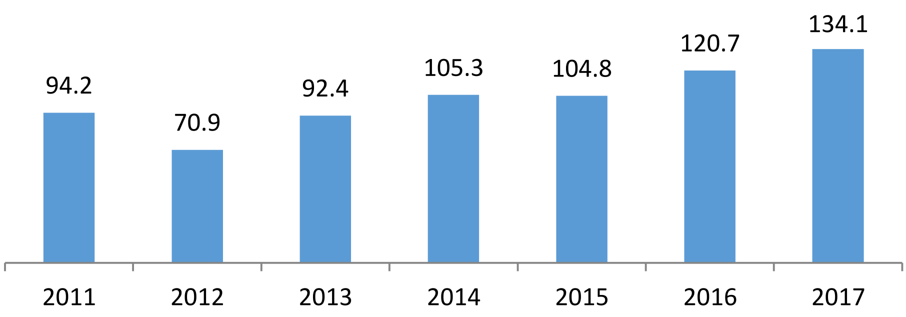
Crop farming

In 2017, grain and grain legume output in Russia was 134.1mn t (+11% vs 2016). The gross wheat harvest increased by 17% to 85.8mn t.
Growth was mainly due to a significant yield increase on the back of production intensification and favourable weather conditions.

High yields continued to have a negative impact on international grain prices, including the price of wheat.

Export of Russian grain and processed grain products reached an all-time high: export shipments in the 2017-2018 season were 47.5mn t, or 10.6mn t more than in the previous year. Russia's leadership in the international grain market is due both to an advantageous price-to-quality ratio and the weakening of the rouble against the US dollar and the euro in recent years, resulting in the US and European wheat becoming less competitive.

Gross grain and grain legume harvest in Russia, mn t



Source: Federal State Statistics Service

Dairy farming

In 2017, milk production in Russia grew by 1.2% year-on-year to 31.1mn t (the first time growth has been recorded in the past three years).

At the end of 2017, the total number of cattle across all producers' farms was 18.6mn head of cattle (0.6% less than in 2016), 8.2mn of which were cows (0.7% less than in 2016).

The decrease in the number of dairy cows (by 8% to 8.2mn in the last five years) was offset by the growth of milk yield per cow to 5,600 l in 2017, a 15-year high.

Fruit growing

Russian apple output has continued growing (in 2017, gross pomaceous fruit yield increased by 5% to 2.0m t), but the Russian market still has high dependency on apple imports (which account for about 36% of consumption). In 2017, apple imports remained at the 2016 level of approximately 700,000 t.

The average apple yield of Russian agricultural enterprises is about 11 t/ha, while yields of intensive-type orchards are 40-50 t/ha.

[34] Sources: Russian Federal Statistics Service, USDA, FAO, the Russian Federal Customs Service

Vegetable growing

In 2017, production of protected-ground vegetables in Russia reached 922,000 t (an increase of 13% year-on-year), the highest in the last 20 years. Vegetable yield growth in recent years has been supported by the introduction of a food embargo in 2014 and subsequent ban on imports of tomatoes and cucumbers from Turkey. In 2017, imports of tomatoes and cucumbers increased by 12%.

Business development in 2017

Crop farming

In 2017, Steppe achieved an all-time high crop yield of 1.35mn t (including about 720,000 t of wheat), 30% more than in 2016. This was in part due to the expansion of land assets and introduction of new agricultural technologies. Steppe's land assets totalled 380,000 ha as of the end of 2017, including 106,000 ha of RZ Agro. In 2017, Steppe acquired 65,000 ha of land in the Stavropol and Rostov regions.

Dairy farming

As of the end of 2017, milk production grew by 9.0% to about 40,000 t due to an increase in the number of dairy cows, while high levels of milk output were maintained. Steppe remains Russia's leader in terms of milk yield per cow, at over 10,000 l per year.

In 2017, the company started the construction of a new generation dairy farm with 1,800 dairy cows (pilot operation began in March 2018). The new farm is expected to reach its design capacity of 20,000 t of milk per year in 2021. Potential for import substitution, inefficient producers leaving the market and a deficit of high quality raw milk create favourable conditions for developing dairy farming in Russia.

Fruit growing

Gross apple output at Steppe's farms grew by 35% in 2017 to 21,500 t. This significant growth is due to new orchards starting to bear fruit and older ones producing bigger yields. The orchard yield also grew by 5% in 2016, to 42.1 t/ha. The area of Steppe's intensive orchards at the end of 2017 was 780 ha.

Vegetable growing

Yuzhny Agricultural Complex, part of Agroholding Steppe, is Russia's biggest producer of protected-ground vegetables, with 144 ha of greenhouses. In 2017, the gross harvest of tomatoes and cucumbers was 44,900 t, and the average yield was 34.4 kg/sq m.
In 2017, Yuzhny Agricultural Complex continued implementation of a programme to increase operational efficiency. The company also focused on promoting its brand and developed a new modern logo and packaging.

Operating results, K t

Indicator	**2017**	**2016**	**Change, %**
Gross grain harvest	1.0	0.7	145%
Milk production	39.4	36.2	109%
Vegetable harvest	44.9	45.8	-2%
- Tomatoes	23.2	21.3	9%
- Cucumbers	21.8	24.5	-11%
Gross apple harvest	21.8	15.9	137%

Steppe's gross harvest (incl. RZ Agro), K t

	2016	2017	Change 2017 / 2016, %
Winter wheat	485.6	723.6	49%
Winter barley	21.9	19.2	-12%
Sugar beet	339.5	347.9	2%
Sunflower	31.9	42.7	34%
Grain corn	40.5	68.9	70%
Other	121.8	153	26%
Total	**1,041.0**	**1,355.31**	**30%**

Business development strategy

Steppe's strategic goal is to be the market leader in its key segments of operation. The company plans to continue acquiring new land, increasing the number of dairy cows and commissioning new dairy farms.

To improve the efficiency of its business, Steppe intends to develop related businesses, in particular grain procurement and trading, seed production and irrigation.

By improving operational efficiency, increasing gross yields and developing its own infrastructure for grain storage and handling, Steppe will be able to enter new export markets by being able to produce larger product batches and having control over the entire value creation chain.

Steppe also continues to focus on developing a high-quality corporate governance system. A new Board of Directors was formed in 2017 with independent directors including industry experts.

Financial performance in 2017

(RUB mn)	**2017**	**2016**	**Change**
Revenue	10,210	8,358	*22.2%*
Adjusted OIBDA	4,019	2,857	*40.6%*
Operating income	2,647	2,941	*(10.0%)*
Adjusted net (loss) / income attributable to Sistema	1,130	871	*29.7%*

Strong operating results allowed Steppe to increase revenues by 22.2% in 2017, despite pressures stemming from lower global wheat prices and the strengthening of the ruble.

Adjusted OIBDA in 2017 amounted to RUB 4.0 billion, a 40.6% increase year-on-year.

Medsi

Medsi is a leading national chain of healthcare facilities, offering a full range of medical services for children and adults (prevention, diagnosis, treatment of diseases and rehabilitation services).

Sistema's stake: 100%

Leadership

- President: Elena Brusilova
- Chairman of the Board of Directors: Artyom Sirazutdinov

Facilities	Quantity
Clinical diagnostic centres (CDCs), total	4
- *CDC Krasnaya Presnya*	*1*
- *CDC Belorusskaya*	*1*

- *CDC Grokholsky*	*1*
- *St Petersburg (Medem)*	*1*
Children's clinics	3
Primary care clinics	20
Hospitals	2
Wellness centres and sanatoriums	4
Regional clinics, total	12

Industry overview for 2017[35]

In 2017, the market for paid healthcare services[36] in Russia grew by 5.2% to RUB 542bn due to the ongoing transformation of the healthcare system and a strengthening of the role of private sector companies.

The largest and fastest growing segment of the market was the commercial segment (direct payments by individuals), which exceeded RUB 399bn in 2017. This segment is expected to continue to grow due to recovered growth of real incomes, adoption of the law on co-financing of medical services (so-called Mandatory Medical Insurance Plus, or MMI+), pressure on the shadow market from regulators and growth of medical tourism.
The voluntary medical insurance (VMI) segment has grown more than 1.5x to RUB 142bn over the past seven years.

Medsi's share in the market of paid medical services in 2017 was 2.2% across Russia (1.8% in 2016) and 4.1% in Moscow (3.8% in 2016). Medsi's revenue growth rate in 2017 was almost double the market average in all segments, strengthening Medsi’s position as a leading private healthcare operator in VMI channels and significantly increasing the share of revenue received as cash from individuals (+22% YoY).

Business development in 2017

Medsi improved key operating indicators in 2017: number of visits rose by 7% and average check by 15%. Revenue from the MMI channel significantly increased (+377% YoY) due to Medsi’s integration into the MMI system in specialised and high-tech care. The MMI channel is becoming a major source of customers for Medsi’s in-patient facilities.

The flagship facilities of the outpatient diagnostic segment are the clinical diagnostic centres (CDCs) at Belorusskaya and Krasnaya Presnya. These are multi-disciplinary centres with a total area of more than 30,000 sq m using world-class innovative technologies. CDC Belorusskaya is Medsi’s leading facility by volume of medical services provided (+5% YoY). Opened at the end of 2015, CDC Krasnaya Presnya reached full capacity in 2017, including the launch of a children's department, dentistry and in-patient care. The number of medical services provided increased by 2.7x.

In 2017, Medsi implemented a number of projects as part of its investment programme. In September 2017, a modern multi-disciplinary medical centre for children and adults with an area of more than 4,000 sq mn opened on 3rd Khoroshovsky Proezd in Moscow. In August 2017, Medsi acquired Medem clinic, thus entering the St Petersburg market. The clinic, with an area of 6,800 sq m, offers a full range of medical services for children and adults, from primary and sophisticated diagnosis to surgery and post-operative rehabilitation.

In January 2018, Medsi opened a family clinic on Leninsky Prospekt in Moscow and a clinic for adults in Leninskaya Sloboda after completing repairs, equipping and licencing in 2017.

[35] Source: mresearcher.com, Businessstat, cbr.ru, Insurance Wikipedia (Business-Service), the Federal Fund of Obligatory Medical Insurance, the Federal State Statistics Service
[36] Including the commercial segment (direct payments by individuals) and VMI

In 2018, Medsi plans to open at least three new clinics with an expanded diagnostic and therapeutic base in Moscow and the regions, and to start construction of a flagship multifunctional medical centre on Michurinsky Prospekt with an area of more than 28,000 sq m.
A priority area in 2017 was the formation of full-cycle medical care to provide patients with a full range of services. To this end, Medsi hired teams of highly qualified physicians led by outstanding specialists Konstantin Lyadov and Anatoly Makhson. In early 2018, Medsi's team was strengthened by the outstanding oncologists Mikhail Davydov and Georgy Manikhas.

In 2017, Medsi and MTS jointly developed a telemedicine service for online consultations to increase access to medical services. The pilot launch of the platform took place in January 2018; the service is planned to be expanded to most of Russian regions by the end of 2018.

Medsi continues to transform its management system: the company has formed vertically integrated business units at the level of clinics and prepared a programme to improve the efficiency of operational and business processes. When the reorganisation is completed in 2018, Medsi's management system will be in line with best practices in the management of medical companies.

Medsi is actively strengthening its relationships with leading international medical companies and research organisations to gain expertise and bring the latest medical technologies to Russia. In 2018, Medsi’s clinical Hospital in Otradnoe is expected to be included in the International Medical Cluster being implemented under Federal Law No 160-FZ.

Business development strategy

Medsi's strategy aims to build Russia's largest nationwide medical chain, combining three main components: healthcare, education and research. The main goal is to create an innovative medical platform based on a vertically integrated system of medical care.
One of Medsi's priorities is continuous improvement of the operating efficiency of its business processes. A key area is to increase security and the quality of customer service, including logistics and patient care in clinics (the “patient experience”). Medsi plans to increase customer comfort by improving its administrative and support functions, eliminating delays and queues, introducing advanced electronic and mobile services, etc.

Medsi's five-year investment programme aims to increase the company’s market share by opening new clinics and/or acquiring existing players, as well as at providing key assets with advanced high-tech equipment.

Financial results in 2017

(RUB mn)	**2017**	**2016**	**Change**
Revenue	11,670	9,409	*24.0%*
Adjusted OIBDA	1,968	592	*232.7%*
Operating (loss)/ income	1,142	(432)	-
Adjusted net income / (loss) attributable to Sistema	837	(720)	-

Medsi increased revenue by 24.0% for the full year 2017. Revenue growth was driven by an increase in patient visits and a higher average check as Medsi delivered a broader array of integrated services and high-tech surgeries. Revenue from the mandatory medical insurance segment, derived primarily from high-tech services, increased more than five-fold in 2017 to RUB 1.2 billion.

The Clinical Diagnostic Centre at Krasnaya Presnya, which opened in December 2015, increased capacity utilisation to 23% in 2017 and delivered 8% of Medsi’s total revenue.

For the full year 2017, the OIBDA margin was 16.9%, versus 6.3% in 2016.

Adjusted profit attributable to Sistema was RUB 837 million in 2017, versus a loss in 2016.

Medsi's operating results

Indicator	Units	2017	2016	%
Patient visits	thousand visits	7,901	7,314	+8.0%
Services provided	thousand services	12,359	11,483	+7.6%
Area	thousand sq m	233	221	+5.8%
Average cheque	thousand RUB	1.5	1.3	+14.8%
Revenue per sq m	thousand RUB	50.00	42.55	+17.5%

RTI

RTI is a major Russian research and production company that develops, produces and supplies technological solutions including radars, automated control systems and situation centres, communications systems, and electronic and microelectronic devices.

RTI has a robust R&D infrastructure and well-equipped serial production facilities employing more than 15,000 researchers, designers, engineers and highly qualified personnel. Thanks to this, the company is able to implement major and uniquely complex projects on a national scale, and create high-tech innovative products.

Sistema's stake: 87%

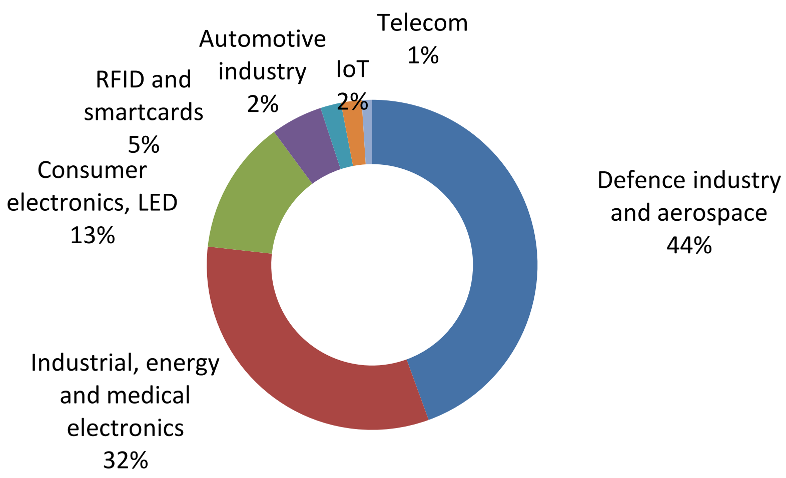
Leadership

- CEO: Maxim Kuzyuk
- Chairman of the Board of Directors: Sergey Boev

Industry overview for 2017[37]

Despite a decrease in defence spending in 2017, the industry is expected to grow in the medium term. Prevailing market trends include increased automation and intelligence of security systems. Russia is following global trends, which will result in increased spending on civilian and military information and control systems. Other trends in the Russian defence sector include consolidation and vertical integration involving other major holdings.

Russian microelectronics market by sector



[37] Source: Ministry of Finance of the Russian Federation

In 2017, the Russian microelectronics market was valued at RUB 131bn. Traditionally the biggest segment, worth RUB 58bn, is production of equipment for the defence, aerospace and nuclear energy sectors. This segment is currently migrating to microcircuits with higher levels of integration, as they have a lower weight and size, which is crucial for most of specialised applications.

RFID tags and smart cards (worth RUB 6bn) are mostly used in transport tickets and chip modules for bank cards. The market is growing by 5%-7% per annum in physical terms, but volumes remain flat in money terms due to falling prices. Growth in the segment will be driven by introduction of RFID tagging for individual inventory items and continued migration of personal identification documents to protected chip carriers.

The total value of the Russian microelectronics market is RUB 32bn. Mikron accounts for 31% of this, remaining the undisputed leader by revenue, production output and level of technology.

Business development in 2017

RTI continues developing new products in the radar segment. In 2017, the company commissioned three radar stations making it possible to close the radar defence loop around Russia. New very long-range radars produced by RTI using prefabrication technology significantly increased the reliability and quality of radar surveillance across Russia.

As part of the programme for developing automated control systems, RTI developed the Region 2020 experimental automation system. The system is designed to optimise the work of control bodies of regional and municipal sub-systems of the Russian Unified System for Prevention and Response to Emergency Situations.

A joint project between RTI subsidiary Yaroslavl Radio Factory and Thales Alenia Space to produce communications equipment entered the final phase of implementation. The companies developed and approved a road map and production schedules for joint manufacturing of equipment for the space industry.

RTI maintained its leadership of the microelectronics segment. Mikron is among Europe’s five largest full-cycle microelectronics producers, and the largest in the CIS. Mikron launches serial production of more than 20 new products annually, each of which forms the basis for new digital solutions and services. One of the key areas for new product development is the RFID segment, in which Mikron produces more than 480 items a year.

Among key new products tested and now ready for serial production are eight new RFID tags for various purposes, including tags for animals and for marking wood and metal goods. The results of such R&D work are noticeable at the lab testing stage: following a pilot project for tagging transportation documents for raw wood in Irkutsk region, volumes of illegal logging fell by 53% in just three months year-on-year.

Mikron's product portfolio contains about 700 types of microchips, cards and tags, with 15-25 new products tested and certified every year, including standard and customised chips. Most of Mikron's microchips were given the status of Category 1 domestically produced integrated microchips by the Industry and Trade Ministry.

Mikron is Russia’s biggest exporter of microchips, accounting for 53% of the national total.

Mikron's operational achievements in 2017:

- launching a new-generation driving licence and vehicle registration certificate
- manufacturing Mir-Maestro national bank cards jointly with MTS Bank
- supplying 2mn chip modules for bank cards of the Mir national payment system
- launching electronic mandatory medical insurance policies using Mikron's microchips and Russian software
- serial production of contactless transport cards and tickets for entertainment events
- export of 919 million microchips

Operating results

	2017	2016	%
Total microchips produced, m, of which:	900	860	5%
transport cards, m	230	230	0%
export chips, m	360	330	9%

Business development strategy

RTI's strategy aims to strengthen the company's market position and pursue organic growth in those segments in which the company already operates, to enter adjacent market segments and boost exports in all segments.

In the public procurement segment RTI focuses on maintaining leadership in radio, surveillance and communication systems, as well as information systems for managing and supporting decision-making. In addition to very long-range radars, RTI is planning to develop sales in adjacent segments and increase exports.

In the microelectronics segment RTI focuses on aggressive market growth to meet the needs of the digital economy. Key industry drivers in the near future will include the IoT and Artificial Intelligence, which require a large number of different microchips, 70% of which Mikron produces using its own technologies.

In 2018, RTI Group will continue building a sustainable business model to meet its obligations to government and external investors. RTI will continue implementing a programme launched in 2017 to boost business efficiency with a focus on creating added value at the operating level and growing cash flows to ensure financial stability.

Financial results in 2017[38]

(RUB mn)	**2017**	**2016**	**Change**
Revenue	50,579	52,628	*(3.9%)*
Adjusted OIBDA	6,626	5,809	*14.1%*
Adjusted operating income	3,708	3,014	*23.0%*
Adjusted net income (loss) attributable to Sistema	(2,563)	(4,730)	-

RTI saw a moderate decline in revenue in 2017 due to a 6.8% year-on-year decrease in revenue from the Radio-technical Systems business unit[39], as well revenue volatility in relation to a major government contract. This was partially mitigated by a 15.7% year-on-year revenue growth in the Microelectronics business unit as a result of increased import substitution of electronic components and heightened demand for Mikron's products.

Adjusted OIBDA for 2017 improved by 14.1% largely due to strong OIBDA dynamics in the Microelectronics business unit.

The net result for the year improved thanks to reduced financial expenses.

MTS Bank

MTS Bank is a universal financial organisation that provides banking services to individuals and corporate customers.

[38] RTI's financial results in this press release are presented in accordance with IFRS 15 standards. In the consolidated accounts of Sistema Group, RTI's financial results are presented in accordance with IAS 18 standard.
[39] Former Defence Solutions business unit

MTS Bank operates in Russia and services clients across the entire chain of MTS outlets. Corporate customers are serviced in seven branches and 80 bank offices in Russia's key regions.

Sistema's stake: 87%

Leadershipt

- Chairman of the Management Board: Ilya Filatov
- Chairman of the Board of Directors: Vsevolod Rozanov

Banking sector overview for 2017[40]

In 2017, the total assets of Russian banks increased by 6% to RUB 85.2tn as the economy stabilised, consumer demand in a number of markets recovered, and interest rates fell. The banking system as a whole earned RUB 790bn in total net income, a 15% decline from the previous year (RUB 930bn). The decrease in total income was triggered by losses at major lenders rescued by the Bank of Russia's Banking Sector Consolidation Fund.

In 2017, the corporate loans portfolio remained virtually unchanged at RUB 30.2tn (as of 1 January 2018).

Retail lending volumes increased by 12.7% to RUB 12.2tn. Household savings rose by 7.0% to RUB 26tn. Average interest rates on ruble deposits at the largest banks fell to 7.25% p.a. by the end of 2017 compared to 8.4% p.a. at the start of the year.

Business development in 2017

As of the end of 2017, MTS Bank ranked 48th among Russian banks by assets, 36th by individual deposits and 44th by capital. The bank also ranked 30th by net income under Russian Accounting Standards.

In 2017, the Bank focused on implementing a digital transformation programme by upgrading its range of cards, introducing agile management of product development processes, and launching product sales through its own remote channels and those of mobile operator MTS.

The number of active customers increased by 36% in 2017, reaching 1.5mn. The use of digital products (online and mobile banking services) increased, with penetration of these services within the customer base reaching 24.3% (above the market average) mostly as a result of the Bank's cooperation with MTS. In 2017, MTS Bank successfully integrated some of its services with the mobile operator's key product, MTS E-Wallet.

The Bank is actively developing digital services for its customers, including online lending. Sales of credit cards through digital channels in 2017 rose from 0.1% to 14% of the total. Digital sales accounted for 7% of total sales in 2017. In the corporate segment MTS Bank pursues a conservative risk policy by focusing on high-quality borrowers. During the year MTS Bank increased the appeal of its offer for corporate customers by developing payment processing services.

MTS Bank continues to expand its cooperation with MTS and other Sistema portfolio companies. In October 2017, the Bank signed an agreement for provision of Internet acquiring services with Ozon, a leading multi-category online retailer in Russia.

The Bank's main goal for 2018 is to continue aggressive growth of the retail customer base by developing a digital banking business model and transaction banking services for small and micro businesses.

Business development strategy

MTS Bank's strategy aims to build a digital bank in cooperation with MTS and other Sistema Group companies.

Key elements of the strategy are:

[40] Source: "Review of the Banking Sector of the Russian Federation" by The Central Bank of the Russian Federation (http://www.cbr.ru)

1. Aggressive growth of the retail business through participation in MTS's eco-system and development of own partnership network to build a 5mn customer base and become a top-10 bank by credit cards and a top-5 bank by point-of-sale loans.
2. Conservative growth of corporate business on a par with the market, and optimisation of cross sales and operating model.
3. Relaunching work with small and micro businesses using a direct banking model with a focus on transactions in remote channels.

Financial results in 2017[41]

(RUB mn)	**2017**	**2016**	**Change**
Revenue	18,106	18,268	*(0.9%)*
OIBDA	923	(2,345)	-
Operating (loss) / income	370	(3,034)	-
Net (loss)/ income attributable to Sistema	169	(2,616)	-

In 2017 MTS Bank successfully delivered on its plan to return to profitability by pursuing a strategy of partnering with MTS and other Sistema portfolio companies.

For the full year, interest income decreased by 5.4% mainly as a result of lower interest rates in Russia. This was partially mitigated by an 8.3% increase in higher-margin retail lending, with retail loans accounting for 59% of the total loan book at the end of the reporting period, versus 53% a year earlier.

In line with the Bank’s strategy of building a leading digital bank, MTS Bank grew fee and commission income by 31.6% for the full year.

The Bank recorded a net profit for the year of RUB 169 million.

Real estate assets

This segment is represented by a number of companies, the key ones being Leader Invest (property development) and Business Nedvizhimost (rental assets).

Financial performance in 2017 (Leader Invest and Business Nedvizhimost)

(RUB mn)	**2017**[42]	**2016**	**Change**
Revenue	**15,267**	12,810	*19.2%*
Adjusted OIBDA	**5,960**	5,237	*13.8%*
Operating income	**4,998**	7,757	*(35.6%)*
Adjusted net income attributable to Sistema	**2,452**	2,877	*(14.8%)*

Leader Invest

Leader Invest is a development company with a focus on housing and commercial real-estate projects in Moscow. Its portfolio includes 45 projects with a total area of about 3.0m sq m in developed and well-ordered districts of the city with a healthy environment, which the company strives to preserve.

Sistema's stake: 100%

[41] *All metrics in the table exclude results of East-West United Bank (EWUB) and the result of divestment of 47% in EWUB in 2Q 2017*
[42] Leader Invest's 2017 results are presented in accordance with IFRS 15. The 2016 results are presented in accordance with IAS 18.

Leadership

- President: Oleg Mamayev
- Chairman of the Board of Directors: Felix Evtushenkov

Industry overview for 2017[43]

Supply grew substantially in 2017 and the number of deals registered on the new housing market increased, while prices stabilised. The market received some support from a record drop in mortgage interest rates: in November, the average interest rate on loans for purchase of new housing was 9.66% p.a., compared to 11.37% the previous year[44]. Mortgage terms are expected to further improve in 2018.

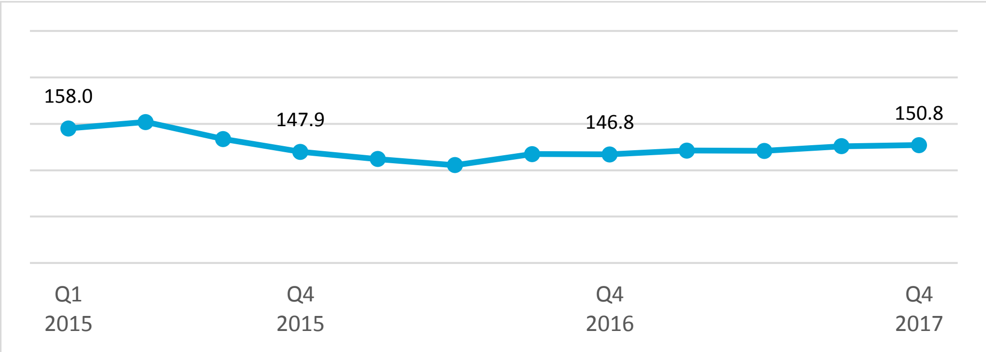
As of the end of 2017, there were 71 properties containing about 19,080 apartments (1.1mn sq m in total) for sale in the new mass-market housing segment. During the year, sales started at 23 new projects, up 1.6 times than in 2016.

In December 2017, the average price per sq m of new comfort class housing was RUB 150,790, 2.7% more than at the end of the previous year.

According to the Federal Service for State Registration, the total number of deals in the new housing market in 2017 was 54,207 (off-plan sales), up 52.2% on 2016.

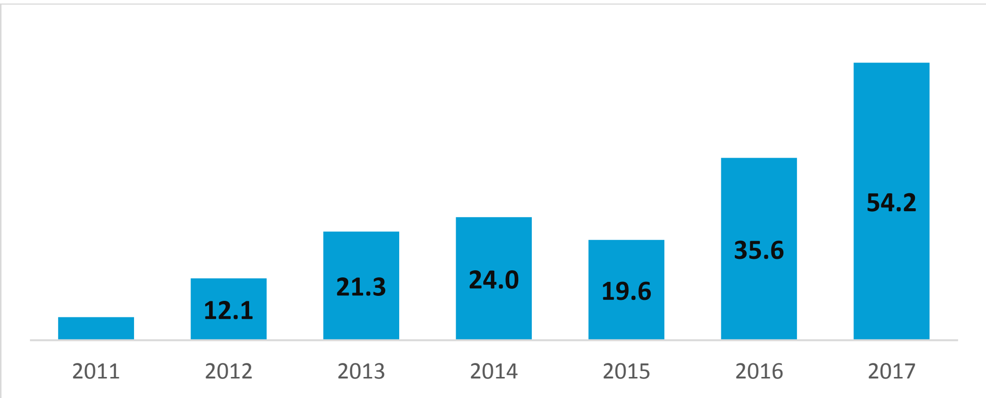
Legislative amendments to introduce more stringent requirements for developers will enter into force in July 2018, which may prompt developers to launch planned projects in the first half of the year.

Average prices in the business and comfort class segments, RUB/sq m



Source: Metrium Group

Increase in the number of off-plan sales, thousand



Source: Federal Service for State Registration

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[43] Industry overview based on data from consulting company Metrium Group.
[44] According to the Central Bank

Business development in 2017

In 2017, Leader Invest focused on streamlining its business processes and improving efficiency at all stages of the project life-cycle. This involved optimising design solutions, introducing new procurement procedures to reduce costs, strengthening the project management function and making the Company's sales team more efficient.

Leader Invest's infill construction activities include 42 projects at various stages with a total area of 520,000 sq m. The average area per project is 12,000 sq m and the implementation period is 2.5 years. During 2017, the company launched 10 new infill construction projects and commissioned a further two. Active sales have already started at 26 infill construction projects.

The company is building three large-scale flagship complexes: ZIL Yug (1,690,000 sq m), Nagatino i-Land (472,000 sq m) and 120 Lobachevskogo St. (273,000 sq m).

Largest completed projects (commissioned in 2017)

Property	Area, thousand sq m	Commissioning permit date
Clubhouse at Sretenka	12.23	8 December 2017
Clubhouse at Serpukhovsky Val	7.54	27 December 2017

Major projects with construction launched in 2017:

Property	Area, thousand sq m
Business-class residential project at 120 Lobachevskogo	273.0
Comfort-class residential project in Tushino	19.1
Comfort-class residential project at Volgogradsky	18.8
Comfort-class residential project in Sadovniki	11.5
Business-class residential project at Maslovka	11.5
Comfort-class residential project at Chertanovskaya	11.3
Business-class residential project at Leninsky	10.6
Comfort-class residential project at Veshnyakovskaya	10.5
Comfort-class residential project at Dmitrovka	10.3
Business-class residential project in Kuskovo	8.9

In 2017, the site design for the ZIL Yug project was approved, the land survey was started and applications for technical specifications were submitted. P-stage design documents are to be drafted in 2018.

The site design for Nagatino i-Land was approved, the architectural concept developed, the first stage of review by the Moscow City Architecture Committee was passed and P-stage design documents were drafted. Construction of the first stage of the project is to start in 2018.

Design documentation was developed for 120 Logachevskogo St., a positive opinion obtained from the Moscow State Expert Review Committee, the architectural and urban planning solution was approved and certification received, and a construction permit was obtained. Sales of apartments in the residential complex started in 2018.

In November 2017, Standard & Poor's assigned Leader Invest a long-term corporate credit rating of B with Stable outlook. The agency cited Leader Invest's margins, which are among the highest of any Russian property developer, as a key factor in assigning the rating.

Business development strategy

Leader Invest's long-term strategic goal is to become one of Moscow's leading residential developers and to create value for Sistema through infill projects and construction of large-scale complexes.

The company's strategy envisages maintaining a portfolio of development projects of 1m sq m. Given the market situation, Leader Invest focuses on residential construction, including both small projects in established neighbourhoods and modern, large-scale developments. The key target segments of the Moscow residential real estate market are the comfort and business classes. The company aims to increase returns on its project portfolio through higher turnover and by making its design, construction and sales processes more efficient.

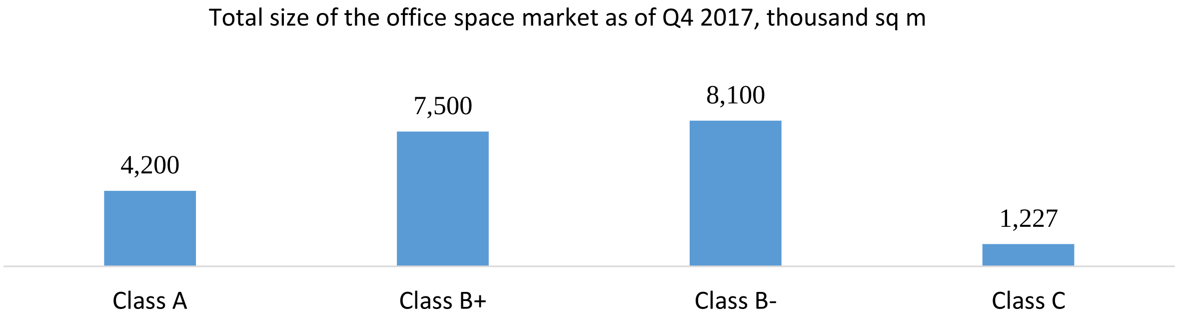
Sistema's rental assets

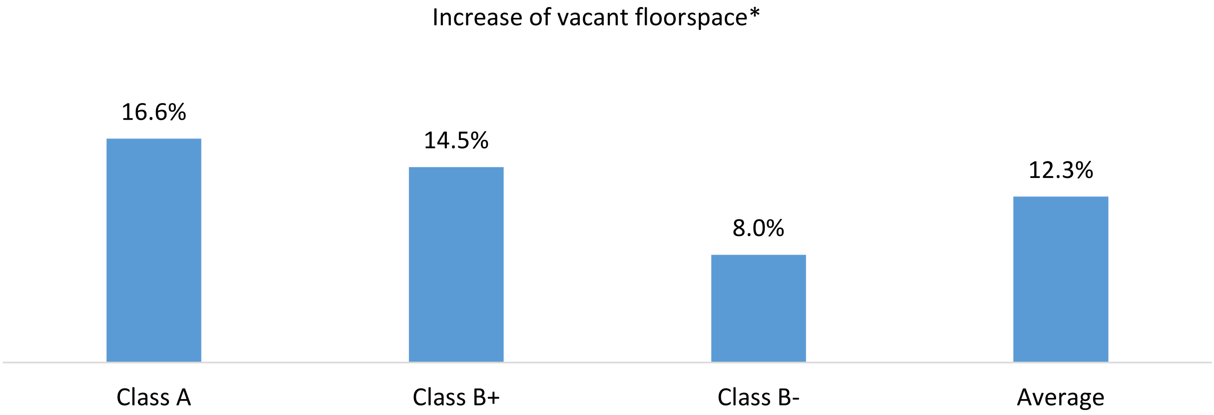
Business Nedvizhimost leases out its own real estate assets and other assets under its management. The average area of Business Nedvizhimost's properties is 3,000-5,000 sq m.
Mosdachtrest is a subsidiary of Business Nedvizhimost that focuses primarily on leasing cottages (in Serebryany Bor and Barvikha) and office buildings in Moscow, as well as maintenance services.

Sistema's stake: 100%

Leadership

- CEO: Vyacheslav Khvan
- Chairman of the Board of Directors: Leonid Monosov





** Change vs the end of Q4 2016*

Business development in 2017

In 2017, Business Nedvizhimost's portfolio decreased by 24% as a result of property sales to Leader Invest and in the open market.

After restructuring its portfolio, Business Nedvizhimost divided its assets into three key groups: for lease, for sale and for development. Two pilot serviced-apartment projects (renovation of automatic telephone system “ATS” buildings) will be launched in 2018.

Business Nedvizhimost's assets by groups[45]:

Group	As of 31 Dec 2017, thousand sq m
Leased	181.4
For sale outside of Sistema	84.3
For renovation	31.6
TOTAL	**297.3**

Business Nedvizhimost's operating results in 2017

Total asset portfolio, thousand sq m	Properties generating rental income, pcs	Real estate assets, thousand sq m	
		Ownership	Management
297.3	66	297.3	63.7

Mosdachtrest's key assets are land plots in Serebryany Bor and the Moscow region.

In 2017, four buildings at the Serebryany Bor Sanatorium with a total area of 1,578 sq m were renovated, and pre-design works were completed for further development of three sites at Serebryany Bor.

Mosdachtrest's operating results in 2017

Total asset portfolio, thousand sq m	Properties generating rental income, , pcs	Land assets, ha	
		Serebryany Bor	Moscow region
58.0	**145**	19.3	89.1

Business development strategy

Business Nedvizhimost's operating strategy includes:

- increasing asset values and improving efficiency
- developing an efficient rental business with annual returns of more than 10%
- consolidating rental assets by combining resources and creating expertise in focus areas (ownership, development, service)

Business Nedvizhimost plans to renovate and develop assets (including reconstruction of 80,300 sq m of commercial floorspace) and commission new housing for leasing out, and to refurbish existing housing.

Binnopharm

Binnopharm is one of Russia’s largest full-cycle biopharmaceutical companies with its own in-house R&D division. The company produces biotechnological drugs, including a hepatitis B vaccine, pulmonology and neurology drugs, infusion solutions, and anti-viral and immunomodulating drugs.

Binnopharm operates two state-of-the-art pharmaceutical plants in the Moscow region.

Sistema's stake: 74%

Leadership

- CEO: Alexey Chupin

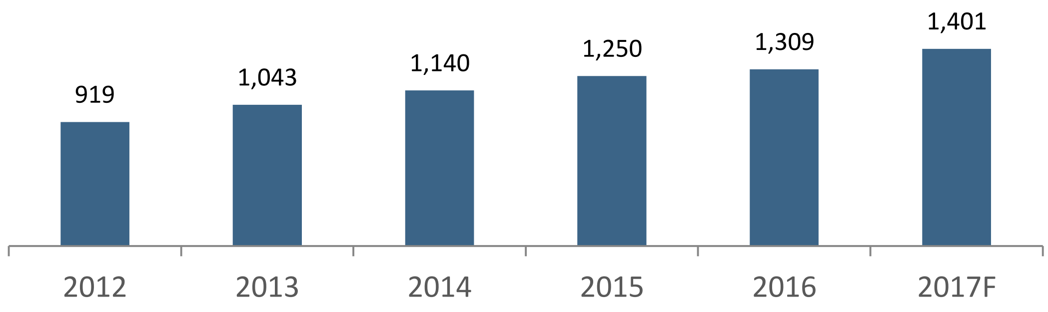
[45] Preliminary distribution at the end of 2017

- Chairman of the Board of Directors: Dmitry Zubov

Industry overview for 2017[46]

The Russian pharma market in 2017 grew at 7% in ruble terms.

Growth of the Russian pharma market, RUB bn



The commercial pharma segment is the main growth driver and remains the largest and most attractive segment for investment, accounting for 75%[47] of the market.

An important trend is the ongoing transition to cheaper generic drugs[48], which consumers prefer to more expensive brand-name products.

In money terms, imported medicines account for more than 70% of the Russian market, highlighting the significant potential for domestic producers to grow due to import substitution.

Legislative initiatives and a number of bills that have already been passed aim to support Russian medicine producers. These include limitations on foreign companies' participation in government medicine procurement tenders in which two or more domestic producers are involved, and also new rules that simplify registration and clinical trials for Russian drugs.

Binnopharm's business development in 2017

In 2017, Binnopharm continued to pursue a strategy of portfolio expansion. The company completed the registration of three generic drugs – Ringer's solution, Neurocholine and Moxifloxacin – and launched production and sales in 2018. Ten more generic drugs are being registered. In 2017, five original combinations were developed and submitted for registration. The company continued work on the last stage of clinical trials of two biotechnological products.

Binnopharm's sales service in 2017 continued to actively promote proprietary commercial drugs and products of partner companies. Secondary sales of drugs promoted by the company in 2017 increased by 68% YoY (by number of packs).

In 2018, the company will continue development of its portfolio of proprietary products: launches of four new drugs are planned, while the company plans to register more than 10 new drugs and finalise a number of new products.

Revenue structure:

[46] Source: DSM Group.
[47] Source: DSM Group.
[48] Generic drugs are drugs that are equivalent to brand-name products in composition and effect. Generic drugs may differ from brand-name products in presentation and trade name, and generally have a lower price.

- Proprietary drugs (commercial segment) – 45%
- Proprietary drugs (hospital segment) – 25%
- Commercial distribution – 27%
- Other – 3%

Business development strategy

Binnopharm's operational strategy focuses on further growing on the commercial segment and reducing the importance of the state segment to the company's business. Binnopharm continues to develop its proprietary portfolio of commercial brands, with a focus on neurology, pulmonology, cardiology and gastroenterology. An important element of this strategy is to increase capacity utilisation, and thus to increase profitability. The company plans to launch about 30 drugs in 2018-2020, including new combinations.

Binnopharm's investment strategy envisages acquisition of individual portfolios of drugs and brands that are complementary to its existing business.

Financial performance in 2017

(RUB mn)	**2017**	**2016**	**Change**
Revenue	2,363	1,939	*21.8%*
OIBDA	482	415	*16.3%*
Operating income	323	219	*47.7%*
Net income attributable to Sistema	14	11	*31.8%*

In 2017 Binnopharm successfully delivered on its strategy to grow the commercial segment, with commercial sales accounting for 63% of total revenue, versus 34% in 2016. Revenue increased by 21.8% to RUB 2.4 billion on the back of an increase in sales of its own products and an increase in commercial distribution sales. The company reduced reliance on sales of Regevac, with the vaccine's share in revenue falling to 13% vs 24% in 2016.

In 2017 the OIBDA margin declined by 1.0 percentage point, as state-sector sales of higher-margin drugs fell, though this trend was partially offset by an increase in OIBDA from sales of the company's own products as well as distribution of products in the commercial segment.

BPGC

Bashkirian Power Grid Company (BPGC) is a large Russian regional power grid company providing electricity transit between the central part of the country and the Urals, electricity transmission in Bashkortostan and distribution to end users. The company also designs, builds and upgrades power facilities. BPGC's subsidiaries include Bashkir Grid Company (BGC) (transmission grids), Bashkirenergo (distribution grids) and BPGC Engineering (power engineering).

Sistema's stake: 91%

Leadership

- CEO and Management Board Chairman: Dmitry Sharovatov
- Chairman of the Board of Directors: Alexey Guryev[49]

Industry overview for 2017

Electricity consumption in Russia in 2017 totalled 1,059.5bn kWh, up 0.5% YoY. Electricity production totalled 1,073.6bn kWh, up 0.2% YoY.

[49] Vadim Pavlus as of 31 December 2017.

In 2017, the average one-part "single pot" tariff for electricity transmission increased by 6.3% compared to 2016. Indexation of single-rate tariffs since July 2017 averaged 109.6% for all voltage levels, while the rate for the maintenance of electrical grids grew by 103.0% and the payment rate for technological losses grew by 105.7%.

Electricity grid services constitute a natural monopoly. All regional distribution grid companies operate under similar market conditions and a common tariff policy. The main trend in the Russian power industry is a moderate increase in demand for electricity (up to 2% per year). Demand is forecast to reach over 11.5tn kWh[50] by 2029.

Bashkirenergo has one of the highest levels of operational efficiency of any Russian grid companies. With tariffs below market average, it also achieves high profit margins.

BPGC's business development in 2017

2017 was the third year of large-scale construction of power facilities in Bashkortostan. BPGC is continuing to roll out its comprehensive equipment modernisation programme and to implement innovative solutions that enhance the reliability of power supplies and reduce power losses.

In 2017, electricity consumption in Bashkortostan grew by 1.1%. The "single pot" net supply increased by 1.5% in 2017.

In 2017, the number of new connections to power grids decreased (-19% compared to 2016), preimarily because most developing districts have already been covered by Bashkirenergo in previous years.

As part of its programme to improve operating efficiency, BPGC implemented the following major projects in 2017:

- energy saving and energy efficiency programme for 2014-2023 (automatic power control and metering system);
- creation of a two-level model to optimise operational and technological management at Bashkirenergo;
- implementation of solutions for automation of power grids in Ufa by using Smart Grid technologies to enhance the quality and reliability of power supply to consumers.

The company continues the gradual automation of its business processes using IT and ERP systems.

In 2017, BPGC completed the construction of the 110 kV Kustarevskaya substation in Ufa. The company also put into operation the 110kV Spartak substation in Sterlitamak and the 110 kV Alekseevka substation in Belebey.

The number of accidents at BPGC facilities decreased in 2017 by 0.97% (-64 accidents).

Operating results of distribution grids (Bashkirenergo) and transmission grids (BGC)

Indicator	Units	2017		2016		%	
		Bashkirenergo	BGC	Bashkirenergo	BGC	Bashkirenergo	BGC
Power losses	%	8.36%	1.29%	8.23%	1.3%	+0.13 p.p.	-0.01 p.p.
Power in	m kWh	22,151.6	26,137.5	22,285.8	24,978.7	-0.6%	4.6%
Net supply from distribution grids	m kWh	20,298.8	25,804.1	20,451.6	24,657.9	-0.7%	4.6%
Number of new connections	connections	19,547	1	24,232	2	-19.3	-50%
Connected capacity	MW	334	2.36	393.9	4	-15.2	-41%

Development strategy

[50] According to forecasts from the Russian Ministry of Energy

BPGC's key focuses are maximisation of free cash flow and increasing the value of the business.

Drivers for maximisation of free cash flow:

- Limiting growth of spending and implementing efficiency enhancement projects;
- Implementing an organic development programme, including Smart Grid and automatic power control and metering system projects;
- Maximising best use of free internal resources (monetisation);
- Actively negotiating tariffs and optimising the investment programme

The value of the business will be increased by growing the non-regulated business (telecom, IT, engineering, etc.) and by inorganic growth (acquisition of power grid and infrastructure assets in line with the company's strategy).

Financial performance in 2017

(RUB mn)	**2017**	**2016**	**Change**
Revenue	17,671	16,052	*10.1%*
OIBDA	5,259	5,636	*(6.7%)*
Operating income	2,926	3,404	*(14.0%)*
Net income attributable to Sistema	2,369	2,706	*(12.5%)*

BPGC's revenue increased in 2017 by 10.1% YoY mainly due to growth of tariffs for electricity transmission services from 1 July 2017. OIBDA and net income attributable to Sistema decreased in 2017 by 6.7% and 12.5% YoY, respectively. Factors affecting OIBDA included an increase in payments for power losses in grids as a result of rising market prices for electricity.

In 2017, as part of the modernisation of Ufa's distribution grids using Smart Grid technology, BPGC upgraded 87 distribution and transformer substations, laid 20.3 km of cable and installed about 8,700 power metering units.

Hospitality assets

Cosmos Group is one of Russia's leading hotel management companies, providing a full range of hotel development services from project consulting and pre-opening preparations to cost optimisation and increasing asset capitalisation.

Cosmos Group's portfolio includes 17 hotels in 14 locations across Russia and the world. Some of the hotels operate under well-known international brands (Park Inn by Radisson and Holiday Inn Express), and some are stand-alone hotels.

Cosmos Group has more than 3,700 rooms under management in 3-5 star hotels located in tourist and business centres including city business hotels and luxury resorts in Russia, Italy, Namibia and the Czech Republic.

Sistema's stake[51]: 100%

Leadership:

- President: Christian Mayer[52]
- Chairman of the Board of Directors: Artem Sirazutdinov

Industry overview for 2017

[51] Sistema's hospitality assets are mainly owned by Sistema Hotel Management LLC and VAO Intourist. Sistema's effective sharholding in Sistema Hotel Management LLC is 100% and in VAO Intourist 66%

[52] Christian Mayer was appointed President on 08 February 2018, before 07 February 2018 - Maxim Khoroshenkov

According to Russia's Federal Agency for Tourism (RosTourism), the number of foreign tourists visiting Russia increased by 14% in 2017, hitting an eight-year high. Domestic tourism in Russia increased by 5%-10%. The most popular tourist destinations traditionally include Moscow, the Moscow region, St Petersburg, the Krasnodar region and Tatarstan.

In 2017, Moscow saw record tourist numbers, with a 13% increase year-on-year and the total number of visitors reaching 21.5m people.

With Moscow becoming more attractive for tourists, hotels of all price categories enjoyed increased occupancy rates, with the average reaching 75% (+3 p.p. compared to 2016). The average price per room at Moscow hotels in 2017 was RUB 7,950 a day, a 1.6% increase on 2016, driven mostly by growth in the average price in the upscale and luxury segments. Improved operating indicators had a positive impact on revenue per available room (RevPAR), which amounted to RUB 5,930 (+5% compared to 2016).

The market of quality hotels in Moscow in 2017 expanded by 12%, while total capacity reached 49,400 rooms. In 2017, eight hotels operating under international brands, were opened with the total of 1,884 rooms.

The main event in Russia in 2018 will be the FIFA World Cup. As of the end of 2017, rooms were booked in many hotels for the dates of the Championship. Total accommodation capacity is expected to increase by about 2,500 rooms. Hotels in World Cup host cities – particularly Moscow, Sochi, Kazan and Volgograd, where five Sistema hotels and one hotel managed by Cosmos Group are located – are expected to enjoy significant revenue growth.

Business development in 2017

Cosmos Group was founded in April 2017 as a result of the separation of Sistema’s hotel asset ownership and management functions.

At the end of 2016, Sistema acquired Regional Hotel Chain (RHC) assets, increasing the accommodation capacity of Sistema's hotel business by 1,379 rooms.

In 2017, revenue at RHC hotels increased by 18% and amounted to RUB 1,567m. Revenue of other hotels in the chain increased by 8% in 2017, and totalled RUB 2,761m.

In 2017, the company also actively developed and extended its eco-hotels Izumrudny Les (in Klin, Moscow region) and Altay Resort (in Gorno-Altaysk).

In November 2017, the 243-room Holiday Inn Express Moscow-Paveletskaya hotel was officially opened in the centre of Moscow. Due to its favourable location and well-known international brand, the hotel's occupancy rate is expected to exceed 50% in 2018.

In 2018, Cosmos Group is planning to take more hotels under management, including Sistema Group assets: two new economy-class hotels under Ibis Budget brand and two apartment hotels under its own CosmosStay brand in Moscow, as well as the Don Plaza hotel in Rostov-on-Don. The hotels have total capacity of 804 rooms. In addition, a new 134-room hotel will be taken under management in the Alabuga special economic zone under the Ramada brand.

Business development strategy

Cosmos Group’s main strategic goal is to become a leading Russian hotel operator and to expand into the European hospitality market.

The company’s key focus is boosting operational efficiency and service quality at its hotels. In 2018 the company aims to increase the gross operating income GOP of Cosmos Group hotels by 17% compared to 2017, primarily by implementing profit and cost management programmes developed on an individual basis for each hotel.

Cosmos Group will also continue developing its proprietary hotel brand line. In 2017, the root brand name Cosmos Hotels and More was used to create four new brands: *My Cosmos* for modern city hotels, *Cosmos* for classical business hotels, *Cosmos Collection* for premium hotels and *CosmosStay* for apartments.

In addition to organic growth, Cosmos Group is planning to attract independent hotels in order to double the number of rooms under management.

Operating results (hotels under management)

Indicator	2017	2016	%
RevPAR, RUB	1,909	1,891	1%
Occupancy rate	56%	49%	7 p.p.
Number of rooms	4,040	3,771	59%

Financial performance in 2017

(RUB mn)	**2017**	**2016**	**Change**
Revenue	4,318	2,794	*54.5%*
OIBDA	849	487	*74.5%*
Operating (loss) / income	198	182	*8.7%*
Net loss attributable to Sistema	(517)	(252)	-

During 2017, Sistema's hospitality business continued to successfully integrate the RHC hotels acquired in 4Q 2016. Revenue for 2017 increased by 54.5% driven by consolidation of RHC, as well as by a higher occupancy rate at Hotel Cosmos, the largest of Sistema's hospitality assets.

For the full year 2017 OIBDA increased by 74.5% and the OIBDA margin added 2.2 percentage points thanks to the consolidation of the RHC properties and improved efficiency at Hotel Cosmos.

OTHER ASSETS

Kronstadt Group

Sistema's effective shareholding: 96%

Kronstadt Group is a Russian high-tech company that engineers and manufactures knowledge-intensive products. The company is one of Russia’s leading producers of unmanned aerial vehicles (UAVs), with deep experience of designing and manufacturing UAVs and on-board equipment.

In 2017, Kronstadt Group successfully completed work under several key government contracts, including supply of 76 simulators to state educational institutions and training centres. The company also continued work on the development and production of Orion, a medium-altitude, long-endurance UAV – the biggest market segment in monetary terms, accounting for 53% of the global market. The Orion project is now at the flight-testing stage, and was successfully presented at a number of major exhibitions where potential customers from over 15 countries expressed interest in the product.

The company completed the next stage of the e-Navigation project, providing additional equipment for a test area covering the Russian part of the Gulf of Finland, the Neva and Svir Rivers and Lake Ladoga. Correcting stations of the differential sub-system of GLONASS/GPS were supplied.

Besides major government contracts, Kronstadt Group successfully completed its part of the work on creating and reconstructing a number of museums and education centres, including the Road of Life museum at Lake Ladoga, the CSKA museum and the Cultural Centre of the Russian Federal Security Service. The company also provided multimedia installations for the Military World Games in Sochi as part of the CISM-2017 project.

Concept Group

Sistema's effective shareholding: 63%

Concept Group is one of Russia’s leading retailers of children's and women's clothes and underwear. The company is successfully developing retail chains under the Acoola and Concept Club brands with more than 410 stores in total, many of them franchised.

The company's portfolio includes the following brands:

- Acoola (clothes for children aged 0-14);
- Concept Club (clothes for women, men and children, home textiles[53]).
- Infinity Lingerie (underwear)

The company operates in Russia (120+ cities), Belarus, Kazakhstan, Armenia and Azerbaijan both through its own retail chain and in partnership with franchise and wholesale partners. In August 2017, it entered the Indian market under the Acoola children's clothing brand, opening its first retail store with an Indian partner.

In 2017, supply volumes grew by 6% year-on-year to 20.1m items. The share of orders from Russian suppliers doubled vs 2016 and reached 2%. 20.8m items were sold in 2017, an increase of 3% year-on-year. Overall revenue across the company grew by 1.3% to RUB 11.0bn.

Concept Group continues active market expansion. It intends to open at least 35 of its own retail stores per year and find more than 30 franchise partners. The company’s plans also include active development of online sales and an omni-channel customer relationship system as a key goal for 2018.

[53] All lines except for women's clothing were introduced in 2018.

SISTEMA'S INVESTMENT FUNDS

Sistema is continuing to develop a range of funds specialising in venture and PE investments. Sistema's funds and investment companies offer investors access to a unique portfolio of high-tech assets, as well as assets in real estate, industrial manufacturing and healthcare.

Sistema Venture Capital Fund

Sistema Venture Capital Fund (Sistema VC) is a venture fund focusing on investment in growth-stage tech companies.

Sistema's stake in the fund	80%
Fund's target size	RUB 10bn
Year of establishment	2016
Geography	Russia, US, Europe, Israel
Industry focus	Internet projects and technology
Life	No fixed term, investment phase Q2 2016 to Q2 2019
Target returns	25-30% (in RUB)

Investment targets and investment focus

Sistema VC invests in internet projects at the growth stage that have strong unit economics, are growing fast and have the potential to become an industry leader. The fund also invests in deep tech projects at an earlier stage.

The key focus of the fund is finding projects in deep tech, such as:
- artificial intelligence, machine learning;
- next-generation network technology (SDN, NFV);
- cognitive technologies;
- virtual/augmented reality projects (VR/AR).

The fund also invests in high-potential projects in communitainment, IoT, etc.

In 2017, Sistema VC maintained its strong position in the Russian market and won the Discovery of the Year category at the National Venture Investor 2017 Award. The fund's team reviewed over 700 projects and successfully completed eight transactions (including follow-on investments).

The fund is actively implementing its strategy of entering the international market: it opened an office in San Francisco and expanded its search for new projects to Europe and the United States.

Individual assets

VisionLabs is one of the world's leaders in computer vision and machine learning. Its flagship product is a face recognition platform, VisionLabs LUNA, which can analyse vast amounts of photo and video data in real-time mode to detect people's faces and run them against multi-million databases. The company's technological partners are Intel, Cisco, Facebook and Google.

Ozon is Russia's oldest and biggest multi-category online store with more than 4m SKUs. It has more than 18m customers, with 750,000 people visiting its website daily. The company features in the annual Forbes ranking of Russia's most valuable internet companies.

MEL Science is an international company offering scientific and educational products based on VR/AR technologies. Its flagship product is a chemistry self-study course, MEL Chemistry, which comprises 38 kits for chemical experiments, a learning app and VR glasses that allow students to see chemical substances and crystals "from the inside". MEL Science kits are sold under a paid subscription model and delivered by post. At the end of 2017, Sistema VC and its partners invested USD 2.2m in the project.

New investments of 2017

NFWare is a developer of solutions for virtualisation of (information) network functions. NFWare develops network software for popular x86 servers that processes traffic as quickly as expensive specialised network equipment produced by leading manufacturers. The solutions are based on NFV/SDN technologies, which allow some functions of network infrastructure to be virtualised.

FinalPrice is a subscription mobile app that enables users to book flights and hotels and rent cars at the lowest price available. For just USD 99 a year, users get access to the floor prices of over 800 airlines, 1m hotels and the world's top 40 car rental companies. The application is available only to US users and targets frequent travellers.

Gosu.Ai is a training platform for cyber-athletes and players of multi-player online games Dota 2, League of Legend, CS:GO, World of Tanks and Overwatch. The project is AI-based.

DataSine is a platform for analysing information about personal financial transactions to understand a user's psychological profile and life circumstances. This information helps financial institutions to determine the best communication channels and products for a particular customer.

Sistema Asia Fund

Sistema Asia Fund is Sistema's venture fund. It is an active and recognisable player in the Indian venture investment market, and has become integrated into the country's entrepreneurial eco system. The fund's goal is to efficiently invest investors' money into high-potential projects in the fast-growing Indian tech market

Sistema's stake in the fund	100%
Fund's target size	USD 50m, with potential increase to USD 120m
Year of establishment	2015
Geography	India, South-East Asia
Industry focus	Consumer tech (e-commerce, healthcare, transport, media, finance, education), enterprise tech (IoT, VR/AR, platform solutions, big data, artificial intelligence, machine learning)
Life	10 years, with an investment stage of four years
Target returns	3x cash-on-cash

Investment targets and investment focus

Sistema Asia Fund invests in tech startups in India (predominantly) and South-East Asia (in exceptional cases) that meet the following criteria:

- a proven business model and/or loyal audience;
- solutions specific for the Indian market;
- founders are involved in management of the business;
- co-investors.

The fund is managed by a professional team with a strong investment expertise. It has an expert council comprising professionals who are integrated into the Indian business community and have a unique track record and a broad network of contacts.

In 2017, the team of Sistema Asia Fund reviewed over 200 projects, thoroughly studied over 100 companies and successfully completed four investment transactions.

Individual assets

Seclore is the developer of an EDRM (Enterprise Digital Rights Management) system that enables corporations to control use of files within and outside the company. It has more than 5m users from 600 companies in 29 countries. Advanced and reliable EDRM solutions and innovations related to access to protected documents via browsers gained Seclore an award for successful growth from Frost & Sullivan, saw the company included in Deloitte's list of top 50 fast-growing tech companies and won it Gartner's Cool Vendor title. The company has representative offices in the US, India, the Netherlands, UAE, Saudi Arabia and Singapore.

Qwikcilver is a supplier of corporate cloud software in the segment of gift cards and loyalty programmes. The company's product enables customers to use pre-paid physical and virtual gift cards at over 10,000 premium branded stores, on e-commerce portals and in mobile apps. Qwikcilver has a licence from the Reserve Bank of India for using prepaid payment instruments. At the end of financial year 2016, the company reached a stable positive net income, with a gross merchandise value of about USD 300m, and is set to continue doubling its results every year.

New investments of 2017

Lendingkart is a company that fundamentally changes traditional lending by using its own data-based lending mechanism to provide loans to small and medium-sized businesses. To acquire customers and repay loans, the company uses a model with a small headcount, and has already provided loans to customers in 600 cities and towns.

Mobikon is a marketing platform for restaurants to attract customers. Restaurants receive tools to manage customer loyalty by monitoring profiles and transactions on various digital platforms and payment systems. The in-built database includes 8.5m profiles from all over the world.

Netmeds.com is India's biggest online pharmacy, with a nationwide presence. The founder used the opportunities offered by his family's pharma distribution company established more than one hundred years ago to create a profitable business with high gross margins.

HealthifyMe is India's biggest digital fitness platform (4m users and over 200 sports instructors and nutritionists) that allows users to control calories consumed, set personal fitness goals and monitor progress. Efficiency is achieved through access to online consultations with nutritionists and instructors. At the end of 2017, the company launched a new service, Ria, which is the world's first virtual AI-based nutritionist. The biggest corporate customers are P&G, Unilever, Accenture, Cognizant, Shell, and Philips.

This transaction was approved in 2017 and closed at the beginning of 2018.

Rusnano Sistema SICAR

Rusnano Sistema SICAR is a private equity fund established by Sistema and RUSNANO in August 2016. The fund has a professional team with a strong track record in the venture industry. It focuses on investing in initial-stage high-tech projects and in growing and established companies in Russia, the CIS, Europe and Israel. The fund is open to outside investors.

All resolutions are passed unanimously by the fund's board of directors, which consists of three members. The Investment Committee of the fund comprises three directors from Sistema and three from Rusnano.

Sistema's stake in the fund	50%
The fund's target size	Up to USD 100m
Year of establishment	2016
Geography	Russia (min. 50% of the fund's investments in monetary terms), CIS, Europe, Israel
Industry focus	Information technology, robotics and onboard equipment, software and cloud technologies, communication equipment and end-to-end solutions, renewable sources of energy and energy-saving technologies (including fuel cells), microelectronics, automated control systems, special communications systems, and software for comprehensive security systems.
Life	Seven years (may be extended by three years if the parties agree)
Target returns	> 6% in USD

In 2017, the fund reviewed a number of projects and invested in Apis Cor and GeoSplit. The fund is at the investment stage, and will make investments in another five projects in 2018, meaning it will have invested 40%-45% of its committed capital.

Investments of 2017

Apis Cor is a developer and manufacturer of unique 3D construction printers. The Apis Cor printer can build a house of up to 130 sq m in 24 hours. The technology has no peers anywhere in the world. This 3D printer can compete with conventional technologies on cost and significantly outperforms them on speed and ease of construction.
Applications to patent the technology have been filed in 146 countries. The business model is based on provision of wall-construction services in partnership with local companies to reduce printer replication risks and control the construction process.

GeoSplit is a high-tech oilfield services company that offers well diagnostics after multi-stage fracturing. Oil wells are diagnosed through tracer analysis by introducing propping agents marked by reporting markers that are several microns in size. It has a number of competitive advantages in terms of price and accuracy.

Sistema Finance S.A.

Sistema Finance S.A. is Sistema's investment platform focusing on investments in Europe and the US.

One of its subsidiaries, Sistema Capital Partners, has been investing Russian institutional capital in the developed real-estate markets of Europe and the US since December 2015.

Sistema's stake in the company	100%
Geography	Large EU countries, US
Industry focus	PE, rental properties, real estate development
Target returns	> 15% in EUR and USD

Investment targets and investment focus

Sistema Finance invests in three main segments:

- Private Equity: investments in public and non-public mid-cap companies generating positive cash flow with attractive growth prospects and focus on Germany;
- Real Estate: investments in rental properties and opportunistic development projects in highly liquid markets of the EU and US;

The average size of Sistema Finance's investment is EUR 10-50m, and investments are held for one to four years.

In June 2017, the company exited two investments: HS IV and HS Prime I. The portfolios of rental properties – a total of 29 assets in several German cities with an aggregate area of over 120,000 sq m – were bought by BVK. IRR of the investments amounted to 28%-36% in EUR.

Individual investment projects

Project	Country / segment	Description
Gienanth	Germany / industrial production	A leading iron foundry with a 30% global share in the segment of cylinder crankcase castings for engines
Silbitz Group	Germany / industrial production	A leading European producer of high-tech steel and iron castings, with a focus on wind power generation and transmission mechanisms
Ambulantis	Germany / healthcare	A fast growing operator of home care services
HS Prime II	Germany / rental properties	Three shopping centres in Flensburg, Lubeck and Bochum

LLC Sistema Capital MC

Sistema's effective stake: 85%.

Sistema Capital is a management company that invests and provides asset management services on global financial markets for individual and corporate customers.

For more than 17 years, the company has offered investment products in Russian and international markets. Products include bonds of Russian and international issuers in various economic segments and geographies, as well as securities across a broad set of geographies and derivative financial instruments.

As of the end of 2017, Sistema Capital had RUB 52bn in assets under management, an increase of 2.2 times from 2016 and 4.9 times from 2014. The company ranks seventh in Russia for the net asset value of its mutual investment funds, with an aggregate NAV of RUB 9.1bn as of the end of 2017.

Mutual rouble bond funds managed by Sistema Capital generate leading yields among similar Russian funds with a NAV of more than RUB 50m. At the end of 2017, the Sistema Capital Mobile.Bonds fund was ranked #1 (with a yield of 15.1%) and Sistema Capital Reserve #3 (14.3%).

Mutual foreign-currency bond funds managed by Sistema Capital rank among Russia's top 10 in yield terms, with NAV of more than RUB 50m. Sistema Capital Mobile.Bonds.FX ranks #3 (with a yield of 5.8%) and Sistema Capital Reserve.FX #6 (5.2%).

The Expert RA rating agency (RAEX) rates Sistema Capital at A+ with a stable outlook. The agency cites the efficiency of the management company's investment process and the high quality of assets under management for its rating.

The company works with three non-government pension funds, including Sberbank's Pension Fund, under trust management agreements.

In 2017, Sistema Capital started working with retail customers and offering its products in the mass segment. It now actively cooperates with MTS, and a service for investing in mutual funds is being integrated into the MTS Money Wallet application.

In 2017, Sistema Capital became a full-fledged player on Moscow Exchange and got direct access to the FX and stock markets. This enabled it to expand and improve services to customers.

In 2018, Sistema Capital expects to see growth of its assets under management, driven by a more active flow of assets from bank deposits to management companies due to continued decline in deposit rates.

Sistema Capital’s strategic goal is to develop a high-quality investment management company targeting private and institutional investors (retail online, HNWI, non-government pension funds), combined with management of Sistema Group's liquidity and investment of the Group's cash in liquid securities with various risk levels.

Yields of mutual investment funds

2015	2016	2017
SC-Reserve.FX – Eurobond fund, USD		
+20.4%	+7.2%	+5.2%
SC-Reserve - Bonds fund, RUB		
+17.3%	+12.1%	+14.3%
SC-Mobile. Bonds. FX- Eurobond fund, USD		
-	-	+15.1%
SC-Mobile. Bonds - Bond fund, RUB		
-	-	+5.8%

3.6 Risks

MAIN RISK FACTORS

Sistema’s activities are subject to a number of risks. Effective management of these risks is a fundamental factor contributing to the successful growth of the Corporation. While risks arise from processes and factors over which Sistema has little or no influence, the Corporation can take measures to reduce the negative consequences in the event that a certain risk event occurs. This makes efficient assessment of existing risks and how likely they are to occur, as well as efficient risk management, an integral part of Sistema Group's strategy.

The Corporation has introduced an integrated enterprise risk management (ERM) system based on international risk-managament standards, recommendations and practices. The ERM system is designed to provide a reasonable guarantee that the Corporation will achieve its strategic goals and to ensure that risks will be kept at a level acceptable to shareholders and management.

3.6.1. Sistema Group’s integrated enterprise risk management (ERM) system

As part of quarterly ERM procedures, Sistema’s risk managers compile risk registers for subsidiaries and a consolidated risk register for the Group, prioritise risks and aggregate them into portfolios, develop a risk map and analyse key trends, and use simulation and financial modelling methods to analyse the impact that material risks have on the financial results of specific subsidiaries and Sistema Group as a whole.

To address the risks listed in the Group’s risk register, the company has developed risk management (mitigation) and response plans that include specific mitigation measures. These plans are modified, adjusted and then approved by the Risk Subcommittee of Sistema’s Finance and Investment Committee.

Risk management reports are submitted for review to relevant collective governance bodies at least once a quarter. Each risk management report contains a revaluation of risks, an assessment of the effectiveness of risk mitigation and response plans, and potential risk areas (those requiring attention) identified for future periods.

3.6.2 External risks

Risks related to changes in the political and economic situation in Russia are material to Sistema because most of the Corporation's business is conducted in the Russian Federation. Many Sistema Group companies also operate in transitional economies, including Armenia, Belarus, India and Ukraine, and therefore are also exposed to material external risks. Group companies sell a significant portion of their products in the CIS, Southeast Asia, Eastern Europe and North Africa. In the event of major political turmoil in these regions, the Group's business in the regions may be discontinued or put on hold, potentially leading to material losses.

Financial risks

Sistema’s business is inextricably connected to the state of the global economy and financial markets, and is sensitive in particular to movements in prices of oil, gas and other commodities that Russia exports. A weakening of the rouble against the US dollar and the euro amid a slump in the oil prices, sanctions measures imposed against Russia and increased capital flight from the country may result in a rise in costs and a drop in revenues, or may affect Group companies’ ability to achieve financial targets and repay debt. At the same time, a significant appreciation of the rouble against the US dollar and the euro may cause a rise in rouble-denominated costs, resulting in a decline in operating performance of some of Sistema's portfolio companies.

Any potential downturn or slowdown in Russia's economic growth could lead to a decrease in household incomes and consumer demand, which could have significant negative consequences for the operating results and financial position of all of Sistema Group companies.

Rising inflation may result in higher costs, putting pressure on profit margins and affecting domestic demand for products and services provided by Sistema Group companies.

An exodus of foreign investors from Russia and a downgrade of the sovereign credit rating by international rating agencies, as well as restrictions introduced for foreign companies in Russia as a result of sanctions, may have a negative impact on Sistema Group’s joint ventures (partnerships) and new investment projects.

If sanctions are maintained in the medium term and access for Russian banks and businesses to foreign debt remains restricted, this may significantly increase the current liquidity deficit in the market and result in further interest-rate raises, making it difficult for Sistema Group to raise funding for its operations and to refinance the debt of the Corporation and its portfolio companies.

An unfavourable macroeconomic environment in many countries where Sistema's assets operate may make it necessary to impair goodwill and other long-lived assets of some of the subsidiaries.

Currency control and restrictions on capital repatriation may adversely affect Sistema's business by posing barriers to capital flows, thus reducing the value of Sistema's investment in Russia.

Potential bankruptcy of one or several Russian or foreign banks due to restricted access to financing may result in a reduction in sources of borrowing for the Corporation and portfolio companies, and may lead to direct losses of funds deposited in the accounts of such banks.

Political and social risks

Geopolitical risks exerted a significant influence on the Corporation and its portfolio companies over the reporting year as protectionism and economic sanctions are increasingly used as tools for achieving geopolitical goals.

The risk of international conflict remains substantial, in terms of both probability and potential effect on various areas of Sistema Group's activities. For example, insurance companies may set higher insurance premiums for Sistema Group or refuse to insure against specific risks, which may lead to a deterioration in financial results.

The introduction of sanctions against Russia or Russian companies may result in disruptions to international payment systems or other mechanisms of international cooperation, which in turn may prevent the Corporation and its portfolio companies from making settlements and reduce Sistema's investment appeal.

A potential rise in social unrest in regions where the Corporation operates may threaten its profits.

Key risks for the Group’s telecommunications business are geopolitical risks entailed by a deterioration of the situation in Ukraine. The political crisis in Ukraine has led to a significant decrease in the growth of the telecommunications market, and continues to adversely affect the exchange rate of the national currency.

Legal risks[54]

There is a risk of unpredictable court rulings and administrative decisions being passed with respect to Sistema Group’s business. Such rulings may have an adverse effect on the Group's business. This risk is the result of numerous factors, including:

- possible discrepancies and ambiguities in: (i) federal and other legislation; (ii) bylaws issued by executive authorities of the states where Sistema Group operates; (iii) regional and local laws, rules and requirements;
- gaps in legislation and a lack of court and administrative guidelines regarding the interpretation of some laws, as well as conflicts between certain court guidelines and rulings.
- The influence of political, social and other external factors on the judicial system;
- potential selective or arbitrary administrative decisions by government authorities.

[54] See also Note 7 and 38 of the Financial Statements

Gaps in civil and corporate legislation and securities regulation in the markets where Sistema operates, as well as frequent and not always consistent changes in legislation in these and related areas, may create barriers to raising funds and impair the company's ability to manage, own and oversee the activities of portfolio companies.

A lack of clarity regarding the understanding, interpretation and application of the Federal Law on the Procedure for Foreign Investments in Companies of Strategic Importance for National Defence and State Security and other regulations concerning investment activities in the Russian Federation and other countries where Sistema Group operates, as well as customs and currency regulations, may have a negative impact on the business of Sistema Group, given that the Group's shareholders include non-Russians.

There is a risk of legislative amendments in countries where Sistema Group companies operate, should governments or international organisations amend regulatory frameworks governing international trade and investments.

Since shareholders are liable for the obligations of affiliates under Russian corporate law, Sistema may incur financial losses related to the liabilities of its portfolio companies.

Minority shareholders of Sistema's subsidiaries may contest or vote against the Corporation's transactions, which may limit Sistema's ability to complete investment transactions and restructure businesses, and could also have a negative effect on Sistema's investment case.

Should the Russian Federal Anti-Monopoly Service conclude that Sistema or one of its material subsidiaries has violated anti-monopoly legislation, this may result in serious administrative sanctions involving losses for the Corporation. The Federal Anti-Monopoly Service may also prevent the Corporation and its portfolio companies from completing and/or servicing certain transactions, which may also limit Sistema's capacity to complete investment deals and restructure businesses.

Tax risks[55]

Tax legislation, regulation and practices in jurisdictions where Sistema's assets operate are complex and opaque, and prone to frequent modifications and ambiguous interpretations. If the Corporation's actions are interpreted as breach of tax law, this may have an adverse effect on the business of Sistema Group.

Russian legislation on transfer pricing may make it necessary to introduce adjustments to price-setting practices used at Sistema Group companies, resulting in additional tax liabilities related to some transactions.

As a result of application of rules relating to the taxation in Russia of undistributed profits of controlled foreign companies and profits from the indirect sale of properties in Russia, the concept of a beneficiary owner and new criteria for tax residency of legal entities, the Group's companies may face new tax liabilities that arise due to the uncertainty around interpretation of tax law and the lack of relevant precedents.

Securities market risks[56]

A deterioration of the geopolitical situation, sanctions imposed on Russian companies, a worsening of the macroeconomic environment and capital and investor flight from the Russian market led to a reduction in valuations of Russian companies in 2014-2017. In these circumstances Sistema's access to investor funding through capital markets may be restricted further in the event that sectoral sanctions are imposed on Russian companies in segments where Sistema operates and/or due to investors taking a cautious approach to Russian companies in general. Sistema's ability to raise funding via bond issues may be limited, which is liable to lead to a lack of working capital and cash available for investment, and thus affect the Corporation's financial performance.

[55] See also Note 38 of the Financial Statements
[56] See also Note 31 of the Financial Statements

3.6.3 Risks related to Sistema's activities

Implementation of the business strategy

The Corporation's strategy aims to develop a balanced and diversified asset portfolio in sectors and regions where Sistema has expertise and competitive advantages, while attracting leading international and Russian partners. Despite having a well-formulated strategy, Sistema cannot guarantee the full or partial achievement of its goals, efficient management of portfolio companies, or benefits from new investment opportunities. Sistema's failure to achieve goals set in its strategy may put pressure on the Corporatoin's consolidated financial indicators.

The development of Sistema Group companies depends on numerous factors, including receipt of necessary permits from state authorities, sufficient demand from consumers, successful development of technologies, efficient risk and cost management, timely completion of R&D and introduction of new products and services. Weaknesses in any of these areas may have a detrimental effect on the growth of Sistema Group companies and the Corporation's financial figures.

Liquidity risks[57]

The Corporation may in the short or long term lose the ability to fulfil its obligations due to a lack of funds, as a result either of losses or insufficient monetisation of investments, combined with a high debt burden and no possibilities to raise the necessary financing.

Acquisition, integration, disposal or restructuring of assets

Sistema implements its strategy by acquiring, disposing of and restructuring assets. New investment opportunities come with certain risks, including failure to find relevant targets or these targets not being available for acquisition, incomplete due diligence of the target's operations and/or financial situation, and potential overvaluation of assets. These risks can also affect Sistema's financial performance.

Acquisitions may increase pressure on the cash position and create a need for raising external funding.

Delays in the implementation of investment deals or failure to close them may obstruct the achievement of Sistema's strategic goals and affect its performance, financial position and investment case.

Sistema may encounter difficulties in creating an efficient system for managing and controlling new assets. The top risks in this area include:

- inability to efficiently integrate operating assets and personnel of the acquired company;
- inability to establish and integrate necessary control mechanisms, including those related to logistics and distribution;
- conflicts between shareholders;
- hostility and/or unwillingness to cooperate on the part of the management and personnel of the acquired asset;
- loss of customers by the acquired asset.

If any of the above risks materialise, the relevant asset may lose part of its value and/or worsen Sistema's financial performance.

When disposing of its assets the Corporation may face the following risks:

- delays in closing or failure to close the deal due to inability to obtain corporate or state approvals;
- mistakes in asset valuation;
- assuming excessive obligations towards the buyer;
- loss of synergies with other assets staying in the portfolio.

[57] See also Note 31 of the Financial Statements

If one or more of the specified risks materialise, the Corporation may lose potential profit and thus see poorer financial performance.

Management and key personnel

The implementation of Sistema's strategy in many respects depends on the efforts and professionalism of the management team. Failure to hire a sufficiently competent and motivated management team can jeopardise Sistema's business, performance, financial position and development prospects.

Cash flows from subsidiaries and affiliates

The Corporation's financial performance depends on the ability of Sistema Group companies to generate cash flows needed to service financial liabilities, including repayment of debt and interest, and to make other investment activities in the future. The cash-generation capacity of Sistema Group companies may be restricted due to regulatory, tax or any other barriers, which may have an adverse effect on the Corporation’s financial position and liquidity of the Corporation.

Overdependence on MTS

Sistema's financial results in many respects depend on the success of its core asset, MTS. Any deterioration in the financial performance of MTS may therefore have a negative effect on Sistema's financial results. Any events damaging to the business of MTS may also negatively influence the current state of Sistema's business and its future prospects, and have an impact on financial results.

Borrowings

Cash flows from portfolio companies may be insufficient to absorb all of the Corporation's investments scheduled for a particular time, making it necessary to borrow funds and thus slowing down strategy implementation.

Loan covenants[58]

Loan and debt securities agreements signed by Sistema and its portfolio companies contain certain restrictive covenants. These covenants restrict further borrowings, encumbrance of property with pledges, asset sales, transactions with affiliates and dividend payouts. They may also restrict certain aspects of Sistema's operations, such as financing of capital expenses, or limit its capacity to repay debts and service other liabilities. Breach of covenants, however inadvertent, may entitle creditors of the Corporation and/or its portfolio companies to demand early repayment of loans, which is a threat to the Corporation's financial performance.

Licences and permits[59]

The operations of Sistema Group's companies are regulated by different government bodies that issue and renew licences, approvals and permits, and also depend on applicable laws and regulations. Regulating authorities to a large extent rely on their own judgement when interpreting and implementing legal requirements, issuing and extending licences, approvals and permits, and monitoring compliance with such licences. There is no guarantee that existing licences and permits, including those issued to the Group's companies, will be extended, that new licences and permits will be issued, or that the companies will be able to comply with the terms of such licences. There is also no guarantee that existing or future licences or permits will not be suspended or revoked on some grounds. Any of these circumstances can have material negative consequences for Sistema's business.

[58] See also Note 26 of the Financial Statements
[59] See also Note 38 of the Financial Statements

Privatised companies

Sistema's portfolio contains several privatised assets including MGTS, Intourist, BPGC, RTI and several other businesses in the technology and agricultural sectors. Some of Sistema's subsidiaries own privatised assets. It is also probable that the Corporation and/or its portfolio companies will take part in privatisations in the future. Since Russia's privatisation-related legislation remains somewhat unclear and inconsistent and contradicts some other provisions (e.g., there are contradictions between federal and regional provisions on privatisation), privatisation of companies or assets may potentially be contested, however selectively.

If the legitimacy of the privatisation of a company or an asset is contested and Sistema or its portfolio company is unable to defend its position in the dispute, it may lose its holdings in the relevant company or its assets. This may have a material negative impact on the Corporation’s business, financial situation, performance or growth prospects.

Anti-corruption regulations

The operations of Sistema and its portfolio companies are regulated by the anti-corruption laws of relevant jurisdictions, including Russian law, the UK Bribery Act and/or the US Foreign Corrupt Practices Act (FCPA). Any investigation into potential violations of the FCPA, UK Bribery Act or other anti-corruption laws of the US, UK, or other jurisdictions may affect Sistema’s reputation, business, financial situation and performance.

Competition

All business segments where Sistema operates are open to competition. Telecom, high tech, banking, retail, media, tourism, private healthcare, pharma, property development, forestry and agricultural markets in Russia and elsewhere are highly competitive. The inability of Sistema Group's companies to compete efficiently may have a material negative impact on the Corporation’s business, performance, financial situation and development prospects.

Brand quality and reputation

Developing and maintaining brand awareness for the Group's companies is crucial to shaping public opinion regarding their existing and future products and services. Sistema believes that the importance of a company’s brand is growing steadily in highly competitive markets. Successful development and improvement of brand awareness depends in large part on the efficiency of a company’s marketing and its ability to provide quality products and services at competitive prices. Effort and money spent on brand development may prove greater than the resulting income, entailing potential financial losses for Group companies.

3.6.4. Risk appetite

One of the key principles of risk management in Sistema Group is the use of the risk appetite method. This approach implies identifying and monitoring the Corporation's target risk profile in accordance with strategic goals and in the context of integration of these strategic goals into risk management procedures. Sistema Group's risk appetite determines the level of risks acceptable for shareholders, and includes the following basic provisions:

- The amount of potential losses under the risks accepted by Sistema Group should not reach a level that would lead to the termination of the Group's operations, including under stressed conditions;
- The structure of cash flows of Sistema Group companies should guarantee the timely fulfilment of obligations to customers in the short and long term;
- In its operations, Sistema Group aims to avoid an increased concentration of risk by counterparties, industries and countries/regions;
- Sistema Group companies must comply with the requirements of national regulators in countries where they operate, as well as the standards and recommendations of international bodies.
- Sistema Group companies should maintain an impeccable business reputation and avoid actions that could undermine it.
- Sistema Group companies should maintain and improve their external individual credit ratings issued by international rating agencies.

3.7 Corporate Governance System

Corporate governance principles

High quality corporate governance and transparency are key elements of Sistema's investment strategy. Sistema aims to meet the best international standards of corporate governance and transparency, and to continuously improve its corporate governance practices through timely implementation of any required changes and high efficiency of managerial decision-making.

Sistema's corporate governance principles

- clear and effective procedures for taking investment decisions;
- reasonable transparency of management processes for investors and partners;
- a predictable dividend policy taking into account reasonable expectations of investors and Sistema's financial resources;
- high level of professionalism of the Board of Directors, and active involvement of the Board in strategic planning, management and supervision of business processes;
- special Board focus on related-party transactions and potential conflict of interest situations;

Sistema is guided by these principles in all of its activities, including strategic and financial management, HR and social policy, preparation of financial statements, control and audit, and risk management. These principles lay the foundations for strengthening the Corporation's investment case.

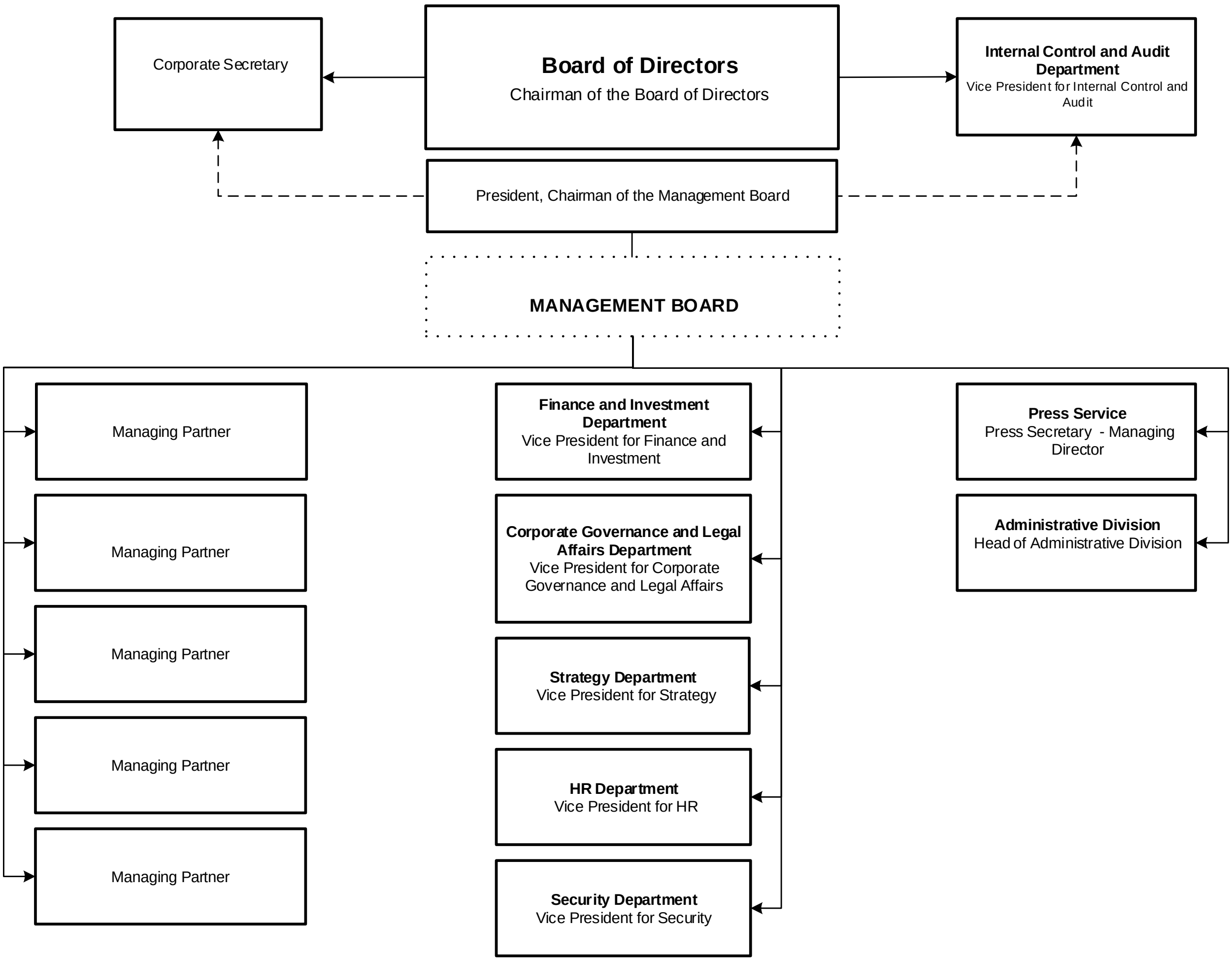
In its corporate governance practices Sistema abides by applicable legislation, the Moscow Exchange Listing Rules, the recommendations of the Russian Corporate Governance Code[60] and the guidelines set out in the UK Corporate Governance Code.

In accordance with Russian legislation and international best practice the Corporation's Charter and internal regulations define its corporate governance principles and procedures, as well as the composition, procedures and powers of its governance and control bodies.

Sistema's Corporate Governance and Ethics Code sets out the Corporation's additional commitments, as well as those of its senior management and employees, in terms of social responsibility, transparency and ethical business principles.

[60] The text of the Corporate Governance Code recommended by the letter of the Bank of Russia No 06-52/2463 dated 10 April 2014 is available at: https://www.cbr.ru/StaticHtml/File/11991/Inf_apr_1014.pdf

Sistema's corporate governance structure as of 2 April 2018



In accordance with its Charter, Sistema's corporate governance bodies are:

- General Meeting of shareholders;
- Board of Directors;
- President;
- Management Board.

3.7.1. General Meeting of shareholders

The General Meeting of shareholders is the supreme governing body of the Corporation. The activities and powers of the Annual General Meeting of shareholders (AGM) are governed by the laws of the Russian Federation, the provisions of Sistema's Charter, and the Terms of Reference of the General Meeting of shareholders.

Sistema aims to encourage shareholders to participate in the AGM. For the last five years (2013-2017) AGMs have therefore been held at the Corporation’s head office in Moscow.

Observance of shareholders' rights

Proposing agenda items for the General Meeting of shareholders, nominating candidates to the Corporation's governance bodies

Shareholders who own at least 2% of the Corporation's voting shares are entitled to propose items for the agenda of the AGM and to nominate candidates for the Corporation's governance and control bodies. Such proposals should be submitted to the Corporation at least 100 days after the end of the financial year in accordance with the Terms of Reference of the General Meeting of shareholders and other internal regulations of the Corporation.[61] Candidates nominated by shareholders to governance and control bodies are provisionally reviewed by the Nomination, Remuneration and Corporate Governance Committee reporting to the Board of Directors.

Participation in General Meetings of shareholders and voting on agenda items

Sistema aims to ensure that shareholders are fully able to exercise their right to participate in managing the Corporation. This includes the right to take part in AGMs and vote on agenda items, as well as the right to receive a share of Sistema's profits in the form of dividends.

To ensure shareholders are fully able to exercise their right to take part in the AGM, all materials regarding agenda items are published on the Corporation's website in Russian and in English (www.sistema.ru and www.sistema.com, respectively) at least 30 days before the meeting. The AGM notice, ballots and all other materials are also sent to registered shareholders by post, and to nominee shareholders in an electronic form.

All shareholders are entitled to take part in General Meetings of shareholders and to vote on agenda items in person or through a representative (if the AGM is held with in-person voting).

Shareholders may complete ballot papers and send them to Sistema before the AGM. From 2017 shareholders may also use the e-voting system available on the website of the Corporation's registrar, JSC Reyestr. To use this service, shareholders should apply through the Reyestr website for access to a personal shareholder account. If a shareholder has a personal account on the e-government portal, they may access the service without applying to the registrar. More detailed information on how to access the e-voting service is available on Reyestr's website: http://www.aoreestr.ru/shareholders/e-voting.

Holders of Sistema's GDRs may vote on AGM agenda items by proxy as per the established procedure via a depositary bank servicing Sistema's GDR programme. In 2017, Sistema's depositary bank was Citibank, N.A. For more information on the depositary bank and voting procedures please go the bank's website www.citiadr.idmanagedsolutions.com. The depositary bank collects votes of GDR holders about which it has information via clearing systems. These votes are included in the general ballot along with all votes cast for and against the proposed draft resolution, as well as abstentions.

The results of voting on agenda items of General Meetings of shareholders held with in-person voting are announced before the end of the meeting. After the minutes of the AGM are drafted, shareholders may also view the AGM voting results on the Corporation's website.

Dividend policy

The Corporation announces the amount of dividends recommended by the Board of Directors and the record date in advance. Shareholders are thus able to use this information about expected dividends in order to take informed decisions regarding management of their shares.

In determining the recommended amount of dividends for 2016, the Board of Directors was guided by the Dividend Policy,[62] which stipulates that dividend distributions to be recommended by the Board for a reporting year shall be based on a target dividend yield of at least 6%, or RUB 1.19 per ordinary share, whichever is greater.

[61] If an Extraordinary General Meeting of shareholders is conducted and its agenda includes the election of the Board of Directors, shareholders who own a sufficient number of shares are entitled to nominate candidates for the Board. Proposals to this effect must be received by the Company at least 30 days before the date of such a meeting.
[62] The revised dividend policy was approved in April 2017.

In line with the Corporation's approved dividend policy, Sistema aims to distribute dividends twice a year: based on the results of the first nine months and of the full reporting year. In October 2017, in accordance with the new Dividend Policy, the Board of Directors recommended that the General Meeting of shareholders approve payment of interim dividends for the nine months of 2017.

Shareholder access to the Corporation's documentation

An important guarantee of shareholders' right to participate in managing the company is the right to access documents that the Corporation is obliged to provide to shareholders in accordance with article 91 of the Federal Law on Joint-Stock Companies. To exercise this right, shareholders should send a written request for access to the relevant documents to Sistema's Corporate Secretary. After the time for providing the documents is agreed upon, the requested documents will be provided to the shareholder. When a shareholder is granted access to confidential documents, they undertake a written non-disclosure obligation, thus providing a guarantee that the rights of all the Corporations shareholders are protected. If the shareholder requires copies of documents, the shareholder bears the costs incurred by the Corporation (RUB 10 per page).

Information about General Meetings of shareholders in 2017

Annual General Meeting of shareholders

Date and venue	24 June 2017, 13/1 Mokhovaya St, Moscow
Form of the meeting	Meeting (in-person voting)
Items reviewed and decisions taken	• annual report and financial statements for 2016 were approved, • dividends for 2016 were approved in the amount of RUB 7,816,500,000.00, or RUB 0.81 per ordinary share (RUB 16.2 per GDR), • Board of Directors and Audit Review Commission were elected, • auditors were appointed to audit the Corporation's RAS and IFRS accounts for 2017, • decisions were taken to approve the revised Charter and internal documents regulating the work of Sistema's governing bodies.
Attended	Shareholders holding a combined 80.6% of votes
Date and reference number of the minutes	24 June 2017, No1-17

Extraordinary General Meeting of shareholders

Date	28 November 2017
Form of the meeting	Absentee voting
Items reviewed and decisions taken	Interim dividends based on the 9M 2017 results were approved in the amount of RUB 6,562,000,000.00 or RUB 0.68 per ordinary share (RUB 13.6 per GDR)
Attended	Shareholders that together hold 79.8% of votes
Date and reference number of the minutes	01 December 2017, No 2-17

3.7.2. Board of Directors

The Board of Directors is a collective governance body in charge of oversight and strategic management of the Corporation.

Under Sistema's Charter the responsibilities of the Board of Directors include:

- supervising the operations of the Corporation in general;
- formulating strategic and financial development plans;

- determining investment principles and criteria;
- assessing the performance of the management team;
- defining the principles of Sistema’s corporate governance;
- approving transactions and strategic projects in accordance with applicable legislation and the Corporation’s internal regulations

Board composition

The Board of Directors effective as of 31 December 2017 was elected at the Company's AGM, which was held on 24 June 2017. Independent directors account for 45% of the Board of Directors.

	Composition of the Board of Directors from 1 January to 24 June 2017 (elected on 25 June 2016)	***Composition of the Board of Directors from 25 June to 31 December 2017 (elected on 24 June 2017)***
1.	Vladimir Evtushenkov *(Chairman)*	Vladimir Evtushenkov *(Chairman)* [63]
2.	Sergey Boev *(Deputy Chairman)*	Sergey Boev *(Deputy Chairman)*
3.	Andrey Dubovskov	Anna Belova[64] [65]
4.	Felix Evtushenkov	Andrey Dubovskov
5.	Patrick Clanwilliam	Felix Evtushenkov
6.	Robert Kocharyan	Ron Sommer
7.	Jeannot Krecké	Robert Kocharyan[66]
8.	Peter Mandelson	Jeannot Krecké[4]
9.	Roger Munnings	Roger Munnings[67] [68]
10.	Mikhail Shamolin	Mikhail Shamolin
11.	David Iakobachvili	David Iakobachvili[1]

The Board of Directors has 11 members. The main change compared to the 2016-2017 corporate year is that Patrick Clanwilliam and Peter Mandelson left the Board and new members Anna Belova and Ron Sommer were elected.

Since the end of the reporting period the status of two Board members has changed. On 13 March 2018, Andrey Dubovskov lost the status of a non-executive director and became an executive director following his appointment as President and Chairman of Sistema's Management Board, and Mikhail Shamolin became a non-executive

[63] The Chairman and Deputy Chairman of the Board of Directors were elected at the first Board meeting on 24 June 2017.
[64] Anna Belova was nominated to the Board of Directors by a group of minority shareholders.
[65] Independent directors that meet the independence criteria set out in the Moscow Exchange Listing Rules.
[66] Robert Kocharyan was recognised as independent by the Corporation in accordance with the Moscow Exchnage Listing Rules. Information on this decision was disclosed on Sistema's website.
[67] Independent directors that meet the independence criteria set out in the Moscow Exchange Listing Rules.
[68] Roger Munnings was recognised as independent by the Corporation in accordance with the Moscow Exchange Listing Rules. Information on this decision was disclosed on Sistema's website.

director. Felix Evtushenkov (previously an executive director) left the Management Board on 1 April 2018 and became a non-executive director.

Meetings of the Board of Directors

Board meetings are held on a regular basis in accordance with the Board’s approved annual work plan, which is drawn up based on Sistema’s strategic planning and reporting cycle.

In 2017, the Board of Directors held 15 meetings: eight scheduled in-person meetings and seven unscheduled meetings with absentee voting. The Board of Directors reviewed a total of 81 agenda items in 2017:

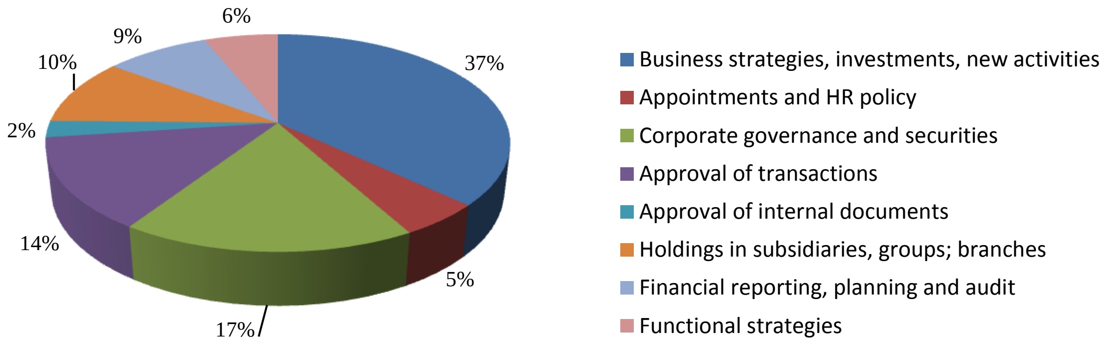
	2017	2016
Number of in-person meetings	**8**	8
Number of absentee votes	**7**	5
Number of items in accordance with the Board's work plan	**46**	43
Actual number of items reviewed by the Board	**81**	101

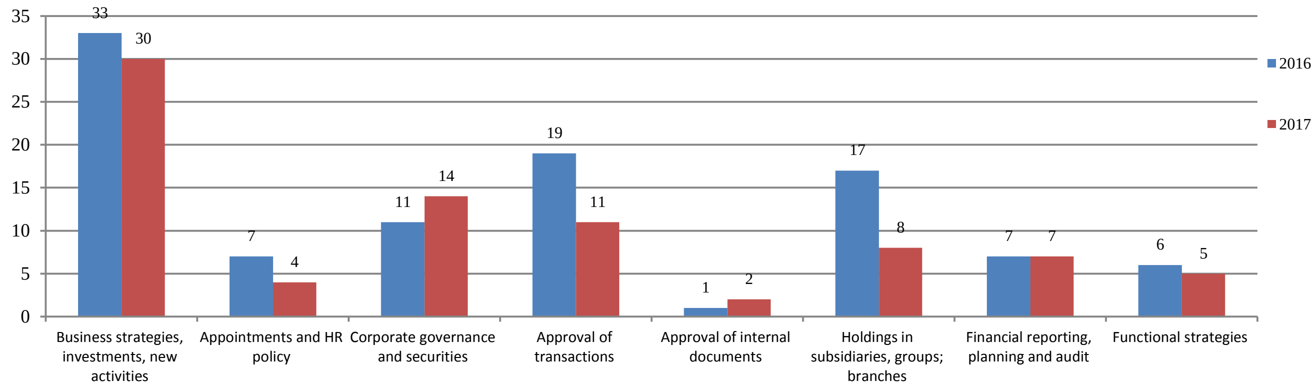
Over the reporting period the Board of Directors considered the following key items:

1) Sistema's development strategy.
2) Sistema Group's strategic planning cycle.
3) Investment policy, strategy of Sistema's investment funds and priority areas for investment in 2017-2018.
4) Managing and creating value for Sistema's investments in the following areas:
    - telecom assets;
    - consumer (retail) assets including e-commerce assets;
    - agricultural assets;
    - timber processing and pulp and paper assets;
    - banking assets;
    - high-tech assets and investments;
    - real-estate assets;
    - healthcare assets;
    - pharmaceutical assets;
    - power-grid assets;
    - hotel assets.
5) Sistema's results and performance against budget.
6) Budget planning, approval of Sistema’s consolidated budget and management’s key performance indicators for 2017.
7) Functional strategies (for financial management and financial planning, human resources management, corporate security, etc).
8) Placement of securities (registration-exempt bonds).
9) Management of the Corporation's risks.
10) Report of the Internal Control and Audit Department.
11) HR matters and employee incentive systems.
12) Assessment of corporate governance including the results of external assessment of the Board of Directors and Committees of the Board of Directors.
13) Corporate social responsibility.

14) Mandatory corporate procedures, including convening the AGM and developing the work plan of the Board of Directors.
15) Composition of Board Committees and determining the status of Board members.
16) Approval of internal regulations.
17) Approval of transactions, including acquisition of equity stakes.

Items reviewed by the Board in 2017





Most items on the agenda of Sistema's Board of Directors in 2017 were related to the business strategy of the Corporation and the management of its investments in various industries, approval of transactions (including equity holdings in other companies) and corporate governance. In 2017, the number of items related to Sistema's investment funds and their management structure significantly increased.

Preparation for meetings and quorum of the Board of Directors

Preparatory procedures for Board meetings are designed to ensure maximum use of the experience and expertise of the Board members. Materials on agenda items are published on the Board's electronic portal at least 10 days before the meeting, which gives members sufficient time to form an informed opinion on all agenda items. Most the agenda items (including approval of transactions) undergo a mandatory preliminary review at meetings of the Committees of the Board of Directors.

The Corporation has introduced the procedure of challenging speakers on key agenda items to enable Board members (as a rule, independent members) to conduct an in-depth review of materials and hold discussions with management. This approach makes it possible to increase the involvement of Board members in the development of the Corporation's strategy.

Board meetings usually have a high attendance rate: the average quorum of meetings in 2017 was 99%.

Participation of the Board members in meetings of the Board of Directors and its Committees in 2017

	Board of Directors	Strategy Committee	Audit, Finance and Risk Committee	Nomination, Remuneration and Corporate Governance Committee	Ethics and Control Committee	Investor Relations and Dividend Policy Committee
			Attendance			
V. Evtushenkov	14/15[69]	9/9	-	-	-	-
A. Belova[70]	9/9	-	6/6	-	3/3	3/3
S. Boev	15/15	4/9	-	8/8	6/6	-
A. Dubovskov	15/15	8/9	-	-	-	-
F. Evtushenkov	15/15	5/9	-	-	3/6	-
R. Sommer [56]	8/9	1/4	2/6	2/3	-	-
P. Clanwilliam [71]	6/6	-	6/6	-	-	3/3
R. Kocharyan	15/15	7/9	-	8/8	6/6	-
J. Krecké	15/15	-	12/12	-	-	6/6
P. Mandelson[55]	6/6	-		2/5	1/3	-
R. Munnings	15/15	-	12/12	8/8	6/6	6/6
M. Shamolin	15/15	9/9	-	-	-	0/3
D. Iakobachvili	15/15	5/9	10/12	7/8	-	6/6

Assessment of the Board of Directors' performance

Assessment of the Board of Directors' performance is an important tool that helps identify the areas where the work of the Board of Directors and its Committees may be improved.

In 2017, Sistema for the first time conducted an external assessment of its Board of Directors by engaging Nestor Advisers, an independent professional advisory firm that specialises in corporate governance.

The goal of the assessment was:

(1) to increase the effectiveness of the Board of Directors by identifying areas for improvement in its structure, functions and ability to constructively challenge management;

(2) to develop a shared position of the Board of Directors as to how to maximise the contribution of each member to the Board's work;

[69] The first number shows the number of meetings attended by the Board member, the second number stands for the total number of meetings.

[70] Member of Sistema's Board of Directors from 24 June 2016.

[71]Member of Sistema's Board of Directors until 24 June 2017

(3) to increase the trust of shareholders and investors in the Corporation's corporate governance practices.

The assessment of the Board of Directors was conducted based on:

(1) analysis of the Corporation’s public and internal documents (Charter, Terms of Reference of the Board of Directors, Terms of Reference of Committees, 2016 Annual Report, Corporate Governance Code), the work plan of the Board of Directors, agendas and minutes of the Board of Directors and materials on agenda items provided to Board members;

(2) Board members completed online questionnaires consisting of 70 questions formulated individually for Board members, the Chairman and the members of the Board's Committees;

(3) interviews were conducted with members of the Board of Directors, the Corporation's President, Senior Vice President, Head of Finance and Investment Function, Head of Internal Audit Department, and Corporate Secretary.

The assessment covered the following areas of the Board's work:

<table>
<tr><th colspan="12">Membership and activities of the Board of Directors</th></tr>
<tr><td colspan="4">Balance of knowledge, skills and industry experience of the Board members</td><td colspan="4">Effectiveness of the procedure for nominating candidates to the Board of Directors</td><td colspan="4">Quality of communication between the Board of Directors and the Corporation’s executive management</td></tr>
<tr><th colspan="12">Functional areas of the Board's work</th></tr>
<tr><td colspan="3">Involvement of the Board of Directors in strategy development</td><td colspan="3">Overseeing the operation of the internal audit system</td><td colspan="3">Work of Committees of the Board of Directors</td><td colspan="3">Assessment of management's performance</td></tr>
</table>

The assessment found the work of the Board of Directors to be high quality and efficient. Nestor Advisors believes that the Board of Directors provides the required level of governance and control at the company. The external assessment provided an independent professional opinion of the priorities for developing the Corporation's corporate governance system.

Committees of the Board of Directors

Sistema PJSFC has five committees of the Board of Directors:

- Strategy Committee;
- Audit, Finance and Risk Committee;
- Nomination, Remuneration and Corporate Governance Committee;
- Ethics and Control Committee;
- Investor Relations and Dividend Policy Committee;

The main role of the Committees is to provide assistance to the Board in preparing and adopting decisions in specific functional areas, and to ensure prior in-depth scrutiny of matters put forward for consideration by the Board of Directors.

The status, procedures for nominating members, responsibilities and decision-making processes of the Board's Committees are regulated by each committee’s Terms of Reference, which are approved by the Board of Directors and published on the Corporate Documens section of the Corporation's website: http://www.sistema.com/about-sistema/corporate-governance/corporate-documents/.

Functions of the Board committees

Name	Functions
Strategy Committee	▪ analysing strategic management issues of Sistema Group; ▪ reviewing strategy planning methodology; ▪ reviewing M&A transactions with a value exceeding USD 100m; ▪ reviewing Sistema Group’s investment projects related to entry into new geographies or industries and projects with significant state ownership.
Audit, Finance and Risk Committee	▪ facilitating and supervising the processes of preparing and auditing the Company's financial statements; ▪ assessing the quality of audit services based on the audit of Sistema's financial statements and making preliminary recommendations to the Board of Directors with respect to selecting RAS and IFRS auditors for the Corporation; ▪ assessing the risk management system and ensuring compliance with applicable legal requirements in financial reporting, audit and planning; ▪ conducting a provisional appraisal of transactions submitted to the Board of Directors; ▪ approval of budgets and financial models.
Nomination, Remuneration and Corporate Governance Committee	▪ facilitating the development of an efficient corporate governance system that meets international standards at the Corporation and its portfolio companies; ▪ conducting a preliminary review of candidates: a. for the Board of Directors of Sistema; b. for the boards of directors of portfolio companies; c. for senior management positions at the Corporation and its portfolio companies; d. for the position of the Corporation's Corporate Secretary; ▪ developing incentive and remuneration policies for the Corporation; ▪ organising the procedure of assessment of the Board of Directors' performance.
Ethics and Control Committee	▪ forming an efficient system of economic and corporate security; ▪ monitoring compliance with the requirements of the Corporation’s Ethics Code; ▪ introducing a system for prevention of corruption and fraud and other misconduct related to violations of applicable laws at Sistema Group companies.
Investor Relations and Dividend Policy Committee	▪ increasing the investment case for the Corporation’s securities; ▪ supporting effective relations with the financial community; ▪ developing Sistema's dividend policy, including development of recommendations for the Corporation's Board of Directors with respect to the amount of dividends payable; ▪ protection of the rights and interests of Sistema's shareholders.

Members of the Committees of the Board of Directors of Sistema PJSFC in 2017

	Strategy Committee	Audit, Finance and Risk Committee	Nomination, Remuneration and Corporate Governance Committee*	Ethics and Control Committee	Investor Relations and Dividend Policy Committee
V. Evtushenkov Chairman of the Board of Directors of Sistema					
A. Belova Independent Director					
S. Boev Deputy Chairman of the Board of Directors of Sistema				**	
A. Dubovskov Until March 2018 – President of MTS; starting from March 2018 – President of Sistema, member of the Board of Directors of Sistema					
F. Evtushenkov Deputy Chairman of the Board of Directors of Sistema ***				**	
R. Sommer Member of the Board of Directors of Sistema, Chairman of the Board of Directors of MTS					
R. Kocharyan Independent Director					
J. Krecké Independent Director					
R. Munnings Independent Director					
M. Shamolin Until March 2018 – President of Sistema; starting from March 2018 – President of Segezha Group, member of the Board of Directors of Sistema					
D. Iakobachvili Independent Director					

** The President of Sistema attends Committee meetings as a permanent invitee and does not vote on matters submitted for consideration of the Committee.*
*** As of 31 December 2017, the Chairman of the Ethics and Control Committee was Sergey Boev. After the reporting period, Felix Evtushenkov was appointed Chairman of the Ethics and Control Committee.*
**** Felix Evtushenkov was elected Deputy Chairman of the Board of Directors after the reporting period.*

Matters considered by the Committees of the Board of Directors of the Corporation

Committee	Number of meetings in 2017	Topics discussed
Strategy Committee	**9**	• value creation at portfolio companies; • investment projects.
Audit, Finance and Risk Committee	**12**	• assessment of the quality of audit services, results of the tender for provision of audit services, recommendations for the Board of Directors on appointing an external auditor; • review and approval of the Corporation's quarterly and annual financial statements, annual report, annual budget and report on performance against the budget; • review of management's reports on risk management at Sistema and the risk map; • preliminary review of transactions submitted to Sistema's Board of Directors.
Nomination, Remuneration and Corporate Governance Committee	**8**	• development of corporate governance at Sistema and Sistema Group companies, consideration of candidates for Sistema’s Board of Directors; • incentive system, performance assessment and bonuses for key managers and employees; • HR process and preliminary review of candidates for top management positions at Sistema and nominees for the boards of directors of the key portfolio companies.
Ethics and Control Committee	**6**	• performance of the Internal Control and Audit Department in 2016 and work plan for 2018; • results of ethics assessment of the Corporation's employees; • system for preventing and curbing fraud and corruption at Sistema.
Investor Relations and Dividend Policy Committee	**6**	• amount of dividends and changes in the Corporation's dividend policy; • the Corporation's charity strategy • market analysis and monitoring, perception of Sistema by the investment community.

3.7.3. President

The President is a permanent chief executive officer whose main tasks include managing the day-to-day operations of the Corporation and dealing with matters outside the remit of the General Meeting of Shareholders, Board of Directors and Management Board, with the aim of ensuring the Corporation's profitability and safeguarding the rights and legitimate interests of its shareholders. The President reports to the Board of Directors and General Meeting of shareholders, and performs the functions of chairman of the collective executive body (Management Board).

Mikhail Shamolin was President of Sistema from 10 March 2011 to 12 March 2018. On 13 March 2018, following a decision of the Board of Directors, Andrey Dubovskov was appointed President and Chairman of the Management Board of Sistema for a three-year term.

Mikhail Shamolin	Born in Moscow in 1970. In 1992, graduated from the Moscow Automobile and Road Technical Institute, and in 1993 from the Russian Presidential Academy of Public Administration. In 1996-1997, completed a finance and management course for senior executives at Wharton School of Business. In 1998-2004, worked for McKinsey & Co. In 2004-2005, Managing Director for Ferroalloys at Interpipe Corp (Ukraine). In 2005-2011, Vice President for Sales and Customer Service, then Vice President, Head of MTS Russia and President of MTS. In 2011-2018, President of Sistema. Since March 2018, President and Chairman of the Management Board of Segezha Group. Member of the Board of Directors of Sistema and the Board of Trustees of Sistema Charitable Foundation.
Andrey Dubovskov	Born in Almaty in 1966. In 1993, graduated from the Russian State Gerasimov University of Cinematography. Has extensive experience at telecoms companies: since 1993, he has held multiple managerial positions at Millicom International Cellular S.A., Millicom International Cellular B.V., LLC Regional Cellular Telecommunications, CJSC 800, and other companies in Moscow, Almaty, Nizhny Novgorod, Yekaterinburg, Perm and Kiev. In 2002-2004, CEO of Tele2 (Nizhny Novgorod). In 2004, joined MTS as head of the company's Nizhny Novgorod branch. In 2006-2007, Director of the MTS Ural Macroregion. In 2007, became First Deputy CEO of UMS (MTS Ukraine) and in 2008 was appointed head of the MTS Ukraine business unit. In 2011-2018, President of MTS. On 13 March 2018, appointed President of Sistema PJSFC following a decision of the Board of Directors. Member of the Board of Directors of Sistema and the Board of Trustees of Sistema Charitable Foundation.

3.7.4. Management Board

The Management Board determines methods for implementing the Corporation's development strategy, formulates development plans, determines and monitors investment processes and previews most matters that are subsequently submitted to the Corporation's Board of Directors.

In 2017, the Management Board conducted 16 meetings and reviewed 46 agenda items in the following key areas:

1) Sistema's development strategy.
2) Management strategy and structure of Sistema's investment funds.
3) Sistema Group's strategic planning cycle.
4) Development strategy, value creation and monetisation of Sistema's key portfolio assets.
5) Sistema’s functional strategies.
6) Budget execution, budget planning and key performance indicators.
7) Debt and liquidity management.
8) Sistema's corporate social responsibility.
9) Review of specific deals.

In 2015, following the expiry of the term of the previous Management Board, Sistema's Board of Directors approved a new Management Board for another three-year term. As of 31 December 2017, the Corporation's Management Board consisted of 14 members.

Members of the Management Board
as of 31 December 2017

1.	Mikhail Shamolin	*Chairman of the Management Board*
2.	Alexander Gorbunov	
3.	Alexey Guryev	
4.	Felix Evtushenkov	
5.	Artem Zassoursky	
6.	Leonid Monosov	
7.	Oleg Mubarakshin	
8.	Vsevolod Rozanov	
9.	Artem Sirazutdinov	
10.	Ali Uzdenov	
11.	Mikhail Cherny	
12.	Evgeny Chuikov	
13.	Sergey Shishkin	
14.	Vladimir Shukshin	

Changes to Sistema's Management Board in 2017

The following changes were made to the Management Board in 2017:

E. Vitchak	18 February 2017	Membership terminated.
A. Guryev	8 March 2017	Elected to the Management Board, appointed Vice President and Head of the HR Department of Sistema.
V. Korchunov	1 April 2017	Membership terminated.
A. Sirazutdinov	1 April 2017	Elected to the Management Board, appointed Vice President of Sistema.

After the end of the reporting period, the powers of the Management Board in its composition as of 31 December 2017 were terminated early, and a new Management Board was elected. Since 2 April 2018, the Management Board consists of 11 members.

Members of the Management Board of Sistema PJSFC
as of 02 April 2018

1.	Andrey Dubovskov	*Chief Executive Officer (President), Chairman of the Management Board*
2.	Igor Alyoshin	Vice President for Security
3.	Alexey Guryev	Vice President for HR
4.	Artem Zassoursky	Vice President for Strategy
5.	Alexey Katkov	Managing Partner
6.	Oleg Mubarakshin	Managing Partner
7.	Vsevolod Rozanov	Managing Partner
8.	Artem Sirazutdinov	Managing Partner
9.	Vladimir Travkov	Vice President for Finance and Investment
10.	Ali Uzdenov	Managing Partner
11.	Sergey Shishkin	Vice President for Corporate Governance and Legal Matters

3.7.5. President's Committees

The following committees chaired by the President contribute to the improvement of managerial decision-making:

- Finance and Investment Committee;
- Tender Committee;
- HR Committee;
- Security Committee;
- Discipline Committee.

The President's committees are permanent consultative collective bodies tasked with detailed analysis of current affairs and processes within their remit, and with assisting the President and the Management Board in their decision-making.

Finance and Investment Committee

The responsibilities of the Finance and Investment Committee include:

- review of the Corporation's investment projects at different stages from project idea to completion;
- approval of financial models, business plans and key performance indicators for investment projects;
- recommendations regarding feasibility of projects, exit scenarios and sources of financing;
- review of external financing terms.

The Committee consists of 10 members. As of 31 December 2017, the Chairman of the Committee was the Corporation's President, Mikhail Shamolin; and the Deputy Chairman was Senior Vice President, Head of the Finance and Investment Function Vsevolod Rozanov.

In 2017, the Committee met 45 times.

The Expert Council operates under the Finance and Investment Committee and considers all new investment ideas for the Corporation and potential acquisitions of assets in new and related industries, as well as in industries in which Sistema already has a presence.

The Expert Council consists of 13 members. As of 31 December 2017, the Chairman of the Expert Council was Vice President, Head of Strategy Function Artem Zassoursky.

In 2017, the Expert Council met 13 times.

The Finance and Investment Committee also has a Risk Subcommittee responsible for assessing the risks facing Sistema and Sistema Group companies and for monitoring performance against risk management action plans.

The Risk Subcommittee consists of six members.

In 2017, the Risk Subcommittee met nine times.

Tender Committee

The responsibilities of the Tender Committee include:

- organising tenders for goods, works, and services;
- ensuring acquisitions of goods, works, and services and sales of the Corporation's property on the best terms available;
- ensuring the transparency of purchasing procedures;
- facilitating prevention of corruption and other wrongdoings in the area of purchasing.

The Committee consists of 11 members. As of 31 December 2017, the Chairman of the Committee was Senior Vice President, Head of the Finance and Investment Function Vsevolod Rozanov.

In 2017, the Tender Committee met 30 times.

HR Committee

The responsibilities of the HR Committee include:

- reviewing and making proposals with regard to the HR policies and internal regulations at the Corporation and its portfolio companies;
- coordinating the activities of HR units of the Corporation and portfolio companies;
- assessing candidates for senior executive positions;
- assessing the efficiency and performance of the Corporation's employees.

The Committee consists of nine members. As of 31 December 2017, the Chairman of the Committee was President of Sistema Mikhail Shamolin.

In 2017, the Committee met 29 times.

Security Committee

The Security Committee reviews matters related to implementation of the adopted security policy across Sistema Group.

The Committee consists of 37 members. As of 31 December 2017, the Chairman of the Committee was Vice President, Head of the Security Department Vladimir Shukshin.

In 2017, the Committee met four times.

Discipline Committee

The Discipline Committee reviews matters pertaining to compliance with labour law, internal regulations and instructions of the company's governance bodies, and develops recommendations on whether there are reasons for imposing disciplinary penalties on employees.

The Committee consists of seven members. As of 31 December 2017, the Chairman of the Committee was President of Sistema Mikhail Shamolin.

In 2017, the Committee met once.

3.7.6. Specific characteristics of risk management, internal control and internal audit systems

Risk management

Sistema’s risk management system uses a two-level approach, with risks identified at Sistema and at portfolio companies consolidated to assess their impact on Sistema Group as a whole.

The Corporation’s integrated risk management system (ERM) addresses the following tasks:

- identification of risks at all levels of management (from senior to line management), which includes finding risk owners and creating risk passports;
- primary assessment of the materiality of identified risks and analysis of thess risks using VaR methodology;
- ranging risks by management levels;

- assessment of the aggregate influence of material risks on the Corporation's key financial indicators (Monte Carlo modelling);
- development of plans to mitigate identified risks at all management levels;
- regular monitoring of performance against mitigation plans and assessment of these plans' effectiveness;
- risk monitoring and preparation of quarterly reports on risks facing the Corporation.

Sistema's risk management procedures are carried out by a dedicated risk management unit.

The Corporation's risks are monitored on a quarterly basis by Sistema's Management Board and Risk Subcommittee, which review the effects of mitigation and response measures taken and reassess persisting and/or new risks.

Sistema's senior executives make regular reports on risk management in the Corporation to the Audit, Finance and Risk Committee. The annual report is submitted to the Board of Directors.

Internal control system

The Internal Control Policy was approved by the Corporation's Board of Directors and is an internal senior-level document describing the key principles of internal control as a continuous and integrated process that involves all of the Corporation's units and governance bodies of the Corporation.

The key objectives of the internal control system are:

- creating control mechanisms that ensure business processes remain efficient and the Corporation's investment projects are implemented;
- protecting the Corporation's assets and making efficient use of its resources;
- protecting the interests of the Corporation's shareholders, and preventing and resolving conflicts of interest;
- creating conditions for timely preparation and submission of reliable reports and other information that the Corporation is legally required to disclose publicly;
- ensuring that the Corporation complies with applicable legislation and regulatory requirements.

The Corporation maintains "three lines of defence" (in addition to the Board of Directors and the Corporation's senior management) to ensure the effectiveness of its internal control system:

- Level 1: Heads of subdivisions and employees are responsible for assessing and managing risks and building an efficient internal control system within their remit;
- Level 2: At this level the function is performed by several subdivisions and Committees. For example:
  - the risk management function and the Risk Subcommittee are responsible for developing and monitoring the implementation of an effective risk management practice;
  - the Finance and Investment Committee approves and monitors implementation of investment projects;
  - the Discipline Committee reviews matters related to breaches of the Ethics Code and disciplinary offences;
  - The Security Department is responsible *inter alia* for economic security, prevention of corruption and information security.
- Level 3: The Internal Control and Audit Department conducts an independent assessment of the effectiveness of the internal control system, as well as risk-management and corporate-governance procedures.

All employees in charge of various control procedures are responsible for the controls and risk management activities set out in their job descriptions and internal regulations.

Internal audit

The body in charge of internal control at the Corporation and Sistema Group companies is the Internal Control and Audit Department, which reports to the Board of Directors (functionally) and Sistema's President (administratively). The head of the Department is appointed and dismissed by the President based on resolutions passed by the Board of Directors following preliminary approval by the Board's Ethics and Control Committee.

The main objectives of the Internal Control and Audit Department are:

- helping shareholders and management improve the internal control system by performing regular audits of the effectiveness of the Corporation's internal-control, risk-management, and corporate-governance systems;
- supplying management and shareholders with objective information on existing internal risks and the probability that they will occur;
- raising awareness among management about the performance of Sistema Group companies;
- monitoring the achievement of the goals of shareholders of the Corporation and Sistema Group companies.

To meet these objectives, the Internal Control and Audit Department:

- carries out independent audits of individual operations, processes and units;
- assesses the effectiveness of the internal-control system;
- assesses the effectiveness of the risk-management system;
- assesses the effectiveness of the corporate-governance system, prevents legal and regulatory violations, ensures compliance with professional and ethical standards and prepares recommendations to raise these standards;
- develops recommendations to remedy identified deficiencies and monitors the execution of any remedial action taken;
- examines documents provided regarding investment projects for compliance with current regulations; performs scheduled and unscheduled monitoring of performance against targets;
- monitors compliance with procurement procedures;
- administers the Hotline, the Discipline Committee and ethics assessments.

The Internal Control and Audit Department has all the resources and powers required to perform these functions.

The Internal Control and Audit Department works closely with independent auditors, coordinates audits and offers consultations while preparing the Department's annual audit plans to assess the effectiveness of internal controls as applied to financial statements, as well as during discussions and assessment of identified risks.

In 2017, the Internal Control and Audit Department conducted 70 scheduled and unscheduled audits to assess the effectiveness of internal-control, risk-management and corporate-governance systems. These audits did not uncover any weaknesses or risks that could affect the sustainability of the Corporation's business as a whole.

Regular reports on the results of the Internal Control and Audit Department are reviewed by the Board’s Audit, Finance and Risk Committee and Ethics and Control Committee, and are also submitted for consideration by the Board of Directors at the end of the year.

Resolution of conflicts of interest

Matters related to conflicts of interest are governed by the Corporation's Code of Ethics. The Corporation has an ethics assessment procedure: all senior managers annually (or as conflicts of interest arise) fill out Ethics and Conflict of Interest Declarations. All new employees must complete a training course and learn the requirements of the Code of Ethics and the procedure to fill out the Declaration.

In 2017, the Corporation held its second ethics assessment. The results were reviewed by the President and the Board’s Ethics and Control Committee. In most cases the declared conflicts of interest were not confirmed and did not require any resolution measures. However, action plans on conflict resolution were implemented with respect to several declarants in accordance with best corporate governance practices.

The ethics assessment makes it possible to identify and manage conflicts of interests in a timely manner, thus preventing shareholders' interests from being compromised.

External audit

In compliance with the decision of the Audit, Finance and Risk Committee, the Corporation uses the following procedures to appoint the independent auditors of Sistema's financial statements. The Committee performs annual assessments of the quality of audit services received. If the quality of services provided by the current auditor is deemed insufficient, the Audit Committee organises a tender to hire a new auditor. If the quality is deemed sufficient, Sistema negotiates the price of services with the current auditor for the following period. According to the decision of the Audit, Finance and Risk Committee, a tender for external audit services should be held at least every three years to ensure that the auditor is impartial and objective.

3.7.7. Corporate governance across Sistema Group

The quality of strategic planning and the investment case of Sistema's portfolio companies depends *inter alia* on the quality of corporate-governance procedures. To increase the value of its investments Sistema focuses on improving the quality of corporate governance at its portfolio companies.

The Corporation aims to execute strategic management of its key portfolio companies through the companies' boards of directors, by bringing in professional independent members with industry expertise, as well as specialists in strategy, finance, audit and corporate governance. Independent directors account for about one-third of members of the boards of key portfolio companies (depending on the company's organisational maturity).

The Corporation continuously improves its corporate-governance system to increase its effectiveness and ensure continued compliance with best practices. Improving the quality of corporate-governance processes at portfolio companies and bringing in competent professionals to their boards of directors is designed to increase the quality of decision-making and shareholder value at Sistema's portfolio assets.

Boards of directors of portfolio companies provide control and coordination, and support management in decision-making in the following functional areas:

- strategy and key transactions;
- budget planning;
- HR policy;
- internal audit.

The Corporation's key tasks related to improving corporate governance at portfolio companies for the next year are:

1. increasing the responsibility of companies' boards for decisions made in their key focus areas;
2. bringing professional independent directors to the boards of portfolio companies.

3.7.8. Development of the corporate governance system in 2017

Independent directors on the Corporation's Board of Directors

In 2017, 11 members were elected to the Corporation's Board of Directors, five of whom qualify as independent directors or are recognised as independent according to Moscow Exchange's Listing Rules and the Russian Corporate Governance Code.

The current Board includes the following independent directors:

- Anna Belova;
- Robert Kocharyan;
- Jeannot Krecké;
- Roger Munnings;
- David Iakobachvili.

All of the Corporation's independent directors have vast experience in managing large organisations and strong professional reputations. This ensures that their judgements are objective and that they remain independent of the influence of the Corporation's management and shareholders when making decisions.

Roger Munnings and Jeannot Krecké, as members of the Audit, Finance and Risk Committee, are experts in the field of finance and audit and have extensive relevant experience.

Independent directors are directly involved in discussing and formulating the strategy of the Corporation and its key assets. For this purpose, working groups headed by independent members of the Board and representatives of the Strategy Function and Finance and Investment Function are established to formulate substantiated positions of the Board of Directors on strategic issues related to development of the Corporation and its key assets.

Changes to the Corporation's Charter and internal regulations

In June 2017, the General Meeting of shareholders approved new versions of Sistema's Charter, the Terms of Reference of the General Meeting of shareholders, the Terms of Reference of the Board of Directors and the Terms of Reference of the Management Board. The changes to the Charter and internal regulations were necessitated by amendments made to the Russian legislation on joint-stock companies with respect to major transactions and related party transactions. Internal regulations were also brought into line with EU legislation in view of the *EU Market Abuse Regulation* coming into force.

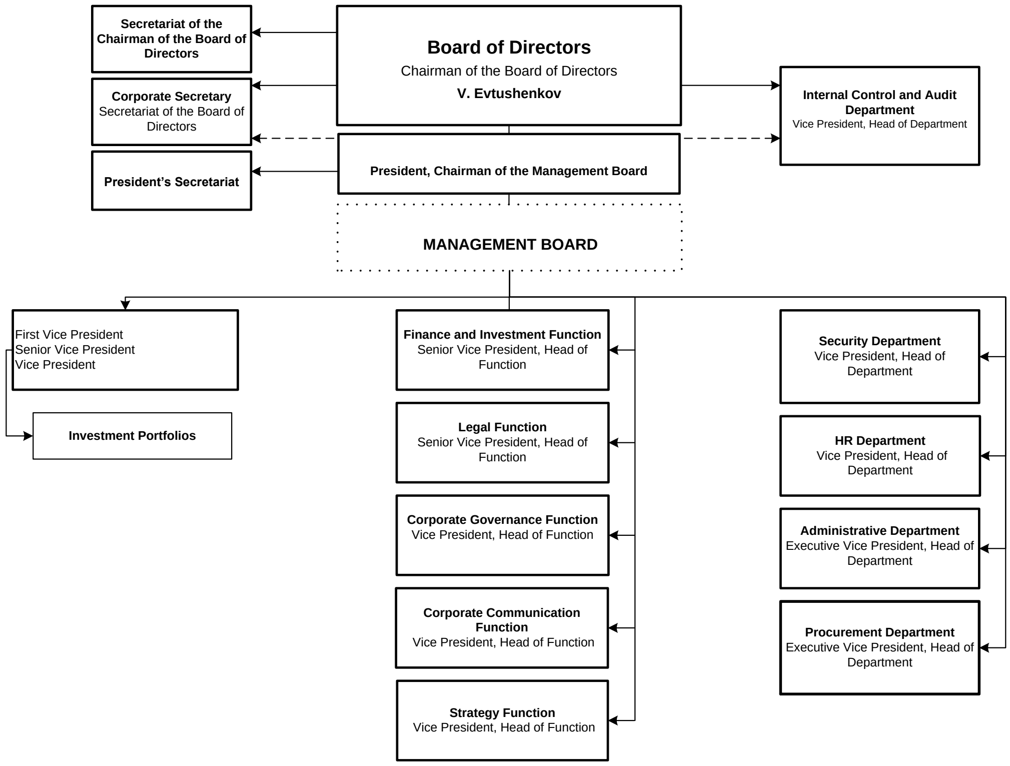
Assessment of the Board of Directors' performance

In 2017, Sistema conducted an external assessment of its Board of Directors for the first time. The assessment found the work of the Board of Directors to be effective and of high quality. In the opinion of the independent professional consultant Nestor Advisors, the Board of Directors provides the required level of governance and control. The assessment provided an independent professional opinion on priorities for the further development of the Corporation's corporate-governance system.

Plans for development of corporate governance

The Board's Nomination, Remuneration and Corporate Governance Committee developed an action plan for improving corporate governance at Sistema in 2018 based on the results of the external assessment. The plan envisages the following activities:

1) revising the Corporation's dividend policy with due account of the Corporation's investment needs (in the first half of 2018);
2) assessing the performance of the Board's Committees (in the first half of 2018);
3) formalising the principles of remuneration payable to the board members of portfolio companies, and approving a standard Policy on remuneration and compensation payable to the board members of portfolio companies (in the second half of 2018);
4) revising and formalising a succession plan for key managers of the Corporation (in the second half of 2018).



Board of Directors
Chairman of the Board of Directors
V. Evtushenkov
Secretariat of the Chairman of the Board of Directors
Corporate Secretary
Secretariat of the Board of Directors
President's Secretariat
Internal Control and Audit Department
Vice President, Head of Department
President, Chairman of the Management Board
MANAGEMENT BOARD
First Vice President
Senior Vice President
Vice President
Investment Portfolios
Finance and Investment Function
Senior Vice President, Head of Function
Legal Function
Senior Vice President, Head of Function
Corporate Governance Function
Vice President, Head of Function
Corporate Communication Function
Vice President, Head of Function
Strategy Function
Vice President, Head of Function
Security Department
Vice President, Head of Department
HR Department
Vice President, Head of Department
Administrative Department
Executive Vice President, Head of Department
Procurement Department
Executive Vice President, Head of Department

3.8 Remuneration of board members and senior management

REMUNERATION POLICY APPLIED TO BOARD MEMBERS OF SISTEMA PJSFC

Remuneration for the work as a member of the Board of Directors is calculated and paid in accordance with the Policy on Remuneration and Compensation Payable to Members of the Board of Directors of Sistema PJSFC[72].

BASIC REMUNERATION OF MEMBERS OF THE BOARD OF DIRECTORS

Basic remuneration of members of the Board of Directors amounts to RUB 13.7m or RUB 17.8m per year depending on whether a director is a tax resident of Russia. Basic remuneration is paid to Board members in cash in equal quarterly instalments.

SUPPLEMENTARY REMUNERATION OF MEMBERS OF THE BOARD OF DIRECTORS

Supplementary remuneration of members of the Board of Directors is paid once a year in the form of ordinary shares of Sistema, subject to achievement of the Corporation's investment targets in the reporting year: (i) the arithmetic mean of TSR and iTSR exceeds or equals CoE[73], or (ii) TSR exceeds or equals the amount of change of the MSCI index (ΔMSCI), provided that iTSR exceeds or equals CoE. The number of ordinary shares awarded to members of the Board of Directors is calculated as follows:

$$\frac{\text{Remuneration in monetary terms}}{\text{Weighted average price of one share}}$$

To calculate the number of shares to be awarded to members of the Board of Directors, the amount of remuneration in monetary terms is equal to the amount of basic remuneration less applicable taxes, while the weighted average price of one share is calculated based on the price of the Corporation's GDRs during the month preceding the date of the Annual General Meeting of shareholders.

REMUNERATION FOR PERFORMANCE OF ADDITIONAL DUTIES

Board members who perform additional duties, e.g., the Chairman of the Board of Directors, Deputy Chairman of the Board of Directors and Chairmen of the Board Committees, receive remuneration on a quarterly basis in the amount stipulated by the Policy on Remuneration and Compensation Payable to Members of the Board of Directors of Sistema PJSFC.

COMPENSATION AND OTHER CONDITIONS

Members of the Board of Directors are reimbursed for expenses incurred during performance of their duties, including participation in meetings of the Board of Directors and Board Committees.

Sistema insures the liability of members of the Board of Directors.

Sistema does not grant loans to members of the Board of Directors.

REMUNERATION POLICY APPLIED TO SENIOR MANAGEMENT OF SISTEMA

Short-term incentive system

The short-term (up to 1 year) incentive scheme for senior managers of Sistema in 2017 consists of:

[72] Approved by the General Meeting of shareholders on 27 June 2015.
[73] This investment target was not achieved in 2017, since TSR was -41.4% and iTSR was -15.8%, while CoE was 14.6% and ΔMSCI was 0.3%. CoE represents the minimum level of return that a company must provide to its shareholders for the expectation of profit and risk. It is calculated as the sum of risk-free returns (such as government bonds) and the risk premium associated with investing in the stock market, taking into account the capital structure of the asset in question and country risk.

- a fixed monthly salary determined in line with the internal system of job categories (grades);
- bonuses paid for project implementation and generating cash income. Remuneration is paid based on employees' individual performance and positive cash flow generated by projects of Sistema's Investment Portfolios and Functions and Departments. Payments may amount to up to 20% of cash income.

For the purpose of calculating bonuses, cash income means the increase in the value of an asset (in the event of an asset sale or an IPO) or the amount of dividends (in the event of a dividend payment), net of:

- the hurdle rate determined by the Corporation's Finance and Investment Committee prior to the commencement of a project or the acquisition of an asset;
- investment in an asset and project costs.

Long-term incentive system

The long-term (over 1 year) incentive scheme for senior managers of Sistema in 2017 was part of an incentive programme. The programme aimed to increase Sistema's shareholder value and create additional incentives for maintaining long-term employment and corporate relations between the Corporation and its management. Participants of the programme are assigned a certain number of shares that are transferred to them in instalments upon achievement of targets set by Sistema's shareholders, on condition that they retain ownership of the shares transferred to them under the programme. Transfers of shares take place annually over the course of five years from the launch of the programme. The number of shares allocated to a programme participant was calculated as follows:

$$\frac{\text{Participant's total annual income}}{\text{Weighted average price of one share during the year}}$$

Co-investment programme

In 2016, the Board of Directors approved a Co-Investment Programme enabling Sistema's senior managers to co-invest in subsidiaries and/or Sistema PJSFC. The Co-Investment Programme is designed to incentivise senior management to increase the Corporation's capitalisation, and provides for additional incentives linked to achievement of strong financial results through origination and implemention of projects and efficient management the Corporation's assets, including asset acquisitions, sales, restructurings, capitalisation growth and increased dividend flows.

Programme participants are the President and heads of investment portfolios, functions and departments. Starting from 2017, employees at Executive Vice President level may also participate in the Co-Investment Programme.

Participants of the Co-Investment Programme use their own funds to acquire:

- shares/stakes in Sistema's subsidiaries, and/or
- ordinary shares in Sistema PJSFC

The amount of co-investment is limited to one year's average annual income of a participant.

Remuneration is paid if:

- there is a liquidity event in relation to a subsidiary (IPO or sale of a stake), or
- a participant holds Sistema's ordinary shares for two years without interruption.

Remuneration is paid in cash; the amount of remuneration is directly linked to the upside in the value of the shares in the subsidiary and/or ordinary shares in Sistema.

Other terms and conditions

No extra compensation above the level stipulated by Russian labour legislation is paid to the President or other senior executives in case of termination of employment.

Sistema does not pay remuneration to members of executive bodies for serving on the Management Board.

The Corporation does not grant loans to senior executives.

REMUNERATIONS PAID TO BOARD MEMBERS AND SENIOR MANAGEMENT IN 2017[74]

Members of Sistema's Board of Directors received the following remuneration in 2017:

	2017	2016
Cash remuneration *Remuneration for work as members of the Board of Directors and additional duties, as well as salaries and bonuses for 2017 paid to Board members who were also employees of the Corporation in 2017.*[75]	**RUB 320,193,625**	RUB 498,400,342
Remuneration in the form of ordinary shares of Sistema PJSFC *Shares paid to Board members for the 2016-2017 corporate year and remuneration under the long-term incentive programme paid to Board members who were also employees of the Corporation in 2017.*[2]	**RUB 218,287,983**	RUB 422,928,991
Reimbursement of expenses incurred by Board members in connection with their duties	**RUB 2,477,710**	RUB 3,713,752

Members of Sistema's Management Board[76] received the following remuneration in 2017:

	2017	2016
Cash remuneration *Including fixed salaries and bonuses.*[77]	**RUB 1,768,437,846**	RUB 3,148,937,048
Remuneration in the form of ordinary shares of Sistema PJSFC *Shares transferred under the long-term incentive programme.*[78]	**RUB 245,821,873**	RUB 1,155,134,028

[74] All figures in this section are given before applicable income tax.
[75] Excluding members of Sistema's Board of Directors who were also members of its Management Board.
[76] Including the President of Sistema.
[77] Bonuses for 2017 were paid to Sistema's employees in January 2018.
[78] The amount only includes the shares awarded under the long-term incentive programme for 2016. Shares allocated to employees for 2017 will only be distributed following a resolution of the Board of Directors.

3.9 Corporate Social Responsibility

Sistema sees corporate social responsibility (CSR) as its sustainable contribution to national social and environmental development in the interests of current and future generations. The Corporation supports social, economic and technological development, modernisation of infrastructure and industry, improvements to the accessibility of essential products and services, job creation, as well as fostering innovation and intellectual and human capital, and running large-scale charitable and volunteer programmes to improve people's quality of life.

Principles for responsible investment

In its operations, Sistema is guided by the basic principles of socially responsible business practices as set out in the United Nations Global Compact and the Social Charter of Russian Business, including:

- strict compliance with legislation, fair competition and zero tolerance for corruption;
- observance of internationally acknowledged human rights in the context of business;
- prevention of all forms of discrimination and creation of equal opportunities with respect to employment relations;
- creation of favourable employment conditions precluding child and forced labour and protecting the occupational health and safety of staff at Group companies;
- reduction of environmental impact, and protection of the environment and climate.

These basic principles are implemented through open and transparent interaction with key stakeholders including shareholders, investors, employees, consumers, suppliers, government authorities, civil society, non-profits and local communities. The Corporation not only requires its portfolio companies to comply with these business standards; it also expects ethical conduct from its partners across the entire supply and value-creation chain.

Sistema is also guided by the Principles for Responsible Investment supported by the UN Global Compact and Environment Programme Finance Initiative (UNEP FI), and shares the goal of integrating environmental, social and governance (ESG) issues in investment decision-making and asset-management processes. The Corporation's responsible approach to investment is based on comprehensive analysis of not just the financial condition and market potential of the assets it acquires, but also on identifying non-financial aspects that can have a significant impact on the sustainability of the investment portfolio. As a strategic investor interested in the long-term growth of shareholder value, Sistema sees its role in minimising ESG risks and improving business efficiency by introducing best practices in HR, prevention of corruption, procurement, quality management and environmental safety, as well as by implementing social projects and building trust-based relationships with stakeholders across its portfolio companies.

At the end of 2017, Sistema received the *Russian Business Leaders: Dynamics and Responsibility* award from the Russian Union of Industrialists and Entrepreneurs (RUIE) for the high quality of its sustainability reports, and was also named among the leading companies in the RUIE's corporate stability, responsibility and transparency indices, which include more than 100 of Russia's largest corporates. The Corporation was named in Group A, which comprises 12 companies with the highest individual scores in the *Responsibility and Transparency* index, reflecting high standards of information disclosure. Sistema and its subsidiary MTS were also among the top 24 companies based on the consolidated results of the *Sustainable Development Vector* and *Prospects* indices, which reflect positive performance dynamics, transparency and the presence of specific SCR and sustainable development goals.

According to the 2017 *Corporate Transparency of Largest Russian Companies* study by the Russian Regional Network for Integrated Accounting, which covers more than 950 companies that together generate 80% of national income, Sistema ranks among the top three in terms of transparency in private business and the finance and investment sector, and in the top 10 among public and strategic companies. The Corporation demonstrated the highest level of corporate-governance transparency of all the companies included in the rating, and was named in the 15 for sustainable development and compliance with international standards. MTS and Detsky Mir, Sistema's public assets, were also named among the companies disclosing information in accordance with international requirements. Detsky Mir was the leader in terms of transparency in the retail segment and won the *Debut of the Year* category.

Sistema as a responsible investor			
Investments in fixed assets	**Investment in human capital and new technologies**	**Social investments and partnerships**	**High standards of governance and transparency**
Modernisation of production facilities and creation of state-of-the-art infrastructure.	Training and development programmes for staff of Sistema and portfolio companies.	Creation of a favourable social environment in regions of operation.	Uniform principles of corporate governance across the Group in line with Russian and global best practices.
Use of the best hardware and modern equipment at Group enterprises.	Training of the next generation of highly qualified young specialists and managers.	Agreements on social and economic cooperation with regions.	Introduction of quality-management systems in line with international standards.
Introduction of the best available technologies, including in resource and energy efficiency.	Own R&D centres and venture investments in technological start-ups.	One of Russia's biggest corporate charitable foundations.	Public non-financial reporting in accordance with Global Reporting Initiative (GRI) standards.
Digitalisation and automation of production and business processes.		Synergies among portfolio companies for social and charitable projects.	
Creation of shared value for the business and society.			

Following the principles of responsible investment, Sistema ensures that its business strategy is consistent with national priorities and the UN Sustainable Development Goals (SDGs), increases the investment case, profitability and competitiveness of important economic segments, creates jobs, and ensures sustainable payments of taxes and social contributions to budgets of all levels.

In 2017, Sistema Group companies paid over RUB 111bn into Russia's consolidated budget, 22% of which went into pension, medical and social security funds. The Corporation's total tax payments over the past three years total almost RUB 300bn. Sistema Group accounted for more than 1% of all private investments in fixed assets in Russia, about 22% of capital investments in the telecommunications sector, and 8% of capital investments in the forestry and pulp and paper industry in 2017.

Contribution to sustainable development

Sistema's contribution to achievement of the Sustainable Development Goals	
Key focus areas and projects	**Main impact**
Economy	
Expansion of land area used for operations. Introduction of state-of-the-art agricultural technologies and automated management systems, R&D in agriculture, including to increase soil fertility and improve the seed pool, in partnership with industry institutions and agricultural companies.	Increase of crop yields and productivity, reduction of import dependency by providing Russian-produced health and organic food products.
Modernisation of forest industry enterprises and creation of high-tech production lines, including installation of a new paper-making machine in Karelia.	Development of modern industry with high value-added products.
Installation of next-generation telecommunications networks across the country, including in small towns and villages. Fundamental and applied research in microelectronics and radio engineering. Development of RFID solutions and microchips for the IoT.	Reduction of digital inequality, improved access to e-services for individuals and businesses. Creation of infrastructure for the digital economy and qualitative growth in various industries.
Reconstruction of power grid infrastructure using Smart Grid technology and introduction of smart power control and metering system in Bashkortostan.	Improvement of energy efficiency and reliability of energy supply to consumers, and reduction of losses in power grids.
Comprehensive urban development in Moscow, development and promotion of new technologies for construction of wooden apartment buildings, and investments in alternative construction technologies, including 3D printing.	Higher speed of housing construction, and creation of a more comfortable, eco-friendly and safe urban environment.
Safe City and Intelligent Transport System projects, smart city lighting system (Sitronics), acoustic surveillance system (Sistema Sarov), smart house services and the Window on a Nursery School video surveillance project in Moscow (MGTS).	Improvement of road traffic flows, strengthening of public safety.
Establishment of an innovative eco-system for tech businesses and R&D, including at Sarov Technopark (Nizhny Novgorod region).	Creation of an ecosystem for innovations and encouragement of development.
Society	
Social, volunteer and charitable projects aimed at helping children, the elderly and people with special needs, including the Taking Care of Veterans programme in Moscow and Medsi's partnership with the Starost V Radost foundation, the Solony regional festival, the Generation M project (development of children's creative abilities and help for seriously ill children), the Participate! campaign to collect goods for children from orphanages, public boarding schools and large families across the Detsky Mir chain, etc.	Promotion of social stability in regions of operation, support for less privileged groups.
Creation of a vertically integrated system to provide comprehensive high-tech medical services: emergency aid, outpatient and inpatient care, hospital substitution services and rehabilitation. Construction of clinics and provision of advanced equipment, introduction of new medical technologies and treatment methods, training programmes for doctors (Medsi's Medical Academy), promotion of healthy lifestyles ("Be Healthy with Medsi!") and early diagnosis of dangerous diseases (oncology, cardiology, etc.).	Introduction of the outcome-based 4P healthcare model: prevention, prediction, personalisation and participation.
Production of vaccines and new "convenient" drugs with improved characteristics, increasing knowledge levels among general practitioners and pulmonologists at the Medical Academy (Binnopharm).	Reduction of sickness rates, higher efficiency of detection, prevention and treatment of diseases.
Career guidance programmes for young people and development of engineering and technology education, including youth contests and schools organised by the Sistema Charitable Foundation, MTS's telecom laboratories in universities, RTI's and Mikron's departments	Training of a new generation of developers, engineering and technical experts and managers for high-tech and knowledge-intensive industries.

at the Moscow Institute of Physics and Technology, conferences for young scientists (the Mintz Readings), etc. The Higher School of Management and Innovation – a faculty established jointly with the Lomonosov Moscow State University. Creation of a network of regional "virtual branches" and multimedia resources for the Russian Museum, MTS's social and educational projects for children ("Children on the Internet") and the older population ("Mobile Academy"), the "Safe Childhood" educational project on power safety (BPGC).	Improvement of levels of digital literacy, safety and culture, and introduction of new education technologies.
Environment	
Segezha Group's transition to zero-waste production by processing bark and wood waste into biofuel for its own needs and for external consumers.	Promotion of resource-saving technologies, creation of a foundation for the cyclical economy and development of the green market.
Production of eco-friendly paper packaging for major retail chains, including Detsky Mir. MTS's switch to eco-friendly packaging for SIM cards. Joint project of MGTS and WWF Russia for switching subscribers to electronic bills.	Reduction of greenhouse gas emissions and combatting climate change. Reduction of the environmental footprint.
Portfolio companies' projects to collect and dispose of waste, including batteries and paper. Reduction of paper consumption. Introduction of alternative power supply sources for MTS's base stations, use of cell towers for monitoring and prevention of forest fires.	Introduction of power saving technologies, use of renewable sources.
Reforestation on leased sites, 96% of which are certified in accordance with the international responsible forest management standards of the Forest Stewardship Council (FSC). Introduction of the intensive forest management model.	Maintaining a constant balance between economic growth and environmental sustainability.
Support for the Far Eastern Leopards NGO and the Russian Geographical Society, environmental volunteering and awareness-raising programmes.	Preservation of biodiversity, and raising levels of environmental knowledge and awareness.

Social investments and partnerships

The Corporation's main vehicle for social investment is the Sistema Charitable Foundation, which manages portfolio of corporate programmes in three strategic focus areas:

Flagship programme Lift to the Future *Support for human capital development in knowledge-intensive and high-tech industries.*	**Social projects and volunteering** *Help for people and non-profit organisations in healthcare, social security and promotion of patriotism.*	**Culture and arts** *Creation of an accessible cultural environment, promotion of the national cultural and historical legacy, awareness-raising.*
Projects and events to **develop engineering and technology education and the knowledge base**; support for research and invention projects by young people in the field of new technologies.	The key focus is support for Second World War veterans and similar categories of citizens, as well as development of volunteering. The Sistema Charitable Foundation established a **corporate volunteer centre** through which all employees of Sistema Group can volunteer to tackle social tasks and participate in charitable events organised by the Foundation and its social partners.	Projects to support culture and museums, introduction of new awareness-raising technologies. **The Russian Museum** is the key target for long-term investment, with a total of about RUB 0.5bn allocated to finance restoration work, exhibitions, and multimedia and other cultural projects until 2023.
In 2017, over 5,000 Russian schoolchildren participated in qualifying competitions, including the nationwide System of Priorities competition. *330 students attended inter-regional engineering and design schools in Gorno-Altaisk, Tomsk, Yekaterinburg and Petrozavodsk, and 150 finalists went on to the Orlyonok youth camp, where they developed eight potential technology start-ups.* *In 2016-2017, more than 80 of the best school-leavers received additional points for their Unified State Exam scores for admission to the top seven universities in Russia.* *Six Russian universities were awarded grants of up to RUB 900,000 (RUB 5mn in total) to prepare graduates for the requirements of the labour market.* *32 STEM (science, technology, engineering and mathematics) supplementary education institutions in 22 regions of Russia received grants of up to RUB*	*Since 2015, about 1,600 veterans have received free rehabilitation treatment at Medsi's Otradnoye sanatorium in the Moscow region.* *In 2017, almost 600 veterans in Moscow and another five regions (Karelia, Krasnoyarsk, Vologda, Arkhangelsk and Kirov) were given pharmacy gift certificates to purchase medical supplies.* *Over 15,000 children from more than 20 communities in Altay and Karelia participated in events at the Solony charitable festival.* *Sistema Charitable Foundation with support from MTS, Segezha Group, Cosmos Group, RTI, Steppe AgroHolding, Detsky Mir and Medsi organised nine charitable New Year parties for over 6,000 orphans, disabled children, children from large and low-income families in Moscow, Vologda, Yaroslavl, Volgograd, Kazan, Onega (Arkhangelsk region), Kemerovo, Ulyanovsk and Rostov-on-Don. In the five years since its establishment, the*	*Over 200 information and education centres known as "virtual branches" of the Russian Museum have been opened in culture and education institutions in the Russian regions and abroad, and are attended by more than 500,000 people annually.* *More than 300,000 people visited an exhibition at the Russian Museum to celebrate the 200th anniversary of the painter Ivan Aivazovsky's birth.* *Over 4,000 people visited exhibitions at the Mikhailovsky castle free of charge as part of a new outreach campaign called Cultural Weekend; as a result, the number of visitors to the museum surged five-fold from usual levels.* *More than 50,000 people attended the Imperial Gardens of Russia international festival of garden art in St Petersburg, where the central theme was the Russian avant-garde.* *Over 30,000 visitors came to see the People's Revolution exhibition about Russian scientific and industrial achievements since 1917 at the Lumière Brothers Centre for*

<table>
<tr><td rowspan="2">500,000 (RUB 15mn in total).

16 student projects developed for the Group's companies were supported by grants of up to RUB 500,000 (RUB 8mn in total) to finalise concept solutions and produce prototypes.</td><td>Corporation has organised New Year performances for over 20,000 children across Russia.

About 700 volunteers from Sistema Group companies participated in corporate initiatives.</td><td>Photography.

More than 1,000 people watched the 19 best films about the lives of people with disabilities at the Breaking Down Barriers film festival held as part of the 6th St Petersburg International Cultural Forum, which the SCF joined as a partner for the first time.</td></tr>
<tr><td colspan="2">The Sistema Charitable Foundation provided about RUB 3m for the creation of the Artillery permanent exposition at the Lenino-Snegiri military history museum in the Moscow region.</td></tr>
<tr><td colspan="3">Over RUB 1.4bn was allocated for Sistema Charitable Foundation in 2015-2017.</td></tr>
</table>

Because of its focus on high-tech sectors and introducing new technologies into traditional industries, Sistema actively invests in human capital and training the next generation of leaders for the country's innovative development. In 2015-2017, over RUB 735mn was allocated to support education through the Sistema Charitable Foundation alone. The majority of investments are made under the Corporation's flagship programme, which aims to raise the level of engineering and technical education by bringing together schools, universities and high-tech businesses, and by developing and implementing efficient ways of identifying and training youth-led technology teams for knowledge-intensive industries.

Sistema was named among Russia's top five companies for corporate charity in 2017, while its flagship social programme, Lift to the Future, was named among the top three initiatives promoting educational development in Russia (based on the results of the annual contest of charity projects organised by the Donors Forum, the Vedomosti newspaper and PwC).

Sistema and its portfolio companies run investment and social programmes via mutually beneficial inter-sector partnerships with government authorities, research and education institutions and non-profit organisations. As well as providing financial support for joint projects, the Corporation also contributes its expertise and other resources, thereby creating a systemic effect. For example, having been an anchor investor for several years not just in the Karelian economy but also in the region's social sphere, the Corporation, under its General Agreement with the region's Government, invests in the development of the forest industry, social infrastructure (the Sports Palace in Segezha and other facilities), culture (support for the Musical Theatre in Petrozavodsk), sports (hockey and boxing competitions for children and young people) and education (work with Petrozavodsk State University). Agreements on social and economic cooperation to implement joint initiatives and projects to foster a healthy economic, investment and social environment have also been signed with the Arkhangelsk, Vologda, Kirov, Irkutsk, Kostroma, Samara and Krasnodar regions.

A vivid example of social cooperation is the long-term programme for supporting Second World War veterans that Sistema runs under its agreement with the Moscow Government and the Moscow City Council of veterans. One of the programme's key elements is free medical care and rehabilitation for veterans and home-front workers, as well as volunteer initiatives and promotion of patriotism among young people.

Under the social partnership agreement with the Government of the Altay region, the first Solony charitable festival was held in 2016 for more than 5,000 young people from the region who participated in educational and cultural events organised by Sistema Charitable Foundation with support from regional and local authorities and with the participation of a number of the Group's companies (MTS, Detsky Mir, Medsi, Segezha Group, Binnopharm, Altay Resort, etc.) In 2017, two such festivals devoted to the Russian Year of Ecology were held in Altay and Karelia, and participant numbers tripled.

The partnership model tested by Sistema combines the resources, social interests and capacities of businesses, local communities, regional non-profits and government authorities to ensure maximum efficiency of the joint initiatives. Such events have a positive effect on social development.

Sistema Group companies also make active use of various social partnership mechanisms.

Environmental responsibility

The Corporation encourages its portfolio companies' initiatives to promote greater responsibility for the environment and climate, conservation of natural resources, development of the green market, popular awareness of environmental issues and sustainable production and consumption patterns. Sistema Group companies try to maintain a high level of compliance with Russian and international environmental standards.

In 2017, major environmental projects run by Sistema portfolio companies included:

- improvement of business processes and practices at Mikron in accordance with the new revision of ISO 14001:2015 Environmental Management Systems;
- successful recertification audit for compliance with quality and environmental management standards (ISO 9001 and ISO 14001) at BPGC;
- development of biotechnological fuel production and a waste-recycling project using biofuel at Segezha Group;
- training for employees of Leader Invest in energy efficiency and environmental safety at real-estate facilities, and participation in a working group on developing GREEN ZOOM City regulations for comprehensive and sustainable site development;
- launch of production of an injury-proof covering with improved characteristics from reprocessed car tyres at Technopark Sarov;
- campaigns to promote preservation of forest resources and reforestation in regions of operation at Segezha Group and other Sistema Group companies.

Responsibility towards employees

Sistema Group companies employ more than 130,000 people in Russia. In its relations with employees, the Corporation is guided by standards that are in line with both Russian labour legislation and the generally accepted principles of the World Labour Organisation. HR management at Sistema is based on observance of employees' fundamental rights, including freedom of association and the right to collective bargaining.

In 2017, new collective-bargaining agreements regulating employer-workforce relations were signed at Segezha PPM, Sokol PPM and Vologda Paper Mill (all part of Segezha Group). As well as preserving all existing social guarantees and compensations, the agreements introduced additional staff benefits covering provision of financial aid, working conditions, etc. The collective agreement at Saransk TV Factory (part of RTI Group) was recognised as the best in the Mordovia region.

Aside from competitive salaries and welfare benefits, an important element in the protection of employees' social and labour rights is occupational health and safety. For example, Lesosibirsk Woodworking Plant No 1, a major woodworking enterprise in the Krasnoyarsk region, opened a training centre with simulators of potential emergencies to help staff learn the proper procedures to avoid injuries.

With teams in various regions and industries, Sistema supports diversity and employment of local populations, helps unlock employees’ professional and personal potential, and creates opportunities for professional and career development. Management focuses in particular on the quality of internal communications and the creation of a uniform corporate culture and opportunities for growth in order to significantly improve levels of engagement and as a result the operational efficiency of the business.

In order to strengthen intra-corporate relationships and to provide non-financial incentives for employees and stimulate innovations, in 2017 the Corporation announced its first Idea of the Year contest, which was open to any employee of Sistema and its portfolio companies.

In September 2017, Sistema held its third annual Knowledge Week. More than 600 employees participated in workshops, training sessions and interactive lectures given by leading experts. This year, the programme included Leadership Saturday, a series of meetings with experts on leadership. At the end of the event, it was decided to hold Knowledge Days on a regular basis to foster personal and professional development. The Corporation has also established discussion platforms that bring together experts from various industries who want to improve their skills, learn something new, share their practical experience and find business solutions by thinking “outside the box”.

For more than a year, Sistema has organised corporate discussion clubs. Twenty meetings have been held in total, with more than 530 experts from 20 portfolio companies participating. Participants shared their experience in business-process automation, analysed coaching methods that can be used at work meetings, expressed opinions on the theory of generations from an incentives point of view, and discussed various scenarios for use of robot software across Sistema. The experts were especially interested in the new element of MTS's training programmes called Development of Digital Skills, which involves preparation of a year-long DIGITAL_MTS programme including a series of webinars on various topics and an interactive training course. Sistema's Corporate University holds professional club meetings every month. Any employee of the Corporation can participate free of charge by submitting an application.

For many years, a key event uniting employees of all Sistema companies has been the corporate Games. Held in 2017 for the 15th time, they brought together several thousand employees and their family members. More than 700 athletes from 17 teams competed in 14 disciplines.

In 2017, Sistema Group strengthened its position in the annual rating of Russia's best managers published by the Managers' Association and Kommersant Publishing House: 83 senior executives were included in the list, up from 66 the previous year.

Three Sistema Group companies operating in the of microelectronics, pharmaceuticals and hospitality segments were named as winners and runners-up in the Best Moscow Employer contest organised by the Moscow Social Security Department, the Moscow Federation of Trade Unions and the Moscow Confederation of Industrialists and Entrepreneurs (Employers). The capital’s largest hotel complex, Cosmos, managed by Cosmos Group, won in the *Further Professional Training of Employees* category, rising from second place in 2016, while Binnopharm and Mikron took second place in the *Ensuring Work/Family Balance for Employees with Children* and *Providing Temporary Employment and Organising Public Work for Young People* categories, respectively.

<u>Attachment A</u>

KEY NON-IFRS PERFORMANCE METRICS

Operating Income Before Depreciation and Amortisation (OIBDA) and OIBDA margin. OIBDA represents operating income before depreciation and amortisation. OIBDA margin is defined as OIBDA as a percentage of our net revenues. Our OIBDA may not be similar to OIBDA measures of other companies; is not a measurement under accounting principles generally accepted under IFRS and should be considered in addition to, but not as a substitute for, the information contained in our consolidated statement of profit and loss. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of businesses and other investments and our ability to incur and service debt. While depreciation and amortization are considered operating costs under IFRS, these expenses primarily represent the non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods. OIBDA is commonly used as one of the bases for investors, analysts and credit rating agencies to evaluate and compare the periodic and future operating performance and value of companies.

Adjusted OIBDA, operating income and profit attributable to Sistema shareholders. The Company uses adjusted OIBDA, adjusted operating income and adjusted profit/(loss) attributable to Sistema shareholders to evaluate financial performance of the Group. These represent underlying financial measures adjusted for a number of one-off gains and losses. We believe that adjusted measures provide investors with additional useful information to measure our underlying financial performance, particularly from period to period, because these measures are exclusive of certain one-off gains and losses.

Adjusted operating income and adjusted OIBDA can be reconciled to our consolidated statements of profit and loss as follows:

RUB millions	***2017***	***2016***
Operating income	**91,222**	**82,169**
Provisions for litigation and amounts due under contracts with clients at RTI	6,025	-
Impairment of long-lived assets (Segezha Group and other)	672	2,422
Impairment of long-lived assets (MTS)	3,775	-
Impairment of other financial assets	-	5,634
Gain on acquisitions at Agroholding Steppe	-	(1,175)
Gain on a penalty payment by a counterparty (Medsi)	-	(221)
Gain on investments at Medsi	(730)	-
Impairment of goodwill (Segezha Group)	-	241
Accruals related to LTI program at Detsky Mir	821	-
Other non-recurring (gains) / losses, net	1,605	43
Adjusted operating income	**103,390**	**89,113**
Depreciation and amortisation	96,159	95,687
Adjusted OIBDA	**199,549**	**184,800**

Adjusted loss attributable to Sistema shareholders can be reconciled to our consolidated statements of profit and loss as follows:

RUB millions	***2017***	***2016***
Loss attributable to Sistema	**(94,602)**	**(11,758)**
Loss on Settlement Agreement net of deferred tax	90,000	**-**
Provisions for litigation and amounts due under contracts with clients at RTI	5,242	-
Impairment of long-lived assets (Segezha Group and other)	672	2,263
Impairment of long-lived assets (MTS)	1,887	-
Gain on acquisitions at Agroholding Steppe	-	(1,175)
Impairment of other financial assets	-	5,634
Loss on disposal of Targin	-	4,889
Gain on a penalty payment by a counterparty (Medsi)	-	(221)
Gain on investments at Medsi	(730)	-
Impairment of goodwill (Segezha Group)	-	241
Accruals related to LTI program at Detsky Mir	366	-
Other non-recurring (gains) / losses, net	1,285	1,608
Adjusted profit attributable to Sistema	**4,119**	**1,481**

4. AUDITED CONSOLIDATED FINANCIAL STATEMENTS

SISTEMA PJSFC AND SUBSIDIARIES

Consolidated Financial Statements for 2017
and Independent Auditor's Report

SISTEMA PJSFC AND SUBSIDIARIES

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SISTEMA PJSFC AND SUBSIDIARIES

STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2017

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of Sistema Public Joint Stock Financial Corporation and its subsidiaries (the "Group") as of 31 December 2017, and the results of operations, cash flows and changes in equity for 2017, in compliance with International Financial Reporting Standards ("IFRSs").

In preparing the consolidated financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance;
- Making judgements and assumptions that are reasonable and prudent;
- Stating whether IFRSs have been followed, subject to any material departures disclosed and explained in the consolidated financial statements; and
- Making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRSs;
- Maintaining statutory accounting records in compliance with the Russian legislation and accounting standards;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements of the Group for 2017 were approved by:

Andrey Dubovskov President and CEO	Vsevolod Rozanov Senior Vice President and CFO

30 March 2018

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INDEPENDENT AUDITOR'S REPORT

To Shareholders and the Board of Directors of Sistema Public Joint Stock Financial Corporation

Opinion

We have audited the consolidated financial statements of Sistema Public Joint Stock Financial Corporation ("Sistema") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2017 and the consolidated statement of profit or loss, consolidated statement of comprehensive income or loss, consolidated statement of changes in equity and consolidated statement of cash flows for 2017, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2017 and its consolidated financial performance and cash flows for 2017 in accordance with International Financial Reporting Standards ("IFRSs").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISAs"). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Consolidated Financial Statements section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (the "IESBA Code") together with the ethical requirements that are relevant to our audit of the consolidated financial statements in the Russian Federation, and we have fulfilled our other ethical responsibilities in accordance with these requirements and the IESBA Code. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Why the matter was determined to be a key audit matter	How the matter was addressed in the audit
Litigations and regulatory claims In the normal course of business, the entities of the Group may be subject to various legal proceedings, disputes, claims and regulatory reviews, where the outcomes are subject to significant uncertainty. In particular, in the reporting period the entities of the Group had claims brought against them, amounts of which are significant. In addition, the U.S. Securities and Exchange Commission and the U.S. Department of Justice are currently investigating the operations of the Group's former subsidiary in Uzbekistan. We focused on this matter because of the materiality of the amounts disputed in the litigations, and subjectivity in the management judgements in recognition, valuation and disclosure of respective provisions and contingent liabilities, as well as the effect this matter has on other financial reporting areas, such as borrowings and liquidity. See Notes 5, 7 and 38 to the consolidated financial statements.	We obtained an understanding of the Group's internal processes and controls in respect of the identification, measurement and disclosure of provisions and contingent liabilities in the consolidated financial statements. We reviewed the summary of claims and possible future claims provided by management and the Group's assessment of the probability of their negative outcome. To ensure completeness of the summary we assessed the process by which claims across the Group are reported and collated for the summary, reconciled it with contingent liabilities identified by component auditors, and researched publicly available sources of information for claims and disputes not included in the summary. On a sample basis, we reviewed the legal claims, court decisions and, if applicable, terms of settlement agreements. We also discussed significant matters with management and internal and, in certain cases, external legal counsels and critically assessed key assumptions. We analyzed management's assessment of the effect the litigations had on the Group's borrowings and covenants and reviewed management's analysis of the Group's ability to continue as a going concern and settle its obligations within contractual maturity. We validated completeness and appropriateness of the related disclosures in the consolidated financial statements required by the applicable financial reporting standards.
Diversified structure of the Group Sistema is a holding company that owns mainly controlling stakes in its subsidiaries, whose results are included in the consolidated financial statements. The large number of entities of the Group and diversified nature of their operations require the Group's management to design and implement group wide controls, including monitoring and control activities to ensure timely, reliable and complete financial information received from its subsidiaries. Audit procedures regarding the financial information of the subsidiaries included in the consolidated financial statements may be performed by us or by the auditors of those subsidiaries ("components") acting under our supervision. As the group auditor, we are fully responsible for conducting the audit and forming our audit opinion.	We obtained an understanding of the group-wide controls over the consolidation process and the preparation of the consolidated financial statements, including instructions of the Group's management to its subsidiaries. Our audit approach was developed considering the Group's diversified structure and associated risks of material misstatement of the consolidated financial statements. It included determination of necessary procedures and audit scope in relation to each component's financial information, depending on its significance for the Group and identification of risks of misstatement of their financial information. The nature and extent of our involvement in the component auditors' work was also dependent on our assessment of their professional competence in the context of allocated scope. To obtain reasonable assurance of fair presentation of the components' financial

Why the matter was determined to be a key audit matter	How the matter was addressed in the audit
We focused on this matter, because the diversified structure of the Group has a significant impact on our audit approach, and the nature and extent of our involvement in component auditors' work is significant.	information, we assessed risks and determined audit procedures performed by the component auditors, and evaluated the results of the procedures. This included a critical analysis of the component auditors' documentation, discussion of significant matters with the component auditors, component or Group management and, if applicable, designing and performing additional audit procedures. We also performed procedures with respect to consolidation adjustments to the financial information of the subsidiaries in order to assess their nature, completeness and accuracy.
Significant non-routine transactions In light of its strategy, the Group regularly conducts complex acquisitions and disposals, debt restructurings and other significant non-routine transactions. We focus on these matters because the appropriate accounting treatment of such transactions is often complex and requires exercise of significant judgement. In the current period, this included, for example, a transaction with Reliance Communications Ltd. (RCOM). See Note 6 to the consolidated financial statements.	Our procedures included obtaining and reviewing legal documents to fully understand the terms and conditions of each transaction and therefore the associated accounting implications and evaluating documentation of management's positions on how IFRSs were applied to the transactions. In relation to the transaction with RCOM, as part of which the Group completed the demerger of the telecommunication business of SSTL in the reporting year, we analyzed the appropriateness of SSTL results being reported in discontinued operations, accuracy of the result from its disposal in the Group's consolidated financial statement of profit or loss, and accounting and measurement of related contingent liabilities.

Other Information

Management is responsible for the other information. The other information comprises the information included in the annual report and quarterly report, but does not include the consolidated financial statements and our auditor's report thereon. The annual report and quarterly report are expected to be made available to us after the date of this auditor's report.

Our opinion on the consolidated financial statements does not cover the other information and we will not express any form of assurance conclusion thereon.

In connection with our audit of the consolidated financial statements, our responsibility is to read the other information identified above when it becomes available and, in doing so, consider whether the other information is materially inconsistent with the consolidated financial statements or our knowledge obtained in the audit, or otherwise appears to be materially misstated.

When we read the annual report and quarterly report, if we conclude that there is a material misstatement therein, we are required to communicate the matter to those charged with governance.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Group's internal control.
- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

We also provide those charged with governance with a statement that we have complied with relevant ethical requirements regarding independence, and to communicate with them all relationships and other matters that may reasonably be thought to bear on our independence, and where applicable, related safeguards.

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period, which constitute the key audit matters included herein.

ВКозырев

Vladimir Kozyrev
Engagement partner

Deloitte & Touche

30 March 2018

The Entity: Sistema Public Joint Stock Financial Corporation	Audit Firm: ZAO Deloitte & Touche CIS
Certificate of state registration № 025.866, issued by the Moscow Registration Chamber on 16.07.1993	Certificate of state registration № 018.482, issued by the Moscow Registration Chamber on 30.10.1992.
Primary State Registration Number: 1027700003891	Primary State Registration Number: 1027700425444
Certificate of registration in the Unified State Register № 77 011222220 of 11.11.2002, issued by Moscow Interdistrict Inspectorate of the Russian Ministry of Taxation № 46	Certificate of registration in the Unified State Register № 77 004840299 of 13.11.2002, issued by Moscow Interdistrict Inspectorate of the Russian Ministry of Taxation № 39.
Address: Building 1, 13 Mokhovaya st., Moscow, Russia, 125009	Member of Self-regulated organization of auditors "Russian Union of auditors" (Association), ORNZ 11603080484.

SISTEMA PJSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF PROFIT OR LOSS
(In millions of Russian Rubles, except for per share amounts)

	Notes	2017	2016
Continuing operations			
Revenue	10	704,551	680,864
Cost of sales		(337,996)	(337,687)
Selling, general and administrative expenses		(154,538)	(152,110)
Depreciation and amortisation		(96,159)	(95,687)
Impairment of long-lived assets	11	(8,061)	(2,714)
Impairment of financial assets	12	(5,745)	(11,323)
Taxes other than income tax		(5,906)	(5,541)
Share of the profit or loss of associates and joint ventures, net		3,030	3,147
Other income		6,256	8,107
Other expenses		(14,210)	(4,887)
Operating income		**91,222**	**82,169**
Finance income		8,069	9,435
Finance costs		(48,983)	(51,850)
Expense under the Settlement Agreement	5	(100,000)	-
Currency exchange (loss)/gain		(398)	6,564
(Loss)/profit before tax		**(50,090)**	**46,318**
Income tax expense	13	(11,443)	(21,565)
(Loss)/profit from continuing operations		**(61,533)**	**24,753**
Discontinued operations			
Loss from discontinued operations	6	(4,995)	(15,594)
(Loss)/profit for the period		**(66,528)**	**9,159**
(Loss)/profit attributable to:			
Shareholders of Sistema PJSFC		(94,603)	(11,758)
Non-controlling interests		28,075	20,917
		(66,528)	**9,159**
Losses per share (basic and diluted), in Russian Rubles:	30		
From continuing operations		(9.67)	(0.03)
From continuing and discontinued operations		(10.01)	(1.25)

The accompanying notes are an integral part of these consolidated financial statements.

Andrey Dubovskov
President and CEO

Vsevolod Rozanov
Senior Vice President and CFO

30 March 2018

SISTEMA PJSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF COMPREHENSIVE INCOME OR LOSS
(In millions of Russian Rubles)

	Notes	2017	2016
(Loss)/profit for the period		(66,528)	9,159
Other comprehensive (loss)/income:			
Items that may be reclassified subsequently to profit or loss:			
Currency translation gain/(loss) on foreign operations in subsidiaries		14,443	(11,004)
Currency translation loss on foreign operations in associates and joint ventures		(499)	(1,553)
Net fair value gain/(loss) on revaluation of available-for-sale financial instruments		5,307	(1,199)
Items that will not be reclassified subsequently to profit or loss:			
Unrecognised actuarial (loss)/gain		(41)	50
Other comprehensive income/(loss), net of tax		19,210	(13,706)
Total comprehensive loss		**(47,318)**	**(4,547)**
Attributable to:			
Shareholders of Sistema PJSFC		(78,387)	(18,431)
Non-controlling interests		31,069	13,884
		(47,318)	**(4,547)**

The accompanying notes are an integral part of these consolidated financial statements.

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Andrey Dubovskov
President and CEO

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Vsevolod Rozanov
Senior Vice President and CFO

30 March 2018

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
(In millions of Russian Rubles)

	Notes	31 December 2017	31 December 2016
Assets			
Non-current assets			
Property, plant and equipment	15	411,467	408,130
Investment property	16	24,664	22,647
Goodwill	17	54,081	52,224
Other intangible assets	18	97,666	107,716
Investments in associates and joint ventures	19	20,783	19,537
Deferred tax assets	13	35,809	24,185
Loans receivable and other financial assets	20	104,395	100,023
Deposits in banks		-	27,274
Other assets		18,169	15,711
Total non-current assets		**767,034**	**777,447**
Current assets			
Inventories	22	81,401	81,366
Accounts receivable	23	54,836	60,888
Advances paid and prepaid expenses		15,324	19,389
Current income tax assets		3,274	2,580
Other taxes receivable		17,190	18,176
Loans receivable and other financial assets	20	99,798	62,588
Deposits in banks		28,068	9,173
Restricted cash	21	8,591	10,098
Cash and cash equivalents		59,959	60,190
Other assets		2,174	2,194
Total current assets		**370,615**	**326,642**
Total assets		**1,137,649**	**1,104,089**

CONSOLIDATED STATEMENT OF FINANCIAL POSITION (CONTINUED)
(In millions of Russian Rubles)

	Notes	31 December 2017	31 December 2016
Equity and liabilities			
Equity			
Share capital	24	869	869
Treasury shares	24	(5,816)	(6,575)
Additional paid-in capital		67,856	87,369
(Accumulated loss)/retained earnings		(17,375)	91,290
Accumulated other comprehensive income/(loss)	25	2,332	(13,752)
Equity attributable to shareholders of Sistema		47,866	159,201
Non-controlling interests		74,957	57,770
Total equity		**122,823**	**216,971**
Non-current liabilities			
Borrowings	26	393,651	395,017
Bank deposits and liabilities	27	33,419	6,432
Deferred tax liabilities	13	38,160	40,753
Provisions	29	3,399	3,411
Liability to Rosimushchestvo	35	13,427	21,282
Other financial liabilities	28	6,514	25,580
Other liabilities		7,537	8,742
Total non-current liabilities		**496,107**	**501,217**
Current liabilities			
Borrowings	26	142,168	83,109
Liability under the Settlement Agreement	5	80,000	-
Accounts payable		114,402	110,879
Bank deposits and liabilities	27	83,873	99,888
Advances received		30,171	26,069
Subscriber prepayments		18,618	17,900
Income tax payable		1,833	962
Other taxes payable		14,378	16,391
Dividends payable		4,578	249
Provisions	29	13,038	10,752
Liability to Rosimushchestvo	35	9,601	11,783
Other financial liabilities	28	6,059	7,919
Total current liabilities		**518,719**	**385,901**
Total equity and liabilities		**1,137,649**	**1,104,089**

The accompanying notes are an integral part of these consolidated financial statements.

Andrey Dubovskov
President and CEO

Vsevolod Rozanov
Senior Vice President and CFO

30 March 2018

SISTEMA PJSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENT OF CHANGES IN EQUITY
(In millions of Russian Rubles)

	Share capital	Additional paid-in capital	Treasury shares	(Accumulated loss)/ retained earnings	Accumulated other comprehensive (loss)/income: Currency reserve	Accumulated other comprehensive (loss)/income: Other	Equity attributable to shareholders of Sistema	Non-controlling interests	Total equity
1 January 2016	**869**	**80,778**	**(4,806)**	**112,921**	**(7,532)**	**453**	**182,683**	**62,914**	**245,597**
(Loss)/profit for the period	-	-	-	(11,758)	-	-	(11,758)	20,917	9,159
Other comprehensive (loss)/income, net of tax	-	-	-	-	(4,839)	252	(4,587)	(7,033)	(11,620)
Total comprehensive (loss)/income	-	-	-	(11,758)	(4,839)	252	(16,345)	13,884	(2,461)
Settlements under long-term motivation program	-	(313)	313	-	-	-	-	-	-
Accrued compensation cost (Note 14)	-	2,522	-	-	-	-	2,522	-	2,522
Purchases of own shares	-	-	(2,082)	-	-	-	(2,082)	-	(2,082)
Capital transactions of subsidiaries (Note 9)	-	4,382	-	-	-	-	4,382	9,358	13,740
Business combinations and disposals of subsidiaries (Notes 8 and 6)	-	-	-	-	(2,086)	-	(2,086)	(600)	(2,686)
Dividends declared by Sistema PJSFC	-	-	-	(9,873)	-	-	(9,873)	-	(9,873)
Dividends declared by subsidiaries	-	-	-	-	-	-	-	(27,786)	(27,786)
31 December 2016	**869**	**87,369**	**(6,575)**	**91,290**	**(14,457)**	**705**	**159,201**	**57,770**	**216,971**
(Loss)/profit for the period	-	-	-	(94,603)	-	-	(94,603)	28,075	(66,528)
Other comprehensive (loss)/income, net of tax	-	-	-	-	(1,187)	4,973	3,786	(1,326)	2,460
Total comprehensive (loss)/income	-	-	-	(94,603)	(1,187)	4,973	(90,817)	26,749	(64,068)
Settlements under long-term motivation program	-	(2,240)	2,240	-	-	-	-	-	-
Accrued compensation cost (Note 14)	-	1,484	-	-	-	-	1,484	-	1,484
Purchases of own shares	-	-	(1,601)	-	-	-	(1,601)	-	(1,601)
Capital transactions of subsidiaries (Note 9)	-	8,674	-	-	-	-	8,674	(11,135)	(2,461)
Agreement with RCOM (Note 6)	-	(27,431)	-	-	12,298	-	(15,133)	30,632	15,499
Dividends declared by Sistema PJSFC (Note 24)	-	-	-	(14,062)	-	-	(14,062)	-	(14,062)
Sale of own shares	-	-	120	-	-	-	120	-	120
Dividends declared by subsidiaries	-	-	-	-	-	-	-	(29,059)	(29,059)
31 December 2017	**869**	**67,856**	**(5,816)**	**(17,375)**	**(3,346)**	**5,678**	**47,866**	**74,957**	**122,823**

The accompanying notes are an integral part of these consolidated financial statements.

CONSOLIDATED STATEMENT OF CASH FLOWS
(In millions of Russian Rubles)

	2017	2016
Cash flows from operating activities		
(Loss)/profit for the period	(66,528)	9,159
	(66,528)	9,159
Adjustments for:		
Expense under the Settlement Agreement	100,000	-
Depreciation and amortisation	96,490	100,546
Share of the profit or loss of associates and joint ventures, net	(3,030)	(3,147)
Finance income	(8,069)	(9,851)
Finance costs	48,983	57,368
Income tax expense	11,443	21,575
Currency exchange loss/(gain)	398	(6,035)
Loss from discontinued operations	(593)	7,614
(Profit)/loss on disposal of property, plant and equipment	(251)	109
Change in fair value of financial instruments through profit or loss	(997)	(110)
Amortisation of connection fees	(2,876)	(2,287)
Impairment loss on loans receivable	360	6,063
Dividends received from associates and joint ventures	4,218	2,955
Non-cash compensation to employees	1,653	2,522
Impairment of long-lived assets	8,061	2,896
Impairment of financial assets	5,744	11,803
Other non-cash items	9,417	3,092
	204,423	204,272
Movements in working capital:		
Bank loans to customers and interbank loans due from banks	(12,432)	11,253
Bank deposits and liabilities	7,938	(16,484)
Restricted cash	1,507	(10,098)
Financial assets/liabilities at fair value through profit or loss	(5,834)	(2,401)
Accounts receivable	(1,795)	11,224
Advances paid and prepaid expenses	1,553	863
Other taxes receivable	(1,840)	2,964
Inventories	(12,648)	(8,862)
Accounts payable	(630)	(3,838)
Subscriber prepayments	4,025	(435)
Other taxes payable	(1,531)	2,720
Advances received and other liabilities	11,025	(7,358)
Payment in accordance with the Settlement Agreement	(20,000)	-
Interest paid	(46,261)	(59,791)
Income tax paid	(28,898)	(19,344)
Net cash provided by operating activities	**98,602**	**104,685**

CONSOLIDATED STATEMENT OF CASH FLOWS (CONTINUED)
(In millions of Russian Rubles)

	2017	2016
Cash flows from investing activities		
Payments for purchases of property, plant and equipment	(78,441)	(89,958)
Proceeds from sale of property, plant and equipment	7,745	4,516
Payments for purchases of intangible assets	(26,003)	(32,920)
Payments for businesses, net of cash acquired	(4,132)	(13,956)
Payments for investments in associates and joint ventures	(5,260)	(3,235)
Proceeds from sale of investments in affiliated companies	5,181	6,118
Payments for financial assets, long-term	(30,100)	(28,212)
Proceeds from sale of financial assets, long-term	11,081	15,774
Payments for financial assets, short-term	(28,139)	(23,489)
Proceeds from sale of financial assets, short-term	34,594	95,294
Cash of discontinued operations	811	(2,576)
Interest received	8,011	10,197
Other	(2,550)	(1,588)
Net cash (used in) investing activities	**(107,202)**	**(64,035)**
Cash flows from financing activities		
Proceeds from borrowings	215,956	209,963
Principal payments on borrowings	(150,357)	(249,126)
Debt issuance costs	(111)	(428)
Acquisition of non-controlling interests in existing subsidiaries	(24,726)	(26,816)
Payments to purchase treasury shares	(1,601)	(2,082)
Proceeds from transactions with non-controlling interests	13,607	19,099
Dividends paid	(38,792)	(37,725)
Proceeds from sale of own shares	120	-
Cash outflow under credit guarantee agreement related to foreign currency hedge	(1,766)	(2,985)
Net cash provided by/(used in) financing activities	**12,330**	**(90,100)**
Effect of foreign currency translation on cash and cash equivalents	(3,961)	(13,135)
Net decrease in cash and cash equivalents	**(231)**	**(62,585)**
Cash and cash equivalents at the beginning of the period	60,190	122,775
Cash and cash equivalents at the end of the period	**59,959**	**60,190**

The accompanying notes are an integral part of these consolidated financial statements.

1. GENERAL

Sistema Public Joint Stock Financial Corporation (the "Company", together with its subsidiaries, the "Group") invests in, and manages a range of companies which operate in various industries, including telecommunications, retail, forestry, pulp and paper, agriculture, high technology, banking services, real estate, healthcare and tourism. The Company and the majority of its subsidiaries are incorporated in the Russian Federation ("RF"). The Company's registered address is building 1, 13 Mokhovaya street, 125009, Moscow.

The majority shareholder of the Company is Vladimir Evtushenkov. Minority holdings are held by certain top executives and directors of the Company. The shares are listed on the London Stock Exchange in the form of Global Depositary Receipts ("GDRs") and on the Moscow Exchange.

2. BASIS OF PREPARATION

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards ("IFRSs").

These consolidated financial statements have been prepared on the assumption that the Group will continue to operate in the foreseeable future. The Group's net loss for 2017 was RUB 66,528 million, its current liabilities as of 31 December 2017 exceeded current assets by RUB 148,104 million, which is mainly due to the conclusion of the Settlement Agreement in December 2017 (Note 5). After the balance sheet date, the Group raised funds to fulfill its obligations under the Settlement agreement (Note 40). The cash flow forecast prepared by the management of the Group for a period of at least twelve months after the end of the reporting period demonstrates the Group's ability to pay off current liabilities within the terms set by the contractual obligations.

These consolidated financial statements were approved by the Company's President and CEO and authorised for issue on 30 March 2018.

3. SIGNIFICANT ACCOUNTING POLICIES, JUDGEMENTS, ESTIMATES AND ASSUMPTIONS

This note sets out significant accounting policies that relate to the Group's consolidated financial statements as a whole and describes the critical accounting judgements that management has identified as having a potentially material impact on the Group's consolidated financial statements. When an accounting policy is generally applicable to a specific note to the accounts, the policy is described within that note.

Summary of significant accounting policies

Basis of consolidation. The consolidated financial statements incorporate the financial statements of the Company, entities controlled by the Company and their subsidiaries. Control is achieved when the Company:

- has power over the investee;
- is exposed, or has rights, to variable returns from its involvement with the investee; and
- has the ability to use its power to affect its returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

When the Company has less than a majority of the voting rights of an investee, it has power over the investee when the voting rights are sufficient to give it the practical ability to direct the relevant activities of the investee unilaterally. The Company considers all relevant facts and circumstances in assessing whether or not the Company's voting rights in an investee are sufficient to give it power, including:

- the size of the Company's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;

- potential voting rights held by the Company, other vote holders or other parties;
- rights arising from other contractual arrangements; and
- any additional facts and circumstances that indicate that the Company has, or does not have, the current ability to direct the relevant activities at the time that decisions need to be made, including voting patterns at previous shareholders' meetings.

Consolidation of a subsidiary begins when the Company obtains control over the subsidiary and ceases when the Company loses control of the subsidiary. Specifically, income and expenses of a subsidiary acquired or disposed of during the year are included in the consolidated statement of profit or loss from the date the Company gains control until the date when the Company ceases to control the subsidiary.

Profit or loss and each component of other comprehensive income is attributed to the owners of the Company and to the non-controlling interests. Total comprehensive income of subsidiaries is attributed to the owners of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies in line with the Group's accounting policies. All intragroup assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

Non-controlling interests. Non-controlling interests represent the equity in a subsidiary not attributable, directly or indirectly, to a parent. Non-controlling interests are presented separately in the consolidated statement of profit or loss and within equity in the consolidated statement of financial position, separately from parent shareholders' equity.

Functional currency. Items included in the financial statements of each of the Group's entities are measured using the currency of the primary economic environment in which the entity operates (functional currency). The functional currency of the Group and the majority of its subsidiaries operating in Russia is the Russian Ruble ("RUB"). The presentation currency of the consolidated financial statements of the Group is also the Russian Ruble.

Sources of estimation uncertainty

In the application of the Group's accounting policies management is required to make estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognised in the period in which the estimate is revised if the revision affects only that period or in the period of the revision and future periods if the revision affects both current and future periods.

Impairment of loans and receivables. The Group regularly reviews its accounts receivable, loans to customers, due from banks and other loans and receivables to assess for impairment. The Group's allowances for impairment of such assets are established to recognize incurred impairment losses in its portfolio of loans and receivables. The Group considers accounting estimates related to impairment of loans and receivables a key source of estimation uncertainty because (i) they are highly susceptible to change from period to period as the assumptions about future default rates and valuation of potential losses relating to impaired loans and receivables are based on recent performance experience, and (ii) any significant difference between the Group's estimated losses and actual losses could have a material impact on its financial statements in future periods.

The Group uses management's judgement to estimate the amount of any impairment loss in cases where a borrower has financial difficulties and there are few available sources of historical data relating to similar borrowers. Similarly, the Group estimates changes in future cash flows based on customer performance in the past, on observable data indicating an adverse change in the payment status of borrowers in a group, and national or local economic conditions that correlate with defaults in the group. Management uses estimates based on historical loss experience for assets with similar credit risk characteristics and objective evidence of impairment. The Group uses management's judgement to adjust observable data for a group of loans to reflect current circumstances not observed in historical data.

Impairment of financial assets in the consolidated financial statements has been determined on the basis of existing economic conditions. The Group is not in a position to predict what changes in conditions will take place in its markets of operations and what effect such changes might have on the adequacy of the accounting for impairment of financial assets in future periods.

Impairment of long-lived assets. IFRS requires management to perform impairment tests annually for indefinite lived assets and, for finite lived assets, if events or changes in circumstances indicate that their carrying amounts may not be recoverable. Impairment testing requires management to judge whether the carrying value of assets can be supported by the higher of the fair value of the asset or the net present value of future cash flows that they generate. Calculating the net present value of the future cash flows requires assumptions to be made in respect of highly uncertain matters.

Deferred tax assets. Deferred tax assets are recognized for all temporary deductible differences, provided that there is a taxable profit in respect of the temporary deductible differences, which could be utilized. The valuation of recognized deferred tax assets is based on management estimation of future taxable profit.

Fair value measurements. Some of the Group's assets and liabilities are measured at fair value for financial reporting purposes. Where the fair value of assets and liabilities recorded in the statement of financial position cannot be derived from active markets, their fair value is determined using valuation techniques, including discounted cash flow models. The inputs to these models are taken from observable markets where possible, but when this is not feasible, a degree of judgment is required in establishing fair values. Information about assets and liabilities measured at fair value on recurring basis is disclosed in Note 33.

Useful lives of property, plant and equipment and intangible assets. Estimates may change due to technological developments, competition, changes in market conditions and other factors and may result in changes in the estimated useful life and in the amortization or depreciation charges. Technological developments are difficult to predict and management views on the trends and pace of development may change over time. The estimated useful lives are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Provisions and contingencies. The Group is subject to various legal proceedings, disputes, claims and regulatory reviews related to the Group's business, licenses, tax positions and investments, where the outcomes are subject to significant uncertainty. Management evaluates, among other factors, the degree of probability of an unfavourable outcome and the ability to make a reasonable estimate of the amount of loss or related expense. Unanticipated events or changes in these factors may require the Group to increase or decrease the amount recorded or to be recorded for a matter that has not been previously recorded because it was not considered probable. See Notes 5, 7, 29 and 38 for further information.

4. SEGMENT INFORMATION

As a diversified holding corporation, the Company invests in a range of businesses, which meet its investment and return criteria. The Company has determined that the chief operating decision maker ("CODM") is its Management Board. Information reported to the Management Board for the purpose of resource allocation and the assessment of segment performance is focused on each individual business. No operating segments have been aggregated in arriving at the reportable segments of the Group. The Group's reportable segments are businesses that offer different products and services and are managed separately.

(Amounts in millions of Russian Rubles, unless otherwise stated)

The Group's reportable segments are Mobile TeleSystems ("MTS"), Detsky mir, RTI, MTS Bank and Corporate. MTS is one of the leading telecommunications group in Russia and the CIS, offering mobile and fixed voice, broadband, internet access, pay TV as well as content and entertainment services in Russia, Ukraine and Armenia. Detsky mir is the largest retail chain in the children's goods market in the Russian Federation and Kazakhstan. Activity of Detsky mir is the sale of children's clothing and goods through retail and internet stores. RTI is a Russian industrial holding company in the field of defence and microelectronic solutions, which integrates high-tech research and manufacturing companies. MTS Bank is a universal commercial bank with operations in Russia. Corporate segment comprises the Company and entities, which hold and manage the Company's interests in its subsidiaries, joint ventures and associates. The Other category includes other operating segments including East-West United Bank, Segezha Group, Sitronics, Kronshtadt Group, Binnopharm, Medsi, Agroholding Steppe, Sistema Venture Capital, Hospitality assets, Leader-Invest and Bashkirian Power Grid Company ("BPGC"), none of which meets the quantitative thresholds for determining reportable segments.

In connection with the acquisition of a 47% share in East-West United Bank from MTS Bank by the Company in 2017 (Note 9), information reported to the Management Board for the purpose of resource allocation and the assessment of segment performance is prepared separately for MTS Bank and East-West United Bank. As a result, the Group identified East-West United Bank as a separate operating segment, excluding its results from the MTS Bank segment and including it instead in the "Other" category as it does not satisfy the criteria for separate reporting. Segment data for the prior period presented for comparative purposes was restated to reflect this change.

The accounting policies of the operating segments are the same as those described in the significant accounting policies. The Group's CODM evaluates performance of the segments on the basis of operating income and OIBDA. OIBDA is defined as operating income before depreciation and amortisation.

The following is an analysis of the Group's revenue and results from continuing operations by reportable segment for 2017 and 2016:

	External revenues		**Inter-segment revenue**		**Segment operating income/(loss)**	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**
MTS	440,242	433,972	2,668	1,720	94,324	86,227
Detsky mir	96,985	79,532	18	15	8,024	6,620
RTI	41,769	44,433	150	156	(4,839)	275
MTS Bank	16,626	17,032	1,480	1,236	370	(3,034)
Corporate	1,763	1,737	877	1,115	(12,670)	(24,042)
Total reportable segments	597,385	576,706	5,193	4,242	85,209	66,046
Other	107,166	104,158	1,509	3,621	5,160	16,004
	704,551	**680,864**	**6,702**	**7,863**	**90,369**	**82,050**
Inter-segment eliminations					853	119
Operating income					**91,222**	**82,169**
Finance income					8,069	9,435
Finance costs					(48,983)	(51,850)
Expense under the Settlement Agreement					(100,000)	-
Currency exchange (loss)/gain					(398)	6,564
Profit before tax					**(50,090)**	**46,318**

The following is an analysis of the Group's depreciation and amortisation, additions to non-current assets (comprising property, plant and equipment, investment property and other intangible assets) and other non-cash items (comprising impairment of certain long-lived and current assets and financial assets and gain on acquisition) by reportable segment:

(Amounts in millions of Russian Rubles, unless otherwise stated)

	Additions to non-current assets		Depreciation and amortisation		Other non-cash items	
	2017	**2016**	**2017**	**2016**	**2017**	**2016**
MTS	86,748	80,630	79,912	81,582	6,698	2,698
Detsky mir	2,501	1,760	1,818	1,591	121	26
RTI	3,014	3,091	2,640	2,539	926	1,643
MTS Bank	2,704	1,840	554	689	360	6,063
Corporate	1,538	6,488	566	564	1,402	8,967
Other	33,647	50,056	10,669	8,722	4,660	962
	130,152	**143,865**	**96,159**	**95,687**	**14,167**	**20,359**

The following is an analysis of the Group’s segment assets and liabilities by reportable segment:

	2017	**2016**
Segment assets		
MTS	565,391	559,008
Detsky mir	44,415	44,730
RTI	62,721	74,237
MTS Bank	144,047	133,598
Corporate	115,990	110,783
Total reportable segments	932,564	922,356
Other	306,021	273,622
Total segment assets	1,238,585	1,195,978
Inter-segment eliminations	(100,936)	(91,889)
Consolidated total assets	**1,137,649**	**1,104,089**
Segment liabilities		
MTS	426,962	400,618
Detsky mir	44,938	45,185
RTI	79,603	81,152
MTS Bank	121,477	113,291
Corporate	226,833	154,235
Total reportable segments	899,813	794,481
Other	193,165	179,922
Total segment liabilities	1,092,978	974,403
Inter-segment eliminations	(78,152)	(87,285)
Consolidated total liabilities	**1,014,826**	**887,118**

As of 31 December 2017 and 2016, the amount of investment in MTS Belarus, an associate of MTS, included in its reportable segment assets was RUB 3,660 million and RUB 4,303 million, respectively. Other associates and joint ventures represent separate operating segments and are reported in the Other category.

(Amounts in millions of Russian Rubles, unless otherwise stated)

The Group's revenue from continuing operations from external customers by location of operations and information about its non-current assets by location of assets are detailed below.

	Revenue from external customers		Non-current assets	
	2017	**2016**	**2017**	**2016**
Russia	632,352	604,768	547,528	538,799
Other	72,199	76,096	44,456	61,135
	704,551	**680,864**	**591,984**	**599,934**

5. LEGAL CLAIM OF ROSNEFT AND BASHNEFT AND THE SETTLEMENT AGREEMENT

In May 2017, PJSC NK Rosneft, PJSOC Bashneft and the Ministry of Land and Property Relations of the Republic of Bashkortostan (the "MLPR of the RB") filed legal claims against the Company and its subsidiary JSC Sistema-Invest with the Republic of Bashkortostan Arbitration Court seeking to recover RUB 106,630 million of damages allegedly suffered by Bashneft as a result of its reorganization (the "Claim-1"), arranged by the Group in 2014. The Republic of Bashkortostan Arbitration Court accepted the Claim-1 and opened case #A07-14085/2017. The amount of damages under the Claim-1 was subsequently increased to RUB 170,619 million.

On 23 June 2017, the Republic of Bashkortostan Arbitration Court made a decision to arrest the following shares owned by the Company and Sistema-Invest as a security under the Claim-1: 31.76% in the share capital of PJSC MTS, 100% in the share capital of Medsi and 90.47% in the share capital of JSC Bashkirian Power Grid Company (BPGC). On 26 June 2017, the bailiffs imposed additional restrictive measures, which, in addition to the arrest of shares, limited the rights of the Company and Sistema-Invest to receive any income on the arrested shares.

On 30 August 2017, the Republic of Bashkortostan Arbitration Court made a decision to partially satisfy the Claim-1. According to the decision, the court has ordered the Company and Sistema-Invest to pay damages of RUB 136,274 million.

On 19 September 2017, Sistema filed an appeal on that decision in the Eighteenth Arbitration Appeal Court (Chelyabinsk).

In early December 2017, the Republic of Bashkortostan Arbitration Court accepted legal claims of Rosneft and Bashneft (the "Claim-2") and the MLPR of the RB (the "Claim-3") seeking to recover RUB 131,639 million of damages allegedly suffered by Bashneft because of the payment of dividends in 2009-2014. Subsequently the Claim-2 and the Claim-3 were combined in one proceeding under case #A07-38665/2017.

On 12 December 2017, the Republic of Bashkortostan Arbitration Court made a decision to arrest the following assets of the Company and Sistema-Invest as a security under case #A07-38665/2017: 52.09% of shares in the authorised share capital of PJSC Detsky Mir, 90.5% of shares in the authorised share capital of JSC Agroholding Steppe, 71.87% of shares in the authorised share capital of PJSC MTS Bank, 100% of the authorised share capital of LLC Sistema Telecom Assets, 98.78% of shares in the authorised share capital of JSC Leader-Invest, 16.18% of the authorised share capital of LLC Segezha Group, 88.78% of the authorised share capital of LLC Kronshtadt Group, 45.96% of the authorised share capital of LLC Sistema Hotel Management, 27% of the authorised share capital of LLC United Bridge Construction Enterprise. The court also limited the rights of the Company and Sistema-Invest to receive income on the arrested shares and shareholdings.

On 18 December 2017, the Eighteenth Arbitration Appeal Court (Chelyabinsk) announced the resume of the decision according to which the court ruled to uphold the judgment of the Republic of Bashkortostan Arbitration Court on the Claim dated 30 August 2017 under case #A07-14085/2017 (Claim-1). According to the ruling of the court of appeal, Sistema and Sistema-Invest must pay to Bashneft RUB 136,274 million of damages allegedly suffered by Bashneft as a result of its reorganisation in 2014. The decision of the appeal court under the Claim-1 was prepared on 25 December 2017.

On 22 December 2017, Sistema, Sistema-Invest, Rosneft, Bashneft and the MLPR of the RB signed a settlement agreement under the Claim-1 (the "Settlement Agreement"). According to the Settlement Agreement, all sides recall all their lawsuits and abandon all claims against each other, and the Company is obliged to pay Bashneft RUB 100 billion by 30 March 2018. Payments will be made in three tranches: RUB 20 billion before 29 December 2017, RUB 40 billion before 28 February 2018 and RUB 40 billion before 30 March 2018.

On 26 December 2017, the Republic of Bashkortostan Arbitration Court approved the Settlement Agreement. The decision of the court on approval of the Settlement Agreement stipulated that on approval of the Settlement Agreement the dispute is considered to be resolved and the decision of the Republic of Bashkortostan Arbitration Court of 30 August 2017 under the Claim-1 should not be enforced.

On 26 December 2017, in accordance with the resolution of the Moscow Directorate of the Federal Bailiffs Service, the restrictions to receive income on 31.76% shares of PJSC MTS, 100% shares of Medsi and 90.47% shares of JSC BPGC have been lifted. The above mentioned restrictions were removed as part of the implementation of the Settlement Agreement.

The Group recognized the expense under the Settlement Agreement of RUB 100 billion in the consolidated statement of profit or loss for 2017. The liability under the Settlement Agreement in the consolidated statement of financial position as of 31 December 2017 is RUB 80 billion.

On 19 February 2018, the Republic of Bashkortostan Arbitration Court lifted the arrest of 52.09% of the share capital of PJSC Detsky Mir and 90.47% of the share capital of JSC BPGC. The court also removed the previously imposed limitations on the right of the Company to receive income on the securities of PJSC Detsky Mir. On 1 March 2018, the court lifted the arrest of 31.76% in the share capital of PJSC MTS.

By 5 March 2018, the Group early repaid the liability under the Settlement Agreement partially from its own funds and partially from borrowed funds.

On 19 March 2018, the Republic of Bashkortostan Arbitration Court lifted all other restrictive measures in relation to 100% shares of Medsi, 90.5% of shares in the authorised share capital of JSC Agroholding Steppe, 71.87% of shares in the authorised share capital of PJSC MTS Bank, 100% of the authorised share capital of LLC Sistema Telecom Assets, 98.78% of shares in the authorised share capital of JSC Leader-Invest, 16.18% of the authorised share capital of LLC Segezha Group, 88.78% of the authorised share capital of LLC Kronshtadt Group, 45.96% of the authorised share capital of LLC Sistema Hotel Management, 27% of the authorised share capital of LLC United Bridge Construction Enterprise

On 21 March 2018, the Arbitration Court of the Republic of Bashkortostan satisfied a motion by Bashneft, Rosneft and the MLPR of the RB regarding the withdrawal of claims (the Claim-2 and the Claim-3) totalling RUB 131.6 billion that were filed against the Company and Sistema-Invest in December 2017, and terminated the proceedings on case #A07-38665/2017.

The Company and Sistema-Invest have also withdrawn previously filed claims as per the terms of the Settlement Agreement.

The parties have thus fully and duly performed the Settlement Agreement.

6. DISCONTINUED OPERATIONS

The Group enters into transactions to sell shares of its subsidiaries, which result in the Group losing control over such subsidiaries. The results of disposed subsidiaries during the reporting period are included in the consolidated financial statements up to the date of loss of control. Information on the sale of shares in subsidiaries and their impact on the Group's results is provided below.

(Amounts in millions of Russian Rubles, unless otherwise stated)

The amounts recognized in profit / (loss) from discontinued operations are as follows:

	2017	2016
SSTL results up to the deconsolidation date	(5,587)	(6,803)
Loss on disposal of SSTL	(428)	-
SG-trading results up to deconsolidation date	(1)	(24)
Gain on disposal of SG-trading	1,146	-
Targin results up to the deconsolidation date	-	142
Loss on disposal of Targin	(125)	(4,888)
UMS results up to the deconsolidation date	-	(1,295)
Loss on disposal of UMS	-	(2,726)
Loss from discontinued operations	**(4,995)**	**(15,594)**

Agreement with RCOM – In November 2015, the Group signed an agreement with Reliance Communications Ltd. (RCOM) regarding the demerger of the telecommunication business of SSTL. On 31 October 2017, the Group completed the demerger. As a result of the transaction, the telecommunication business of SSTL, including licenses and obligations to the Department of Telecommunications of India (the "DoT") for the 800-850 MHz spectrum, was transferred to RCOM. SSTL received a 10% equity stake in RCOM as a result of the additional issuance of shares. If the DoT and courts confirm that the SSTL spectrum may be used to deploy fourth generation networking without additional charges, SSTL will get the right for an additional payment from RCOM. The non-controlling shareholders of SSTL received the right to exchange their SSTL shares to equivalent shares in RCOM equity before 20 March 2018. The Group concluded that this puttable instrument should be classified as a financial liability. As a result, the Group derecognized accumulated non-controlling interests of RUB 30.6 billion, recognized a financial liability of RUB 1.1 billion with a corresponding effect on additional paid-in capital. From the date of the demerger, the financial liability increased to RUB 2.3 billion as a result of the increase of the quoted price of RCOM shares. As a result of the exchange SSTL's equity share in RCOM was reduced to 7.48%.

The results of SSTL and SG-trading are reported as discontinued operations in the accompanying consolidated statements of profit or loss for all periods presented. In accordance with IFRSs, the consolidated statement of financial position and consolidated statements of cash flows were not retrospectively restated for discontinued operations.

Gain/(losses) of the disposed subsidiaries after intercompany eliminations included in discontinued operations in the consolidated statements of profit or loss for 2017 and 2016 are as follows:

	2017		2016			
	SSTL	**SG-trading**	**SSTL**	**SG-trading**	**Targin**	**UMS**
Revenue	3,898	1,754	12,466	4,375	26,666	5,115
Expenses	(9,485)	(1,783)	(19,268)	(4,389)	(26,365)	(6,602)
(Loss)/ profit before tax	(5,587)	(29)	(6,803)	(14)	301	(1,487)
Income tax benefit / (expense)	-	28	-	(10)	(159)	192
Results up to deconsolidation date	**(5,587)**	**(1)**	**(6,803)**	**(24)**	**142**	**(1,295)**

(Amounts in millions of Russian Rubles, unless otherwise stated)

Cash flows from discontinued operations included in the consolidated statements of cash flows are as follows:

	2017		2016			
	SSTL	SG-trading	SSTL	SG-trading	Targin	UMS
Net cash (used)/ received in operating activities	(3,631)	(124)	(13,418)	(371)	2,384	(544)
Net cash received/(used) in investing activities	22	(53)	(302)	-	(3,562)	-
Net cash (used)/ received from financial activities	-	-	(15,111)	-	1,792	1,234
Total net cash (used)/received	**(3,609)**	**(177)**	**(28,830)**	**(371)**	**614**	**690**

The loss and gain on disposal is as follows:

	2017		2016	
	SSTL	SG-trading	Targin	UMS
Net assets as at disposal date	12,233	(204)	(8,989)	(6,598)
Non-controlling interests	-	-	-	1,787
Accumulated other comprehensive (loss)/income	(16,619)	-	-	2,085
Fair value of consideration received	3,958	1,350	4,100	-
(Loss)/gain on disposal	**(428)**	**1,146**	**(4,889)**	**(2,726)**

7. INVESTIGATIONS INTO FORMER OPERATIONS IN UZBEKISTAN

In March 2014, MTS received requests for the provision of information from the United States Securities and Exchange Commission ("SEC") and the United States Department of Justice ("DOJ") relating to a currently conducted investigation of the Group's former subsidiary in Uzbekistan.

In July 2015, activities related to the MTS former operations in Uzbekistan have been referenced in civil forfeiture complaints (the "Complaints"), filed by the DOJ in the U.S. District Court, Southern District of New York (Manhattan), directed at certain assets of an unnamed Uzbek government official. The Complaints allege among other things that MTS and certain other parties made corrupt payments to the unnamed Uzbek official to assist their entering and operating in the Uzbekistan telecommunications market. The Complaints are solely directed towards assets held by the unnamed Uzbek official, and none of the Group assets are affected by the Complaints.

MTS continues to cooperate with these investigations. MTS, the DOJ and the SEC are having discussions about a potential resolution to allegations of non-compliance with the Foreign Corrupt Practices Act. However, at this stage, the Group is unable to predict whether or not such discussions will result in a settled resolution to the investigations, the magnitude of any settlement, or whether there will be further developments in the investigations.

8. BUSINESS COMBINATIONS

Acquisitions of businesses are accounted for using the acquisition method, with assets and liabilities of acquired entities being measured at their fair values as of the date of acquisition. Goodwill is determined as the excess of the consideration transferred plus the fair value of any non-controlling interests in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired. The excess of the fair values of the identifiable net assets acquired over the cost of the business combination plus the fair value of any non-controlling interests in the acquiree at the acquisition date is credited to income ("negative goodwill").

(Amounts in millions of Russian Rubles, unless otherwise stated)

Non-controlling interests that are present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at the non-controlling interests' proportionate share of the recognised amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the acquisition occurs, the Group reports in its consolidated financial statements provisional amounts for the items for which the accounting is incomplete. During the measurement period, which could be up to one year from the acquisition date, the Group retrospectively adjusts the provisional amounts recognised at the acquisition date to reflect new information obtained about facts and circumstances that existed as of the acquisition date.

Business combinations in 2017

In 2017 MTS, Agroholding "Steppe" and Medsi acquired several companies related to their operating segments for RUB 1,195 million, RUB 3,171 million and RUB 661 million respectively.

The following table summarizes the amounts of the assets acquired and liabilities assumed relating to such acquisitions at the acquisition date:

	MTS	**Agroholding «Steppe»**	**Medsi**
Cash consideration	1,195	3,171	661
Recognised amounts of identifiable assets acquired and liabilities assumed:			
Property, plant and equipment	-	2,443	193
Other non-current assets	594	996	20
Current assets	461	913	59
Deffered tax liabilities	-	(203)	-
Loans and borrowings	-	(1,362)	(169)
Other non-current liabilities	(516)	-	-
Current liabilities	(138)	(251)	(152)
Non-controling interest	-	-	46
Goodwill	**794**	**635**	**664**

Acquisition of companies in MTS operating segment – The excess of the consideration over the value of net assets acquired in the amount of RUB 794 million was allocated to goodwill. Goodwill is mainly attributable to the expected synergies and to the company employees.

Acquisition of companies in Agroholding "Steppe" operating segment – The initial accounting for the acquisitions of companies in operating segment Agroholding "Steppe" has only been provisionally determined at the end of the reporting period. At the date of finalisation of these consolidated financial statements, the necessary market valuations and other calculations, including goodwill calculation had not been finalised and the amounts of identifiable assets acquired and liabilities assumed have therefore only been provisionally determined based on the best estimate of the likely fair values.

The excess of the consideration paid over the value of net assets of agriculture businesses was allocated to goodwill, which mainly arised from expected synergies on economies of scale related to operating and capital expenditures.

(Amounts in millions of Russian Rubles, unless otherwise stated)

Acquisition of companies in Medsi operating segment – The initial accounting for the acquisitions of companies in operating segment Medsi has only been provisionally determined at the end of the reporting period. At the date of finalisation of these consolidated financial statements, the necessary market valuations and other calculations, including goodwill calculation had not been finalised and the amounts of identifiable assets acquired and liabilities assumed have therefore only been provisionally determined based on the best estimate of the likely fair values.

The excess of the consideration paid over the value of net assets was allocated to goodwill. Goodwill mainly arised from expertise of company client base and the expected synergies from expertise in management of medical clinics and established business process.

Business combinations in 2016

The information on business combinations which took place in 2016 is summarized below:

Acquiree	Principal activity	Date of acquisition	Interest acquired	Acquiring segment	Purchase price
Lesosibirsk LDK No. 1	Pulp and paper	February	60%	Segezha Group	3,085
Agriculture businesses	Agriculture	April-October	99%-100%	Steppe	7,909
Regional Hotel Chain	Hotel businesses	December	100%	Intourist	2,786
Other					810
Total					**14,590**

The following table summarizes the amounts of the assets acquired and liabilities assumed relating to such acquisitions at the acquisition date:

	Lesosibirsk LDK No. 1	Agriculture businesses	Regional Hotel Chain	Other
Cash consideration	**3,085**	**7,909**	**2,786**	**810**
Recognised amounts of identifiable assets and liabilities assumed:				
Property, plant and equipment	6,511	7,168	5,867	3
Other non-current assets	12	106	255	371
Current assets	2,688	2,728	461	218
Deferred tax (liabilities)/assets	(128)	(1,006)	335	(3)
Borrowings	(6,613)	(1,511)	(3,766)	-
Other non-current liabilities	-	(40)	-	(69)
Current liabilities	(824)	(342)	(366)	(77)
Non-controlling interests	(2,015)	-	-	-
Gain on acquisitions	-	(1,175)	-	(235)
Goodwill	**3,454**	**1,981**	**-**	**602**

During the measurement period, the Group recognized impairment of goodwill of Lesosibirsk LDK No. 1 of RUB 241 million.

The excess of the consideration paid over the value of net assets of Lesosibirsk LDK No. 1 was allocated to goodwill, which mainly arised from expected synergies on effective management expertise in wood processing projects, well-functioning business processes, access to resources and availability of raw materials.

The excess of the consideration paid over the value of net assets of agriculture businesses was allocated to goodwill, which mainly arised from expected synergies on economies of scale related to operating and capital expenditures.

The Group determined that the gain on acquisition of agriculture businesses was primarily attributable to the sellers' decision to no longer operate in agriculture sector and their willingness to sell the related businesses in short run.

(Amounts in millions of Russian Rubles, unless otherwise stated)

Pro forma results of operations

Pro forma financial information for 2017 and 2016 which gives effect to the acquisitions as if they had occurred as of 1 January 2017 is not presented because the effects of these business combinations, individually and in aggregate, were not material to the Group's consolidated results of operations.

Included in the loss for 2017 is a loss of RUB 1,108 million attributable to financial results of business acquired in 2017. Revenue for the period includes RUB 1,147 million in respect of these business combinations.

The following table summarises the details of purchase of subsidiaries, net of cash acquired, reported in the statements of cash flows:

	2017	2016
Cash consideration	5,027	14,590
Payables at the end of the year	(270)	(501)
Cash acquired	(450)	(133)
Contingent liability	(175)	-
Acquisition of subsidiaries, net of cash acquired	**4,132**	**13,956**

9. CAPITAL TRANSACTIONS OF SUBSIDIARIES

The Group enters into transactions to acquire or dispose ownership interests in its existing subsidiaries that do not result in the Group losing control over the subsidiaries. Also, the entities of the Group enter into transactions with each other to transfer ownership interests in subsidiaries within the Group. Such transactions are accounted for as equity transactions. The carrying amounts of the Group's interests and the non-controlling interests ("NCI") are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognised directly in equity in additional paid-in capital ("APIC") and attributed to shareholders of the Company.

Transactions in 2017

The information on capital transactions of subsidiaries which took place in 2017 and their impacts on the Group's equity is summarised below:

	Increase/ (decrease) of additional paid-in capital	(Decrease)/ increase of non-controlling interests
Initial public offering of Detsky mir	10,094	(107)
MTS shares tender offer	(1,369)	(10,858)
Intragroup transfer of 47% in EWUB	678	(678)
Other	(729)	508
Total impact	**8,674**	**(11,135)**

Initial public offering of Detsky mir – In February 2017, Detsky mir completed an initial public offering on the Moscow Exchange. The offering price was set at RUB 85 per share. The Company sold 151,301,256 shares during the offering retaining a 52.1% ownership interest in Detsky mir.

MTS shares tender offer – Under the MTS tender offer to repurchase its ordinary shares (including shares represented by American depository shares), MTS purchased a total of 42,484,404 shares for a total cost of RUB 12.2 billion from non-controlling shareholders. Simultaneously, MTS purchased 33,223,980 shares from Sistema Finance S.A., a subsidiary of the Group, for an aggregate purchase price of RUB 9.5 billion.

(Amounts in millions of Russian Rubles, unless otherwise stated)

Intragroup transfer of 47% in East-West United Bank – In May 2017, the Company acquired 47% in East-West United Bank from MTS Bank for RUB 2.6 billion and increased its effective interest to 97%.

Transactions in 2016

The information on capital transactions of subsidiaries which took place in 2016 and their impacts on the Group's equity is summarised below:

	(Decrease)/ increase of additional paid-in capital	Increase/ (decrease) of non-controlling interests
Acquisition of 15% in RTI	(4,272)	1,749
Disposal of 3.35% in MTS	12,367	6,023
Additional share issues of Mikron	(967)	967
Additional share issues of MTS Bank	(1,527)	1,527
Restructuring of Steppe	(831)	1,342
Restructuring of Sitronics	(818)	183
Disposal of 10% and 3% in RTI	1,714	(714)
Acquisition of 39% of Lesosibirsk LDK No. 1	-	(2,091)
Other	(1,284)	372
Total impact	**4,382**	**9,358**

Acquisition of 15% in RTI – In December 2016, the Group purchased from VTB 15.32% of RTI share capital for a cash consideration of RUB 4.5 billion with a final settlement due in January 2019 including restructuring an option in respect of 2.91% for cash consideration of RUB 0.9 billion. The current Group's ownership interest in RTI is 87%.

Disposal of 3.35% in MTS – In 2016 in a series of transactions the Group sold 33,911,737 American Depositary Shares of MTS to a non-affiliated buyer for a consideration of USD 279.3 million (RUB 17.7 billion). As of 31 December 2016, the remaining Group ownership interest in MTS was 50.03%.

Additional share issues of Mikron – In February and December 2016, the Group participated in an additional share issues of PJSC Mikron (subsidiary of RTI) for RUB 3.4 billion.

Additional share issues of MTS Bank – In February 2016 and November 2016, the Group participated in additional share issues of MTS Bank for RUB 15.5 billion.

Restructuring of Steppe – In October 2016, the Group sold 11.9% of Steppe in exchange for a minority stakes in Steppe's subsidiaries.

Restructuring of Sitronics – In October 2016, the Group purchased 26% of Sitronics CAMS (subsidiary of Sitronics) in an exchange of assets. In May 2016, Sistema Finance S.A. performed intragroup acquisition from Sitronics 100% of SITRONICS IT BV for cash consideration of RUB 5.7 billion.

Disposal of 10% and 3% in RTI – In April 2016, the Group sold 10% of RTI share capital to PJSC Sovcombank for a total cash consideration of RUB 1 billion. In March 2016, the Group also exchanged 3% in RTI for 1.5% in JSC Concern RTI Systems (subsidiary of RTI).

Acquisition of 39% in Lesosibirsk LDK No. 1 – In April 2016, in a series of transactions the Group acquired an additional stake in Lesosibirsk LDK No. 1 for a total cash consideration of RUB 2 billion and increased its stake from 60% to 99%

10. REVENUE

The Group primarily receives its revenue from the sale of goods and rendering services in Russia. Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other similar allowances.

Revenues under arrangements specific to the reportable segments of the Group are recognised as follows.

MTS – Revenues derived from wireless, local telephone, long distance, data and video services are recognised when services are provided. This is based upon either usage (minutes of traffic processed, volume of data transmitted) or period of time (monthly subscription fees).

Content revenue is presented net of related costs when MTS acts as an agent of the content providers while the gross revenue and related costs are recorded when MTS is a primary obligor in the arrangement.

Upfront fees received for the connection of new subscribers, installation and activation of wireless, wireline and data transmission services ("connection fees") are deferred and recognized over the estimated average subscriber life, as follows:

Mobile subscribers	8 months - 7 years
Residential wireline voice phone subscribers	15 years
Other fixed line subscribers	3-5 years

MTS calculates an average life of mobile subscribers for each region in which it operates and amortises connection fees based on the average life specific to that region.

Incentives provided to customers are usually offered on signing a new contract or as part of a promotional offering. Incentives representing the reduction of the selling price of the service (free minutes and discounts) are recorded in the period to which they relate, when the respective revenue is recognized, as a reduction to both accounts receivable and revenue.

***Detsky mir* -** The amount of revenue is determined as the fair value of consideration received or receivable, less the estimated amount of returns, discounts and other similar amounts.

Detsky mir recognises sales proceeds from retail customers at the time of sale of goods in stores. When selling goods through the Internet, Detsky mir recognizes revenue at the time of receipt by the customer.

In its retail stores, Detsky mir also utilises gift cards. Gift cards have a certain validity period and may be used before a certain date. Detsky mir recognizes the income from the sale of gift cards either at the time the gift card is used by its holder, or at the expiration date.

MTS Bank and East-West United Bank – Revenues from interest bearing assets are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortised cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

MTS Bank and East-West United Bank revenues are included in the rendering of services line below.

(Amounts in millions of Russian Rubles, unless otherwise stated)

RTI – When the outcome of a construction contract can be estimated reliably, revenue and costs are recognised by reference to the stage of completion of the contract activity at the end of the reporting period, measured based on the proportion of contract costs incurred for work performed to date relative to the estimated total contract costs, except where this would not be representative of the stage of completion. Variations in contract work, claims and incentive payments are included to the extent that the amount can be measured reliably and its receipt is considered probable. When the outcome of a construction contract cannot be estimated reliably, contract revenue is recognised to the extent of contract costs incurred that it is probable will be recoverable. Contract costs are recognised as expenses in the period in which they are incurred. When it is probable that total contract costs will exceed total contract revenue, the expected loss is recognised as an expense immediately.

Revenues from the long-term contracts are recognised using the percentage-of-completion method, measured by the percent of contract costs incurred to-date to estimated total contract costs. The stage of completion of a contract is determined based on the proportion that contract costs incurred for work performed to date bear to the estimated total contract costs.

The following is an analysis of the Group's revenue from continuing operations:

	2017	2016
Rendering of services	455,114	443,866
Sale of goods	226,130	204,690
Construction contracts	23,307	32,308
	704,551	**680,864**

Construction contracts

When contract costs incurred to date plus recognised profits less recognised losses exceed progress billings, the surplus is shown as amounts due from customers for contract work. For contracts where progress billings exceed contract costs incurred to date plus recognised profits less recognised losses, the surplus is shown as the amounts due to customers for contract work. Amounts received before the related work is performed are included in the consolidated statement of financial position, as a liability for advances received. Amounts billed for work performed but not yet paid by the customer are included in the consolidated statement of financial position under inventories.

The following is an analysis of amounts due from/(to) customers under construction contracts:

	2017	2016
Contracts in progress at the end of the year:		
Construction costs incurred plus recognised profits less recognised losses to date	113,970	97,726
Less: progress billings	(110,411)	(98,983)
	3,559	**(1,257)**
Costs and estimated earnings in excess of billings on uncompleted contracts	11,908	8,285
Billings in excess of costs and estimated earnings on uncompleted contracts	(8,349)	(9,542)
	3,559	**(1,257)**

(Amounts in millions of Russian Rubles, unless otherwise stated)

11. IMPAIRMENT OF LONG-LIVED ASSETS

Impairment of long-lived assets includes impairment of property, plant and equipment, goodwill, impairment in MTS Turkmenistan and other intangible assets.

	2017	2016
Impairment of other long-lived assets	4,857	2,473
Impairment in MTS Turkmenistan	3,204	-
Impairment of goodwill (Note 17)	-	241
Total impairment of long-lived assets	**8,061**	**2,714**

MTS Turkmenistan – In 2017, the Group recognized impairment charges of RUB 3,204 million attributable to the non-current assets of MTS Turkmenistan. In September 2017, the Group's subsidiary in Turkmenistan MTS-TM suspended the provision of telecommunication services to its subscribers, due to the termination by Turkmen state-owned companies and state authorities of line rental, frequency allocation, interconnect, and other agreements necessary to servicing MTS clients. However, the license for the provision of telecommunication services on the Turkmenistan territory is valid till the end of July 2018. The Group considered facts described above as impairment indicators and consequently determined that all long-lived assets attributable to Turkmenistan subsidiary were impaired. The recoverable amount of CGU "MTS Turkmenistan" was equal to nil as of 31 December 2017 and was classified within Level 3 of the fair value hierarchy.

12. IMPAIRMENT OF FINANCIAL ASSETS

Impairment of financial assets for 2017 and 2016 comprise the following:

	2017	2016
Allowance for doubtful accounts	3,721	3,696
Impairment of available for sale securities	150	1,027
Impairment of loans carried at amortised cost	1,874	6,600
Total impairment of financial assets	**5,745**	**11,323**

Provision for financial assets attributable to MTS Bank and East-West United Bank is reported in cost of sales.

13. INCOME TAXES

The Group measures and records its current income tax payable and its tax bases in its assets and liabilities in accordance with the tax regulations of the countries where the Group and its subsidiaries operate, which may differ from IFRS.

The Group is subject to permanent tax differences due to the non-tax deductibility of certain expenses and certain income being treated as non-taxable for tax purposes. Deferred taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for tax purposes.

Deferred tax assets are not recognized when it is more likely than not that some portion or all of the deferred tax assets will not be realized. In making such determination, the Group considers all available positive and negative evidence, including projected future taxable income, tax planning strategies and recent financial operations.

The tax rate used for the reconciliations below is the corporate tax rate of 20% payable by corporate entities in the RF on taxable profits (as defined) under tax law in that jurisdiction.

(Amounts in millions of Russian Rubles, unless otherwise stated)

The Group's income tax expense for 2017 and 2016 comprise the following:

	2017	2016
Current income tax expense	28,975	23,358
Deferred income tax benefit	(17,532)	(1,793)
Total income tax expense recognised in the current year relating to continuing operations	**11,443**	**21,565**

Income tax expense calculated by applying the Russian statutory income tax rate to income from continuing operations before income tax differs from income tax expense recognized in the consolidated statements of profit or loss as a consequence of the following adjustments:

	2017	2016
Loss/(profit) before tax	**50,090**	**(46,318)**
Income tax (benefit)/expense calculated at 20%	(10,018)	9,264
Adjustments due to:		
Earnings distribution from subsidiaries and associates	3,833	3,454
Increase of unrecognised deferred tax assets	14,991	4,749
Other non-deductible expenses	2,704	5,174
Settlements with tax authorities	-	68
Different tax rate of subsidiaries	86	(410)
Non-taxable income	(335)	(869)
Other	182	135
Income tax expense	**11,443**	**21,565**

The following is the analysis of deferred tax assets/(liabilities) presented in the consolidated statements of financial position:

2017	Opening balance	Recognised in profit or loss	Recognised in OCI	Recognised in Equity	Business combinations and disposals	Closing balance
Deferred tax (liabilities)/ assets in relation to:						
Accrued expenses and accounts payable	8,103	413	(9)	-	-	8,507
Property, plant and equipment	(24,189)	498	(39)	-	-	(23,730)
Intangible assets	(10,632)	168	17	-	(130)	(10,577)
Deferred connection fees	540	32	(10)	-	-	562
Inventory obsolescence	1,292	(328)	-	-	-	964
Allowance for doubtful accounts and loans receivable	962	(106)	(30)	-	-	826
Deferred revenues	164	(42)	-	-	-	122
Undistributed earnings of subsidiaries and joint ventures and associates	(5,831)	(280)	119	-	-	(5,992)
Tax losses carried forward	13,895	13,908	-	(2,399)	-	25,404
Other	(872)	3,078	(555)	-	(88)	1,563
Total	**(16,568)**	**17,341**	**(507)**	**(2,399)**	**(218)**	**(2,351)**

(Amounts in millions of Russian Rubles, unless otherwise stated)

2016	**Opening balance**	**Recognised in profit or loss**	**Recognised in OCI**	**Recognised in Equity**	**Business combinations and disposals**	**Closing balance**
Deferred tax (liabilities)/ assets in relation to:						
Accrued expenses and accounts payable	10,806	(2,376)	(131)	-	(196)	8,103
Property, plant and equipment	(19,912)	(994)	(653)	-	(2,630)	(24,189)
Intangible assets	(9,749)	(1,621)	166	-	572	(10,632)
Deferred connection fees	639	(20)	(32)	-	(47)	540
Inventory obsolescence	791	532	-	-	(31)	1,292
Allowance for doubtful accounts and loans receivable	877	267	(236)	-	54	962
Deferred revenues	-	164	-	-	-	164
Undistributed earnings of subsidiaries and joint ventures and associates	(7,240)	861	548	-	-	(5,831)
Tax losses carried forward	12,502	1,606	(49)	-	(164)	13,895
Other	(4,412)	3,523	374	-	(357)	(872)
Total	**(15,698)**	**1,942**	**(13)**	**-**	**(2,799)**	**(16,568)**

As of 31 December 2017 and 2016 the Group reported the following deferred income tax assets and liabilities in the consolidated statements of financial position, following the application of the right of offset:

	2017	**2016**
Deferred tax assets	35,809	24,185
Deferred tax liabilities	(38,160)	(40,753)
Net deferred tax liabilities	**(2,351)**	**(16,568)**

As of 31 December 2017 and 2016 the tax losses carried forward, for which deferred tax assets were recognised, amounted to RUB 127,021 million and RUB 69,474 million, respectively.

Federal law №401-FZ dated 30 November 2016 allowed for the indefinite carry forward of tax losses, whereas this was previously restricted to 10 years. Also the law specified that the tax base for the years 2017-2020 may not be reduced by tax losses carried forward in an amount exceeding 50% of the base. The following table summarizes temporary differences, for which deferred tax assets were not recognised in the consolidated statements of financial position as of 31 December 2017 and 2016:

Jurisdiction	**Carry-forward period**	**2017**	**2016**
India	2018-2026	113,591	189,505
Russia	infinite	187,517	158,301
Total		**301,108**	**347,806**

(Amounts in millions of Russian Rubles, unless otherwise stated)

14. EMPLOYEE BENEFITS EXPENSES

Employee benefits expenses consist of salaries, bonuses and social security contributions. Employee benefits expenses included in cost of sales and selling, general and administrative expenses for 2017 and 2016 comprised RUB 132,419 million and RUB 142,099 million, respectively.

Share options granted under the Company's employee share option plan – In 2017 and 2016 the Company's Board of Directors established two-year motivational programs for senior and mid-level management. Participants of the programs, upon fulfilment of certain performance conditions and subject to continuing employment with the Group, are granted ordinary shares in the Company.

As a result, the Group recognised an expense of RUB 1,484 million and RUB 2,522 million in the consolidated statements of profit or loss for 2017 and 2016, respectively. The fair value of awards granted was measured based on the fair value of the Company's ordinary shares.
The awards are equity-settled and are recognised in additional paid-in capital.

15. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are stated at historical cost. Cost includes major expenditures for improvements and replacements, which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance, including preventive maintenance, are charged to the consolidated statement of profit or loss as incurred.

The cost of major overhauls and replacements, which extend useful lives of the assets or increase their revenue generating capacity, are capitalised to the cost of the assets.

Depreciation for property, plant and equipment is computed under the straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	20-50 years
Leasehold improvements	the term of the lease
Base stations	7 years
Other network equipment	up to 31 years
Power and utilities	up to 35 years
Other	up to 15 years

Borrowing costs directly attributable to the acquisition, construction or production of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale. The Group considers a construction period of more than six months to be substantial. Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation. All other borrowing costs are recognised in profit or loss in the period in which they are incurred.

Property, plant and equipment, net of accumulated depreciation, as of 31 December 2017 and 2016 consisted of the following:

	2017	2016
Carrying amount		
Switches, transmission devices, network and base station equipment	235,503	243,349
Buildings and leasehold improvements	77,360	77,169
Power and utilities	26,269	25,206
Land	19,959	18,133
Other	52,376	44,273
Total	**411,467**	**408,130**

(Amounts in millions of Russian Rubles, unless otherwise stated)

	Billing and telecom software	Operating licenses	Customer base	Radio frequen - cies	Software and other	Trade - marks	Total
Cost or valuation							
Balance at 1 January 2016	85,427	60,457	12,366	9,326	29,434	6,563	203,573
Additions	27,658	3,382	324	245	1,843	-	33,452
Disposals	(12,400)	(47)	(163)	(582)	(7,665)	-	(20,857)
Business combinations	-	323	-	-	-	-	323
Currency translation							-
adjustment	(3,763)	(9,462)	-	-	(1,227)	6	(14,446)
Other	(87)	44	-	(40)	(44)	-	(127)
Balance at 31 December 2016	96,835	54,697	12,527	8,949	22,341	6,569	201,918
Additions	24,686	1,660	27	13	3,400	49	29,835
Disposals	(8,429)	(19,041)	(50)	(1,112)	(1,394)	-	(30,026)
Business combinations	163	260	-	-	1,221	-	1,644
Currency translation							-
adjustment	(980)	(1,131)	-	-	(35)	6	(2,140)
Other	(6)	(2)	-	1	55	-	48
Balance at 31 December 2017	**112,269**	**36,443**	**12,504**	**7,851**	**25,588**	**6,624**	**201,279**
Accumulated depreciation and impairment							
Balance at 1 January 2016	(44,448)	(16,997)	(8,007)	(4,261)	(17,552)	-	(91,265)
Disposals	10,687	2	164	582	5,889	-	17,324
Amortisation expense	(17,548)	(3,587)	(1,378)	(1,170)	(2,756)	-	(26,439)
Currency translation adjustment	2,697	2,779	-	-	702	-	6,178
Other	43	(7)	-	20	(56)	-	-
Balance at 31 December 2016	(48,569)	(17,810)	(9,221)	(4,829)	(13,773)	-	(94,202)
							-
Disposals	8,345	3,391	50	1,108	1,385	-	14,279
Amortisation expense	(17,614)	(2,989)	(1,184)	(1,042)	(1,450)	-	(24,279)
Impairment	(148)	-	-	-	(542)	-	(690)
Currency translation adjustment	726	570	-	-	33	-	1,329
Other	(17)	-	-	2	(35)	-	(50)
Balance at 31 December 2017	**(57,277)**	**(16,838)**	**(10,355)**	**(4,761)**	**(14,382)**	**-**	**(103,613)**

(Amounts in millions of Russian Rubles, unless otherwise stated)

16. INVESTMENT PROPERTY

Investment property primarily includes apartment buildings, cottages, office and commercial space and business centres owned by the companies of the Group operating in real estate segment, including Leader-Invest and Business Nedvizhimost.

Investment property is stated at cost less accumulated depreciation and impairment losses.

Depreciation for investment property is computed under the straight-line method utilising average estimated useful lives of the assets of 25 years. Accumulated depreciation as of 31 December 2017 and 2016 amounted to RUB 3,461 million and RUB 3,035 million respectively.

	2017	2016
Balance at the beginning of the year	22,647	14,085
Reclassified to property, plant and equipment	-	(804)
Additions	3,203	10,902
Disposals	(757)	(1,368)
Depreciation expense	(426)	(256)
Reclassified (to)/from inventories	(3)	88
Balance at the end of the year	**24,664**	**22,647**

Included in revenue is investment property rental income for 2017 of RUB 2,396 million (2016: RUB 2,608 million). Operating expenses arising from the investment property that generated rental income during 2017 totalled RUB 436 million (2016: RUB 377 million).

In estimating the fair value of the investment property, the Group classified the properties within Level 3 of the fair value hierarchy. As of 31 December 2017 and 2016, the Group determined the fair values of the investment property at RUB 62,808 million and RUB 59,107 million, respectively.

The fair values as of 31 December 2017 and 2016 were determined either based on discounted cash flows or by reference to market values of similar properties in the relevant region. The main inputs to the fair value measurement are the discount rate, revenue growth rates, OIBDA margin and adjustments to market values of similar properties. OIBDA is determined as operating profit before on depreciation and amortization.

(Amounts in millions of Russian Rubles, unless otherwise stated)

17. GOODWILL

Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business less accumulated impairment losses, if any.

The carrying amounts of goodwill attributable to operating segments are as follows:

	MTS	SSTL	RTI	Steppe	Segezha Group	Other	Total
Balance as of 1 January 2016							
Gross amount of goodwill	48,169	20,408	8,323	3,862	-	7,317	88,079
Accumulated impairment loss	(4,982)	(20,408)	(8,219)	-	-	(7,214)	(40,823)
	43,187	**-**	**104**	**3,862**	**-**	**103**	**47,256**
Business combinations	-	-	-	1,981	3,454	602	6,037
Impairment	-	-	-	-	(241)	-	(241)
Currency translation adjustment	(783)	-	-	-	-	(45)	(828)
Balance as of 31 December 2016							
Gross amount of goodwill	47,386	16,578	8,323	5,843	3,454	7,874	89,458
Accumulated impairment loss	(4,982)	(16,578)	(8,219)	-	(241)	(7,214)	(37,234)
	42,404	**-**	**104**	**5,843**	**3,213**	**660**	**52,224**
Business combinations	794	-	-	635	-	664	2,093
Impairment	-	-	-	-	-	-	-
Currency translation adjustment	(198)	-	-	-	-	(38)	(236)
Balance as of 31 December 2017							
Gross amount of goodwill	47,982	-	8,323	6,478	3,454	8,500	74,737
Accumulated impairment loss	(4,982)	-	(8,219)	-	(241)	(7,214)	(20,656)
	43,000	**-**	**104**	**6,478**	**3,213**	**1,286**	**54,081**

The Group performs impairment tests for the goodwill assigned to cash-generating units (CGUs) at least annually and when there are any indications that the carrying amount of the cash-generating unit is impaired. When the carrying amount of the cash-generating unit to which goodwill is allocated exceeds its recoverable amount, goodwill allocated to this cash-generating unit is impaired.

(Amounts in millions of Russian Rubles, unless otherwise stated)

MTS - For the purposes of impairment testing, goodwill attributable to the MTS segment is allocated to cash-generating units for the years ended 31 December as follows:

	2017	2016
Russia convergent	28,781	28,800
Armenia and other	4,249	3,707
Moscow fixed line	1,164	1,083
Ukraine	87	95
Unallocated	8,719	8,719
Total	**43,000**	**42,404**

The "Russia convergent" CGU represents mobile and fixed line operations, which encompasses services rendered to customers across regions of Russia, except for "Moscow fixed line", which represents the results of fixed line operations carried out in Moscow by MGTS, a subsidiary of the Group. "Armenia" and "Ukraine" represent operations carried out by subsidiaries of MTS in the respective countries. Goodwill allocated to these CGUs has arisen on acquisitions made by MTS. The Group does not allocate goodwill recognised as a result of its purchases of MTS shares by the Group to CGUs as it is monitored for internal management purposes at the level of the MTS segment as a whole. Unallocated amount of goodwill is tested for impairment with the reference to the market capitalisation of MTS.

The recoverable amounts of the CGUs are determined based on their value in use. In assessing value in use, the estimated future cash flows are discounted to present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the CGU.

Future cash flows calculations are based on a five-year operation plan. Estimation of future cash flows requires assumptions to be made in respect of uncertain factors, including management's expectations of margins, timing and amount of future capital expenditure, terminal growth rates and appropriate discount rates to reflect the risks involved.

During 2017 and 2016, no impairment charges were recorded in respect of the Group's goodwill balances attributable to MTS segment.

The key assumptions used in the value in use calculations are as follows:

Forecasted OIBDA margin and capital expenditure were primarily derived from internal sources, based on past experience and extended to include management expectations.

The table below presents forecasted OIBDA margin and capital expenditure as a percentage of revenue over the following five years utilised for value in use calculation of related CGUs:

	OIBDA margin		Capital expenditure as a percentage of revenue	
CGU	**2017**	**2016**	**2017**	**2016**
Russia convergent	38.0%-39.1%	34.6%-37.0%	17.2%	18.8%
Armenia	40.2%-41.2%	42.0%-45.0%	17.8%	11.9%
Moscow fixed line	41.0%-48.5%	42.2%-51.0%	20.6%	17.5%
Ukraine	31.4%-40.6%	40.6%-46.5%	22.7%	19.9%

(Amounts in millions of Russian Rubles, unless otherwise stated)

The terminal growth rate has been determined based on the nominal gross domestic product rates for the country of operation, adjusted for specific characteristics of the CGU's business. The discount rate is the weighted average cost of capital, being equity and debt, according to the industry average finance structure. The cost of equity is calculated based on the risk free rate for long-term bonds issued by the government in the respective market. These rates are adjusted for a risk premium to reflect both the increased risk of investing in equities and the systematic risk of the specific CGU. The cost of debt is defined as the rate effective for borrowings drawn by the Group at or near the date of the impairment test.

The table below presents terminal growth rate and pre-tax rates for discounting cash flows in functional currencies utilized for value in use calculation of related CGUs:

	Terminal growth rate		Discount rate	
CGU	**2017**	**2016**	**2017**	**2016**
Russia convergent	1%	1%	16.0%	15.1%
Armenia	nil	nil	15.2%	15.5%
Moscow fixed line	1%	1%	14.5%	13.7%
Ukraine	3%	3%	20.8%	21.6%

Management believes that no reasonably possible change in any of the above key assumptions would cause the carrying value of any cash-generating unit to materially exceed its recoverable amount.

Agroholding "Steppe" – The recoverable amounts of the CGUs are determined based on their value in use. Cash flow models were prepared in Russian rubles. These calculations use cash flow projections based on financial budgets approved by management covering a five-year period. Cash flow beyond the 5-year period were extrapolating using growth rates stated below. The growth rate do not exceed the long-term average growth rate for the business sector of the economy in whch CGU operates.

Key assumptions used for value-in-use calculations are determined on the basis of market analysis which is performed regularly. The table below presents key assumptions used for value-in-use calculations:

	2017	**2016**
Terminal cash flows growth rate	4%	4%
Discount rate	16-16.25%	16-17%
Range of average annual market price growth rate	4-6%	4-10%

Management believes that no reasonably possible change in any of the above key assumptions would cause the carrying value of any cash-generating unit to materially exceed its recoverable amount.

(Amounts in millions of Russian Rubles, unless otherwise stated)

18. OTHER INTANGIBLE ASSETS

Other intangible assets are mainly represented by billing and telecommunication software and other software, operating licenses, acquired customer bases of MTS.

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortisation and impairment losses. Intangible assets acquired in a business combination and recognised separately from goodwill are initially recognised at their fair value at the acquisition date (which is regarded as their cost). Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortisation and impairment losses, on the same basis as intangible assets that are acquired separately.

All finite-life intangible assets are amortised using the straight-line method utilising estimated useful lives of the assets as follows:

Operating licenses	3-20 years
Billing and telecommunication software	1-20 years
Radio frequencies	2-15 years
Customer base	1-8 years
Software and other	1-10 years

The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis.

Trademarks with indefinite contractual life are not amortised, but are reviewed, at least annually, for impairment.

Intangible assets other than goodwill as of 31 December 2017 and 2016 consisted of the following:

	2017	2016
Carrying amounts of:		
Amortised intangible assets:		
Billing and telecommunication software	54,992	48,266
Operating licenses	19,605	36,887
Radio frequencies	3,090	4,120
Acquired customer base	2,149	3,306
Software and other	11,206	8,568
	91,042	**101,147**
Unamortised intangible assets:		
Trademarks	6,624	6,569
Total	**97,666**	**107,716**

(Amounts in millions of Russian Rubles, unless otherwise stated)

	Billing and telecom software	Operating licenses	Customer base	Radio frequen - cies	Software and other	Trade - marks	Total
Cost or valuation							
Balance at 1 January 2016	85,427	60,457	12,366	9,326	29,434	6,563	203,573
Additions	27,658	3,382	324	245	1,843	-	33,452
Disposals	(12,400)	(47)	(163)	(582)	(7,665)	-	(20,857)
Business combinations	-	323	-	-	-	-	323
Currency translation							-
adjustment	(3,763)	(9,462)	-	-	(1,227)	6	(14,446)
Other	(87)	44	-	(40)	(44)	-	(127)
Balance at 31 December 2016	96,835	54,697	12,527	8,949	22,341	6,569	201,918
Additions	24,686	1,660	27	13	3,400	49	29,835
Disposals	(8,429)	(19,041)	(50)	(1,112)	(1,394)	-	(30,026)
Business combinations	163	260	-	-	1,221	-	1,644
Currency translation							-
adjustment	(980)	(1,131)	-	-	(35)	6	(2,140)
Other	(6)	(2)	-	1	55	-	48
Balance at 31 December 2017	**112,269**	**36,443**	**12,504**	**7,851**	**25,588**	**6,624**	**201,279**
Accumulated depreciation and impairment							
Balance at 1 January 2016	(44,448)	(16,997)	(8,007)	(4,261)	(17,552)	-	(91,265)
Disposals	10,687	2	164	582	5,889	-	17,324
Amortisation expense	(17,548)	(3,587)	(1,378)	(1,170)	(2,756)	-	(26,439)
Currency translation adjustment	2,697	2,779	-	-	702	-	6,178
Other	43	(7)	-	20	(56)	-	-
Balance at 31 December 2016	(48,569)	(17,810)	(9,221)	(4,829)	(13,773)	-	(94,202)
							-
Disposals	8,345	3,391	50	1,108	1,385	-	14,279
Amortisation expense	(17,614)	(2,989)	(1,184)	(1,042)	(1,450)	-	(24,279)
Impairment	(148)	-	-	-	(542)	-	(690)
Currency translation adjustment	726	570	-	-	33	-	1,329
Other	(17)	-	-	2	(35)	-	(50)
Balance at 31 December 2017	**(57,277)**	**(16,838)**	**(10,355)**	**(4,761)**	**(14,382)**	**-**	**(103,613)**

MTS operating licenses – In connection with providing telecommunication services, the Group has been issued various GSM operating licenses by the Russian Ministry of Information Technologies and Communications (the «Ministry»). In addition to the licenses received directly from the Ministry, the Group has been granted access to various telecommunication licenses through acquisitions. In foreign subsidiaries, the licenses are granted by the local communication authorities.

Operating licenses contain a number of requirements and conditions specified by legislation. The requirements generally include the targets for start date of service, territorial coverage and expiration date. Management believes that the Group is in compliance with all material terms of its licenses.

(Amounts in millions of Russian Rubles, unless otherwise stated)

The Group's operating licenses do not provide for automatic renewal. As of 31 December 2017, all expired licenses covering the territories of the Russian Federation were renewed. The cost to renew the licenses was not significant. The weighted-average period until the next renewal of licenses in the Russian Federation is five years.

The license for the provision of telecommunication services in Ukraine was renewed in 2013 and is valid until 2026. The license for the provision of telecommunication services in Armenia is valid until 2019.

SSTL spectrum – As a result of the demerger of the telecommunication business of SSTL (Note 6) 800-850 MHz spectrum was transferred to RCOM.

19. INVESTMENTS IN ASSOCIATES AND JOINT VENTURES

The Group holds interests in several associates, the most significant of which are MTS Belarus, OZON, and joint ventures represented by real estate projects. All investments in associates and joint ventures are accounted for using the equity method.

Investments in associates and joint ventures as of 31 December 2017 and 2016 consisted of the following:

	2017		2016	
	Voting power	**Carrying value**	**Voting power**	**Carrying value**
OZON	22.37%	4,678	21.60%	4,929
MTS Belarus	49.00%	3,660	49.00%	4,303
Real estate projects	48%-50%	3,204	48%-50%	4,629
Razvitie	50.00%	2,238	50.00%	928
Michurinskiy project	50.00%	1,270	-	-
Other		5,733		4,748
Total		**20,783**		**19,537**

Investments in real estate projects – As of 31 December 2016, the Group held between 48% and 50% of the shares in companies owning foreign and Russian retail and other real estate with a total book value of RUB 4,629 million. In April 2017, the Group sold its shares in two German projects to a third party with a carrying value of RUB 3,498 million. In other projects, the Group retained its ownership interests as of 31 December 2017 and additionally invested RUB 1,909 million in 2017. The Group continues to account for them as investments in associates and joint ventures.

Michurinsky project – During the first half of 2017, the Group established a new legal entity LLC "Michurinsky project" and contributed buildings to its share capital. In June 2017, a third party investor purchased a 50% interest in LLC "Michurinsky project" for a cash consideration of RUB 2 billion. As a result, the Group's interest in LLC "Michurinsky project" decreased to 50% and it was accounted for as an investment in a joint venture.

(Amounts in millions of Russian Rubles, unless otherwise stated)

The financial position and results of operations of significant associates and joint venture as of and for the years ended 31 December 2017 and 2016 were as follows:

	2017					2016			
	MTS Belarus	**OZON**	**Real estates projects**	**Razvitie**	**Michu-rinskiy project**	**MTS Belarus**	**OZON**	**Real estates projects**	**Razvitie**
Non-current assets	9,819	4,656	6,863	4,003	4,030	9,414	3,922	12,162	4,004
Current assets	8,117	8,189	8,421	465	21	6,800	8,073	1,262	260
Total assets	**17,936**	**12,845**	**15,284**	**4,468**	**4,051**	**16,214**	**11,995**	**13,424**	4,264
Non-current liabilities	(703)	(572)	(1,361)	-	(5)	-	(629)	(4,631)	-
Current liabilities	(9,764)	(7,789)	(5,064)	(1)	(43)	(7,433)	(5,413)	(412)	(2,506)
Total liabilities	**(10,467)**	**(8,361)**	**(6,425)**	**(1)**	**(48)**	**(7,433)**	**(6,042)**	**(5,043)**	**(2,506)**
Net assets of investee	**7,469**	**4,484**	**8,859**	**4,467**	**4,003**	**8,781**	**5,953**	**8,381**	**1,758**
Group's ownership interest	49.00%	22.37%	48%-50%	50.00%	50.00%	49.00%	21.60%	48%-50%	50.00%
Fair value adjustment on the date of purchase	-	3,674	(1,048)	4	(731)	-	3,644	606	49
Carrying amount of the Group's interest	**3,660**	**4,678**	**3,204**	**2,238**	**1,270**	**4,303**	**4,929**	**4,629**	**928**
Total revenues	23,037	21,998	25	-	-	22,256	15,322	557	-
Total profit/(loss) for the year	6,552	(1,589)	3	7	-	6,356	(1,190)	769	(17)
The Group's share in profit/(loss)	**3,210**	**(355)**	**1**	**3**	**-**	**3,114**	**(257)**	**369**	**(8)**
Total comprehensive income/(loss)	6,027	(1,589)	3	7	-	4,064	(1,194)	769	(17)
The Group's share in comprehensive income/ (loss) for the year	**2,953**	**(355)**	**1**	**3**	**-**	**1,991**	**(258)**	**369**	**(8)**

The following is a summary of the aggregated financial information of other associates and joint ventures that are not individually material:

Group's share of profit/(loss) from continuing operations	171	(71)
Group's share of total comprehensive income	428	1,053
Aggregate carrying amount of the Group's interests in these associates and joint ventures	5,734	4,748

20. LOANS RECEIVABLE AND OTHER FINANCIAL ASSETS

The Group's financial assets, other than cash and cash equivalents, deposits in banks and accounts receivable shown separately on the face of the statements of financial position, primarily comprise assets of MTS Bank and East-West United Bank, the Group's subsidiaries engaged in banking activities, and investments of the Corporate segment.

Financial assets are classified into the following specified categories depending on their nature and purpose:

Category	Description	Accounting policy
Financial assets at fair value through profit or loss (FVTPL)	Financial assets which are either held for trading or are designated as at FVTPL.	Measured at fair value with changes recognised in profit or loss.
Held-to-maturity (HTM) investments	Non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity.	Measured at amortised cost using the effective interest method less any impairment.
Loans and receivables	Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market.	Measured at amortised cost using the effective interest method less any impairment.
Available-for-sale (AFS) financial assets	Non-derivatives that are either designated as AFS or are not classified within the above categories.	Measured at fair value with changes recognized in other comprehensive income. When the investment is disposed of or is determined to be impaired, the cumulative gain or loss is reclassified to profit or loss.

Financial assets, other than those at FVTPL, are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

For certain categories of financial assets, such as loans and receivables, assets that are assessed not to be impaired individually are assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of loans and receivables could include the Group's past experience of collecting payments, an increase in the number of delayed payments in the portfolio, as well as observable changes in national or local economic conditions that correlate with default loans on receivables.

The Group entered into a variety of derivative financial instruments to manage its exposure to interest rate and foreign exchange rate risks, including foreign exchange forward contracts, interest rate swaps and cross currency swaps. Further details of derivative financial instruments are disclosed in Note 32.

(Amounts in millions of Russian Rubles, unless otherwise stated)

At 31 December 2017 and 2016, financial assets, other than those shown separately on the face of the statements of financial position, less allowance for impairment losses, comprise:

	2017	2016
Financial assets at FVTPL		
Debt and equity securities	37,414	30,935
	37,414	**30,935**
Loans and receivables at amortised cost		
Bank loans to customers	64,708	62,900
Interbank loans due from banks	15,512	3,090
Other loans and receivables	22,647	18,431
	102,867	**84,421**
AFS financial assets		
Debt and equity securities	28,163	16,460
	28,163	**16,460**
HTM financial assets		
Debt and equity securities	27,346	17,163
	27,346	**17,163**
Hedging instruments at fair value		
Interest rate swaps designated as cash flow hedges	8,403	13,632
	8,403	**13,632**
	204,193	**162,611**
Current	99,798	62,588
Non-current	104,395	100,023
	204,193	**162,611**

At 31 December 2017 and 2016, included in the above categories as well as cash and cash equivalents, financial assets attributable to the Group’s banking activities (MTS Bank and its subsidiaries, East-West United Bank) comprise:

	2017	2016
Cash and cash equivalents	31,758	28,895
Bank loans to customers	75,126	99,556
Interbank loans due from banks	15,553	3,339
Financial assets at FVTPL	16,106	18,430
AFS financial assets	11,485	8,166
HTM financial assets	27,346	17,163
Other	110	713
Less: allowance for loan losses	(10,459)	(36,905)
	167,025	**139,357**

The movement in the allowance for loan losses during 2017 and 2016 was as follows:

	2017	2016
Allowance for loan losses, beginning of the year	**36,905**	**46,910**
Additions charged to the results of operations, net	199	6,063
Write-off of loan loss provisions	(26,374)	(14,883)
Currency translation adjustment	(271)	(1,185)
Allowance for loan losses, end of the year	**10,459**	**36,905**

(Amounts in millions of Russian Rubles, unless otherwise stated)

The analysis of bank loans to customers by sector is presented below:

	2017	2016
Individuals	37,797	44,157
Manufacturing	10,668	17,277
Real estate	5,906	9,809
Trade	5,816	9,454
Transport and communication	3,575	2,844
Food production	2,993	6,407
Finance lease	1,455	1,598
Finance sector	1,099	2,865
Culture and art	21	886
Other	5,796	4,259
Total bank loans to customers	**75,126**	**99,556**

Loans to individuals comprise the following:

	2017	2016
Credit cards	8,421	17,451
Mortgage loans	14,200	14,671
Consumer loans	15,045	11,020
Other	131	1,015
	37,797	**44,157**
Less allowance for loan losses	(4,019)	(12,979)
Total loans to individuals	**33,778**	**31,178**

21. RESTRICTED CASH

According to the amendments to the law "On State Defense Orders", cash received under state defense orders has to be held on special accounts and its spending is restricted to activities related to these orders. As of 31 December 2017 and 2016, RTI has RUB 8,591 million and RUB 10,098 million of cash on special accounts which was presented as restricted cash within current assets.

22. INVENTORIES

Inventories mainly include goods for resale of Detsky mir and the retail network of MTS, costs in excess of billings of RTI and construction in progress of Leader-Invest.

Inventories are stated at the lower of cost or market value. Inventories are accounted for using the weighted-average cost method. Inventory should be accounted further at the lower of net realisable value and carrying amount. The Group periodically assesses its inventories for obsolete or slow-moving stock.

The cost of raw materials includes the cost of purchase, customs duties, transportation and handling costs. Work-in-progress and finished goods are stated at production cost which includes direct production expenses and manufacturing overheads.

Costs and estimated earnings in excess of billings on uncompleted contracts include the accumulated costs of projects contracted with third parties, net of related progress billings.

(Amounts in millions of Russian Rubles, unless otherwise stated)

Inventories as of 31 December 2017 and 2016 consisted of the following:

	2017	2016
Detsky mir finished goods and goods for resale	26,287	25,328
Construction in progress of Leader-Invest	16,084	5,130
Costs and estimated earnings in excess of billings on uncompleted contracts	11,908	8,285
Raw materials and spare parts	10,665	6,956
MTS finished goods and goods for resale	9,995	16,276
Other finished goods and goods for resale	9,239	9,929
Other work-in-progress	3,875	10,786
Subtotal	**88,053**	**82,690**
Excluding non-current inventories	(6,652)	(1,324)
Total	**81,401**	**81,366**

The cost of inventories recognised as an expense during the year in respect of continuing operations was RUB 159,940 million (2016: RUB 125,690 million). The cost of inventories recognised as an expense includes RUB 4,659 million (2016: RUB 3,423 million) in respect of write-downs of inventory to net realisable value, construction contracts value write-down in amount of RUB 5,262 million (2016: RUB 350 million) and such costs have been reduced by RUB 509 million (2016: RUB 611 million) in respect of the reversal of such write-downs.

23. ACCOUNTS RECEIVABLE

Accounts receivable include amounts owed by the customers to the Group.

Accounts receivable are stated at their net realizable value after deducting a provision for doubtful accounts. Such provision reflects either specific cases of delinquencies or defaults or estimates based on evidence of collectability.

Accounts receivable, net of provision for doubtful accounts, as of 31 December 2017 and 2016 consisted of the following:

	2017	2016
Accounts receivable	60,018	69,579
Allowance for doubtful accounts	(5,182)	(8,691)
Total	**54,836**	**60,888**

Below is the age analysis of receivables that are past due but not impaired:

	2017	2016
60-90 days	3,334	3,621
more than 90 days	2,201	2,480
Total	**5,535**	**6,101**

Movement in the allowance for doubtful accounts is as follows:

	2,017	2,016
Balance at the beginning of the year	(8,691)	(9,997)
Allowance for doubtful accounts	(3,748)	(3,303)
Amounts written off during the year as uncollectible	6,433	3,421
Disposal of subsidiaries	717	343
Currency translation gains/(losses)	107	845
Balance at the end of the year	**(5,182)**	**(8,691)**

(Amounts in millions of Russian Rubles, unless otherwise stated)

24. EQUITY

Share capital – As of 31 December 2017 and 2016, the Company had 9,650,000,000 voting common shares with a par value of RUB 0.09 issued, of which 9,437,514,653 and 9,397,374,298 shares were outstanding, respectively.

Treasury shares – Movement of treasury shares during 2017 and 2016 years was as follows:

	2017	2016
Balance at the beginning of the year, number of shares	252,625,702	165,360,565
Purchase of own shares, number of shares	72,823,265	98,250,000
Purchase of own shares of the Company by empoyees, number of shares	(5,536,162)	-
Settlements under long-term motivation program, number of shares	(107,427,458)	(10,984,863)
Balance at the end of the year, of number shares	**212,485,347**	**252,625,702**

Dividends – Dividends declared to the holders of the Company's ordinary shares are included in the financial statements in the period in which the dividends are approved for distribution by the shareholders.

On 24 June 2017, an annual general meeting of shareholders approved the total dividend payment of RUB 7,817 million for 2016 (including dividends on treasury shares of RUB 183 million), representing RUB 0.81 per ordinary share or RUB 16.2 per GDR.

On 28 November 2017, an extraordinary general meeting of shareholders approved an interim dividend payment of RUB 6,562 million for the first nine months of 2017 (including dividends on treasury shares of RUB 134 million), representing RUB 0.68 per ordinary share or RUB 13.6 per GDR.

25. ACCUMULATED OTHER COMPREHENSIVE INCOME

Components of accumulated other comprehensive income balance, net of taxes of nil, as of 31 December 2017 and 2016:

	2017	2016
Accumulated currency translation loss	(7,842)	(21,745)
Unrealised gain/(loss) on financial instruments	5,195	(153)
Unrecognised actuarial loss	(75)	(34)
Total accumulated other comprehensive loss	**(2,722)**	**(21,932)**
Less: amounts attributable to non-controlling interests	5,054	8,180
Total accumulated other comprehensive income/(loss) attributable to Sistema PJSFC	**2,332**	**(13,752)**

26. BORROWINGS

The Group's borrowings primarily comprise bank loans and corporate bonds. The Group enters into variable-to-fixed interest rate swap agreements to manage exposure to changes in variable interest rates related to a portion of its obligations, as well as into cross-currency interest-rate swap agreements to mitigate the impact of both, interest rate and exchange rate fluctuations, for a certain portion of its USD- and EUR- denominated borrowings.

Borrowings are initially recognised at fair value less transaction costs and subsequently measured at amortised cost using the effective interest method.

Finance costs in profit or loss consist of interest expense for financial liabilities not classified as at FVTPL. In 2017, finance costs did not include borrowing costs that were included in the cost of qualifying assets in amount of RUB 307 million (2016: RUB 388 million).

(Amounts in millions of Russian Rubles, unless otherwise stated)

At 31 December 2017 and 2016, the Group's borrowings comprised:

	2017	2016
Bank loans	336,582	323,838
Corporate bonds	183,476	138,301
Finance lease obligations	14,855	14,361
Other	906	1,626
	535,819	**478,126**
Current	142,168	83,109
Non-current	393,651	395,017

Bank loans – As of 31 December 2017 and 2016, the Group's loans from banks and financial institutions consisted of the following:

	Maturity	Interest rate (actual at 31 December 2017)	31 December 2017	31 December 2016
USD-denominated:				
Calyon, ING Bank N.V, Nordea Bank AB, Raiffeisen Zentralbank Osterreich AG	2018-2020	LIBOR + 1.15% (2.994%)	17,076	25,394
Citibank	2018-2024	LIBOR + 0.9% (2.744%)	10,592	12,812
China Development Bank	2018-2021	LIBOR 6m+3.15%; 1.92%	8,640	9,099
Other			4,996	4,486
			41,304	**51,791**
EUR-denominated:				
ING Bank	2018-2021	4.30%	25,040	9,190
Other			1,284	1,699
			26,324	**10,889**
RUB-denominated:				
Sberbank	2018-2023	8.45%-16.60%	188,222	180,161
VTB	2018-2022	7.99%-12.35%; CBR+2.50%-4.80% (10.25% - 12.55%)	37,733	37,943
Gazprombank	2018-2022	8.9%-10.0%	21,021	4,819
Alfa Bank	2018-2023	8.7%-11.8%	15,501	10,210
Expobank	2017	14.00%-14.50%	-	3,000
Other			5,918	20,451
			268,395	**256,584**
Other currencies			559	4,574
Total bank loans			**336,582**	**323,838**

(Amounts in millions of Russian Rubles, unless otherwise stated)

Corporate notes – As of 31 December 2017 and 2016, the Group's notes consisted of the following:

	Currency	Interest rate	31 December 2017	31 December 2016
MTS International Notes due 2023	USD	5.00%	26,188	28,217
Sistema International Notes due 2019	USD	6.95%	23,441	25,067
MTS International Notes due 2020	USD	8.63%	17,621	18,537
Sistema PJSFC Bonds due 2027	RUB	8.90%	15,000	-
Sistema PJSFC Bonds due 2018	RUB	12.70%	10,000	10,000
Sistema PJSFC Bonds due November 2026	RUB	9.90%	9,953	9,949
Sistema PJSFC Bonds due September 2025	RUB	12.50%	5,000	5,000
Sistema PJSFC Bonds due October 2026	RUB	9.80%	4,536	6,200
Sistema PJSFC Bonds due October 2025	RUB	10.90%	1,700	1,700
MTS Notes due 2022	RUB	7.70%	14,947	-
MTS Notes due 2023	RUB	8.25%	9,997	9,984
MTS Notes due 2031	RUB	9.40%	9,995	9,986
MTS Notes due 2022	RUB	9.00%	9,991	-
MTS Notes due 2018	RUB	7.70%	9,986	-
MTS Notes due 2021	RUB	8.85%	9,986	-
MTS Notes due 2020	RUB	9.25%	49	1,448
MTS Notes due 2017	RUB	8.70%	-	9,995
Detsky mir Notes due 2024	RUB	9.50%	3,000	-
Other			2,086	2,218
Total notes			**183,476**	**138,301**

The Group has an unconditional obligation to repurchase certain notes at par value if claimed by the noteholders subsequent to the announcement of the sequential coupon. Such notes are disclosed maturing in the reporting period when the demand for repurchase could be submitted, irrespective of the Group's expectations about the intentions of the noteholders. The dates of the announcement for each particular note issue are as follows:

MTS Notes due 2020	November 2018
MTS Notes due 2023	March 2018
MTS Notes due 2031	August 2018
Sistema PJSFC Bonds due September 2025	October 2018
Sistema PJSFC Bonds due October 2025	November 2019
Sistema PJSFC Bonds due November 2027	February 2020
Sistema PJSFC Bonds due October 2026	November 2020
Sistema PJSFC Bonds due 2027	April 2022

Covenants – Loans and notes payable by the Group are subject to various restrictive covenants and events of default, which permit lenders to demand accelerated repayment of debt. Such covenants and events include non-compliance with certain financial ratios, cancellation of principal telecom licenses, significant court rulings, encumbrances and confiscation of certain assets and other material adverse changes.

(Amounts in millions of Russian Rubles, unless otherwise stated)

As of 31 December 2017 the Group had long-term debt denominated in Russian rubles, presented as part of current liabilities in the consolidated statement of financial position for the following reasons:

	2017	2016
Ongoing arrest of shares of the Group's shares of subsidiaries (Note 5)	9,703	-
Noncompliance with other non-financial covenants	16,957	-
Noncompliance with certain financial ratios by the Group's subsidiaries	382	2,404
Total	**27,042**	**2,404**

To the date when these consolidated financial statements were authorized for issue, the lenders have not exercised their rights for early redemption.

Assets pledged as security – As of 31 December 2017 and 2016 land and buildings with carrying amounts of RUB 31,358 million and RUB 34,746 million, respectively, have been pledged to secure borrowings of the Group. The freehold land and buildings have been pledged as security for bank loans under a mortgage. The Group is not allowed to pledge these assets as security for other borrowings or to sell them to another entity. As of 31 December 2017 and 2016, other assets including inventories and deposits with carrying amounts of RUB 3,877 million and RUB 4,200 million respectively have been pledged to secure borrowings of the Group. 87% shares of RTI have been pledged to secure borrowings of the Group.

In addition, the Group's obligations under finance leases as of 31 December 2017 and 2016 are secured by the lessors' title to the leased assets, which have a carrying amount of RUB 11,726 million and RUB 10,785 million, respectively.

27. BANK DEPOSITS AND LIABILITIES

Liabilities of MTS Bank and East-West United Bank primarily consist of customer accounts and deposits. These liabilities are initially measured at fair value, net of transaction costs. Liabilities are subsequently measured at amortised cost using the effective interest method and classified based on their contractual maturity.

Bank deposits and liabilities as of 31 December 2017 and 2016 consisted of the following:

	2017	2016
Customer accounts	115,105	100,974
Debt securities issued	2,074	2,030
Other liabilities	113	3,316
	117,292	**106,320**
Less: amounts maturing within one year	(83,873)	(99,888)
Total bank deposits and liabilities, net of the current portion	**33,419**	**6,432**

(Amounts in millions of Russian Rubles, unless otherwise stated)

28. OTHER FINANCIAL LIABILITIES

Other financial liabilities as of 31 December 2017 and 2016 consisted of the following:

	2017	2016
Payable for RTI shares (Note 9)	3,489	2,975
SSTL liabilities to non-controlling shareholders (Note 6)	2,348	-
MTS liabilities under put option agreements (MTS Armenia)	2,012	2,243
Interest rate and cross-currency swaps not designated as hedging instruments	1,104	1,734
Credit guarantee agreement related to foreign currency hedge	1,045	2,907
MTS liabilities related to hedging activities	664	531
Liabilities for change of the permitted use of the parcel of land for the purposes of construction of residential real estate.	726	-
SSTL payable for 800 MHz spectrum (Note 6)	-	19,126
Liabilities to Rosnano for Mikron's shares (Note 29)	-	3,300
Other	1,185	683
Non-current	6,514	25,580
Current	6,059	7,919
Total other financial liabilities	**12,573**	**33,499**

29. PROVISIONS

Provisions primarily consist of provisions related to employees' bonuses and other rewards, decommissioning and restoration obligations. The provision for employee benefits represents annual compensation and share-based compensation.

Provisions are recognised when the Group has a present obligation (legal or constructive) as a result of past event, it is probable that the Group will be required to settle that obligation and a reliable estimate can be made of the amount of obligation. Provisions are measured at the management's best estimate of the expenditure required to settle the obligation at the reporting date and are discounted to present value where the effect is material.

Provisions as of 31 December 2017 and 2016 consisted of the following:

	2017	2016
Employees' bonuses and other rewards	11,924	10,348
Provisions for decomissioning	1,049	1,192
Tax provisions other than for income tax	310	457
Other	3,154	2,166
Total	**16,437**	**14,163**
Current	13,038	10,752
Non-current	3,399	3,411

(Amounts in millions of Russian Rubles, unless otherwise stated)

	Employees' bonuses and other rewards	Provisions for decomis-sioning	Tax provisions other than income tax	Other	Total
Balance at 1 January 2016	**(9,920)**	**(1,459)**	**(525)**	**(2,437)**	**(14,341)**
Additional provisions recognized	(16,169)	(1)	(1,055)	(1,330)	(18,555)
Payments	14,408	-	374	764	15,546
Unwinding of discount and effect of changes in the discount rate	(12)	(142)	-	-	(154)
Unused amounts reversed	1,102	393	739	462	2,696
Disposed	91	-	-	375	466
Currency translation adjustment	152	17	10	-	179
Balance at 31 December 2016	**(10,348)**	**(1,192)**	**(457)**	**(2,166)**	**(14,163)**
Additional provisions recognized	(15,776)	(108)	(229)	(1,930)	(18,043)
Payments	12,769	5	342	694	13,810
Unwinding of discount and effect of changes in the discount rate	49	(103)	-	-	- - (54)
Unused amounts reversed	1,283	339	33	325	1,980
Currency translation adjustment	99	10	1	(77)	33
Balance at 31 December 2017	**(11,924)**	**(1,049)**	**(310)**	**(3,154)**	**(16,437)**

30. EARNINGS/(LOSSES) PER SHARE

Earnings per share is the amount of profit for the year attributable to ordinary shares of the Company divided by the weighted average number of ordinary shares outstanding during the year.

The losses and weighted average number of ordinary shares used in the calculation of basic and diluted earnings per share are as follows:

	2017	2016
Loss for the year from discontinued operations attributable to shareholders of Sistema PJSFC	(3,260)	(11,470)
Loss for the year from continuing operations attributable to shareholders of Sistema PJSFC	(91,343)	(288)
(Losses) used in the calculation of basic and diluted earnings per share	**(94,603)**	**(11,758)**
Weighted average number of ordinary shares for the purposes of basic and diluted earnings per share	9,448,453,265	9,439,069,910
(Losses) per share – basic and diluted in RUR	**(10.01)**	**(1.25)**
From continuing operations	(9.67)	(0.03)
From discontinued operations	(0.34)	(1.22)

(Amounts in millions of Russian Rubles, unless otherwise stated)

The following potential ordinary shares and the impact of the related expense are together anti-dilutive and are therefore excluded from the weighted average number of ordinary shares for the purpose of calculation of diluted earnings per share:

	2017	**2016**
Share options granted under the Company's employee share option plan	81,183,545	102,204,780

31. CAPITAL AND FINANCIAL RISK MANAGEMENT

Capital risk management – The Group manages its capital to ensure that entities of the Group will be able to continue as a going concern while maximising the return to the shareholders through the optimisation of the debt and equity balance.

The capital structure of the Group consists of net borrowings (borrowings offset by cash and cash equivalents) and equity of the Group.

The Group's policy is to maintain a strong capital base so as to maintain investor, creditor and market confidence and to sustain future development of the business. The Group manages its capital structure and makes adjustments to it, in light of changes in economic conditions. The Group may sell assets to reduce debt, maintain or adjust the capital structure.

The Board of Directors monitors the net borrowings to OIBDA ratio. Since these are not IFRS measures, the Group's definition of OIBDA and net borrowings may differ from that of other companies. The Group's net borrowings to OIBDA ratio was as follows:

	2017	**2016**
Net borrowings	475,860	417,936
OIBDA	187,381	177,856
Net borrowings to OIBDA ratio	**2.54**	**2.35**

The Group is subject to certain externally imposed capital requirements and restrictions that are incorporated into the management of capital:

MTS Bank – The CBR requires that banks comply with the minimum capital adequacy ratio of 8% calculated on the basis of statutory standalone financial statements. MTS Bank met the requirements established by the CBR. As of 31 December 2017 and 2016, MTS Bank's capital adequacy ratio was 14.54% and 21.3%, respectively.

Limitations on cash distribution – There were certain limitations on cash distribution in Ukraine (Note 38) and India as of 31 December 2017. Cash balances in Ukraine and India were as follows:

	2017	**2016**
Ukraine	1,330	3,142
India	147	1,145

Financial risk management objectives – The Board of Directors has overall responsibility for the establishment and ongoing management of the Group's risk management framework and the implementation and operation of the Board's policies are handled by the Management Board.

The Management Board monitors and manages the financial risks relating to the operations of the Group through internal risk reports which analyse exposures by degree and magnitude of risks. These risks include market risk (including foreign currency risk, interest rate risk and other price risk), liquidity risk and credit risk.

(Amounts in millions of Russian Rubles, unless otherwise stated)

Foreign currency risk – Foreign currency risk is the risk that the financial results of the Group will be adversely impacted by changes in exchange rates to which the Group is exposed. The Group undertakes certain transactions denominated in foreign currencies and is primarily exposed to the US Dollar and Euro.

The Group manages its net exposure to foreign exchange risk by balancing both financial assets and financial liabilities denominated in Russian Ruble, US Dollar and Euro and by conducting certain hedging activities (Note 32).

The carrying amounts of the Group's foreign currency denominated monetary assets and monetary liabilities (excluding hedged items) at the year end are as follows.

	Liabilities		Assets	
	2017	**2016**	**2017**	**2016**
US Dollar	181,508	198,930	85,254	77,349
Euro	31,969	24,529	22,074	35,542

The table below details the Group's sensitivity to the strengthening of the US Dollar and Euro against the Russian Ruble by 20%. This analysis assumes that all other variables, in particular interest rates, remain constant. This analysis is based on foreign currency exchange rate variances that the Group considered to be reasonably possible at the end of the reporting period. The analysis was applied to monetary items at the year end denominated in the respective currencies.

	31 December 2017	**31 December 2016**
Profit or loss before tax	17,815	17,035

The effect of a corresponding strengthening of the Russian Ruble against the US Dollar and Euro is equal and opposite.

Interest rate risk – Interest rate risk arises from the possibility that changes in interest rates will affect finance costs. The Group is exposed to interest rate risk because entities in the Group borrow funds at both fixed and floating interest rates. The risk is managed by the Group by maintaining an appropriate mix between fixed and floating rate borrowings and by conducting certain hedging activities (Note 32).

The table below details the Group's annualised sensitivity to a change of floating LIBOR rate by 1% which would impact its operations. The analysis was applied to borrowings (excluding hedged items) based on the assumption that amount of the liability outstanding at the date of statements of financial position was outstanding for the whole period.

	2017	**2016**
Profit or loss before tax	192	231

Fixed rate loan agreements often stipulate creditor's right to increase interest rates under certain circumstances, including increase of the key rate of the Central Bank of Russia. Therefore, in addition to the effect from changes in floating interest rates, the Group is also exposed to interest rate risk arising from these agreements.

Other price risks – Price risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices. These changes may be caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market.
The sensitivity analysis below has been determined based on the exposure to price risks at the end of the reporting period. Sensitivity analysis was prepared on pre-tax basis.

(Amounts in millions of Russian Rubles, unless otherwise stated)

If prices of securities as of the year end had been 10% higher/lower:

	31 December 2017	31 December 2016
Profit before tax increase/decrease	3,741	3,094
OCI increase/decrease	2,253	817

Liquidity risk – Liquidity risk is the risk that the Group will not be able to settle all its liabilities as they fall due.

The Group's liquidity position is monitored and managed at the level of operating segments. The Group manages liquidity risk by continuously monitoring forecasted and actual cash flows, by matching the maturity profiles of financial assets and liabilities and by maintaining available credit facilities.

At 31 December 2017, the schedule of repayments of undiscounted financial liabilities of the Group for the next five years and thereafter was as follows:

	<1 year	1-2 years	2-3 years	3-4 years	4-5 years	5+ years
Borrowings	142,168	132,171	124,584	51,748	47,996	37,152
Liabilitiy under the Settlement Agreements	80,000	-	-	-	-	-
Accounts payable	114,402	-	-	-	-	-
Bank deposits and liabilities	83,873	15,162	3,249	2,166	1,083	11,759
Liability to Rosimushchestvo	9,601	6,714	6,713	-	-	-
Other financial liabilities	6,059	5,091	363	-	-	1,060
Total financial liabilities	**436,103**	**159,138**	**134,909**	**53,914**	**49,079**	**49,971**

At 31 December 2017, the schedule of repayments of undiscounted financial liabilities of the Corporate segment for the next five years and thereafter was as follows:

	<1 year	1-2 years	2-3 years	3-4 years	4-5 years	5+ years
Borrowings	30,342	39,143	39,489	-	15,000	-
Liabilitiy under the Settlement Agreements	80,000					
Accounts payable	4,735	-	-	-	-	-
Liability to Rosimushchestvo	9,601	6,714	6,713	-	-	-
Other financial liabilities	-	3,489	-	-	-	1,060
Total financial liabilities	**124,678**	**49,346**	**46,202**	**-**	**15,000**	**1,060**

For day to day liquidity requirements the Group had unused credit facilities of RUB 136,674 million as of 31 December 2017, including RUB 66,520 million related to Corporate segment.

Credit risk – Credit risk refers to the risk that a counterparty will default on its contractual obligations resulting in a financial loss to the Group. The Group is exposed to credit risks on cash and cash equivalents, deposits, derivatives and certain other financial instruments with financial institutions, loans and receivables carried at amortised cost and debt securities.

Financial assets with financial institutions – The Group maintains mixture of cash and cash equivalents, deposits, derivatives and certain other financial instruments with financial institutions. These financial institutions are located in different geographical regions and the Group's policy is designed to limit exposure to any one institution. As part of its risk management processes, the Group performs periodic evaluations of the relative credit standing of the financial institutions.

(Amounts in millions of Russian Rubles, unless otherwise stated)

As of 31 December 2017 the Group has a significant balances according to settlements with the following financial institutions:

	2017	2016
Sberbank	27,712	31,619
The Central bank of Luxemburg	18,416	9,356
The Central bank the Russian Federation	9,908	3,157
Total	**56,036**	**44,132**

Bank loans to customers and interbank loans due from banks – MTS Bank performs daily monitoring of future expected cash flows on clients' and banking operations, which is a part of assets/liabilities management process. The credit risk exposure is monitored on a regular basis to ensure that the credit limits and credit worthiness guidelines established by the MTS Bank's risk management policy are not breached. The Group structures the levels of credit risk it undertakes by placing limits on the amount of risk accepted in relation to one borrower, or group of borrowers, and to geographical segments.

Other loans and receivables carried at amortised cost – Concentrations of credit risk with respect to loans and trade receivables are limited given that the Group's customer base is large and unrelated. Management believes there is no further credit risk provision required in excess of the normal provision for bad and doubtful receivables.

32. HEDGING ACTIVITIES

The Group uses derivative instruments, including interest rate and foreign currency swaps, to manage foreign currency and interest rate risk exposures. The Group measures derivatives at fair value and recognizes them either other current or other non-current financial assets or liabilities in the consolidated statement of financial position. Cash flows from derivatives are classified according to their nature. The Group reviews related fair value hierarchy classifications on a quarterly basis. The fair value measurement of the Group's derivative instruments is based on the observable yield curves for similar instruments.

The Group designates derivatives as either fair value hedges or cash flow hedges in case the required criteria are met.

Fair value hedges – Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recognized in profit or loss immediately together with any changes in the fair value of the hedged asset or liability that is attributed to the hedged risk.

Cash flow hedges – The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognized in other comprehensive income.

The gain or loss relating to the ineffective portion is recognized immediately in profit or loss. Gains or losses accumulated in other comprehensive income are immediately reclassified into consolidated statement of profit and loss when related hedged transactions affect earnings.

For derivatives that do not meet the conditions for hedge accounting, gains and losses from changes in the fair value are recorded immediately in profit or loss.
Assets and liabilities related to multiple derivative contracts with one counterparty are not offset by the Group.

Cross-currency interest rate swap agreements – The Group has entered into several cross-currency swap agreements. The contracts are designated to manage the exposure to changes in currency exchange rate. The contracts assumed periodic exchange of principal and interest payments from RUB-denominated amounts to USD- and EUR- denominated amounts at a specified rate. The rate was determined by the market spot rate upon issuance. Cross-currency interest rate swap contracts mature in 2019-2020.

In aggregate the Group entered into cross-currency interest rate swap agreements designated to manage the exposure to changes in currency exchange rate for 21% of the Group's bank loans denominated in USD and EUR outstanding as of 31 December 2017 (2016: 19%).

(Amounts in millions of Russian Rubles, unless otherwise stated)

The notional amounts related to currency derivative instruments amounted to RUB 28,669 million (USD 497 million) and RUB 25,885 million (USD 421 million and EUR 5 million) as of 31 December 2017 and 2016, respectively.

Variable-to-fixed interest rate swap agreements – The Group's bank loans denominated in USD and EUR bear primarily floating interest rates. To eliminate the exposure to changes in variable interest rates related to its debt obligations, the Group enters into variable-to-fixed interest rate swap agreements, so that interest rate swap matches the exact maturity dates of the underlying debt allowing for highly-effective cash flow hedges. In aggregate, the Group entered into variable-to-fixed interest rate swap agreements designated to manage the exposure of changes in variable interest rates related to 42% of the Group's bank loans with variable rates outstanding as of 31 December 2017 (2016: 21%).

Fixed-to-variable interest rate swap agreements – The Group's notes and bank loans denominated in Russian Rubles bear primarily fixed interest rates. To eliminate the exposure to changes in fair value of debt obligations, the Group enters into fixed-to-variable interest rate swap agreements. In aggregate the Group entered into fixed-to-variable interest rate swap agreements designated to manage the exposure to changes in value of the debt related to 5% of the Group's notes and bank loans with fixed rates outstanding as of 31 December 2017 (2016: 7%).

The notional amounts related to interest rate derivative instruments amounted to RUB 49,429 million and RUB 49,451 million as of 31 December 2017 and 2016, respectively.

33. FAIR VALUES

The following fair value hierarchy table presents information regarding Group's financial assets and liabilities measured at fair value on a recurring basis at 31 December 2017 and 2016. Fair value measurements are categorised into Level 1, 2 or 3 based on the degree to which the inputs to the fair value measurements are observable and the significance of the inputs to the fair value measurement in its entirety. Level 1 classification comprises financial instruments where fair value is determined by unadjusted quoted prices in active markets for identical assets or liabilities that the Group can access at the measurement date; Level 2 – from inputs, other than quoted prices included within Level 1, that are observable for the asset or liability, either directly or indirectly; Level 3 – from unobservable inputs.

	31 December 2017				31 December 2016			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets								
Financial assets at FVTPL	37,414	-	-	37,414	30,935	-	-	30,935
AFS securities	18,167	-	9,996	28,163	8,166	-	8,294	16,460
Hedging instruments at fair value	-	8,403	-	8,403	-	13,632	-	13,632
	55,581	**8,403**	**9,996**	**73,980**	**39,101**	**13,632**	**8,294**	**61,027**
Financial liabilities								
Derivative instruments	-	(1,766)	-	(1,766)	-	(2,407)	-	(2,407)
Contingent consideration	-	-	(180)	(180)	-	-	(3)	(3)
Liabilities under put option agreements	-	-	(2,424)	(2,424)	-	-	(2,243)	(2,243)
SSTL liabilities for RCOM shares	(2,348)	-	-	(2,348)	-	-	-	-
	(2,348)	**(1,766)**	**(2,604)**	**(6,718)**	**-**	**(2,407)**	**(2,246)**	**(4,653)**

The fair value of financial assets and liabilities categorised into Level 3 is primarily measured using the discounted cash flows technique. The unobservable inputs to the models include assumptions regarding the future financial performance of the investee, its risk profile, and economic assumptions regarding the industry and jurisdiction in which the investee operates.

(Amounts in millions of Russian Rubles, unless otherwise stated)

There were no changes made during the year to valuation methods or the processes to determine classification and no transfers were made between the levels in the fair value hierarchy. The carrying value of the Group's financial instruments accounted for at amortised cost approximates their fair value due to their short-term nature and market interest rates, except for borrowings and bank deposits and liabilities as disclosed in the table below:

	31 December 2017		31 December 2016	
	Carrying value	**Fair value**	**Carrying value**	**Fair value**
Financial assets				
HTM financial assets	27,346	27,328	17,163	17,091
Financial liabilities				
Borrowings	535,819	540,255	478,126	483,858
Bank deposits and liabilities	117,292	117,353	106,320	106,276

The table below presents information regarding reconciliation of Level 3 fair value measurements as of 31 December 2017 and 2016.

	Liabilities under put option agreements	**AFS securities**	**Contingent consideration**	**Total**
Balance at 1 January 2016	**(2,925)**	**1,643**	**(115)**	**(1,397)**
Total gains/(losses):				
- in profit or loss	199	-	-	199
- in other comprehensive income	483	-	-	483
Purchases	-	6,651	112	6,763
Balance at 31 December 2016	**(2,243)**	**8,294**	**(3)**	**6,048**
Total gains/(losses):				
- in profit or loss	120	-	-	120
- in other comprehensive income	111	1,008	-	1,119
Purchases	(412)	694	(177)	105
Balance at 31 December 2017	**(2,424)**	**9,996**	**(180)**	**7,392**

No unrealized gains or losses of Level 3 liabilities as a result of fair value measurements were recognized during the years ended 31 December, 2017 and 2016.

34. RELATED PARTY TRANSACTIONS

The Group has a number of related parties including its controlling shareholder and entities under common control, associates and joint ventures, and key management personnel.

Trading transactions – The Group's trading transactions with related parties that are not members of the Group comprise sales and purchases of goods and services in the normal course of business. During the year ended 31 December 2017, sales to related parties comprised RUB 651 million (2016: RUB 638 million), purchases from related parties comprised RUB 273 million (2016: RUB 2,741 million). As of 31 December 2017, advances paid to, trade balances receivable from and payable to related parties comprised RUB 1,257 million, RUB 5,227 million and RUB 1,464 million, respectively (31 December 2016: RUB 1,838 million, RUB 3,627 million and RUB 1,199 million).

(Amounts in millions of Russian Rubles, unless otherwise stated)

Financial transactions – The Group's financial transactions with related parties primarily comprise loans, deposits and other debt instruments issued to or by the Group entities. At 31 December 2017 and 2016, amounts owed by or to related parties under such arrangements are as follows:

	Amounts owed by related parties		Amounts owed to related parties	
	31 December 2017	31 December 2016	31 December 2017	31 December 2016
Controlling shareholder and entities under common control	3,783	2,936	33,442	37,034
Key management personnel	-	-	3,095	2,868
Other related parties	-	-	1,322	1,169

Finance costs related to such transactions with related parties and recognized in the consolidated statement of profit or loss in 2017 amounted to RUB 2,222 million (2016: RUB 3,199 million).

Compensation of key management personnel – In 2017 and 2016, the aggregate compensation for key management personnel, being the members of the Company's Board of Directors and Management Board and the independent directors was as follows:

	2017	2016
Short-term benefits	2,096	4,026
Share-based payments	737	1,100
Total	**2,833**	**5,126**

35. SUBSIDIARIES

Details of the Group's most material direct subsidiaries at the end of the year are as follows:

Significant entities	Short name	Principal activity	Beneficial ownership as of 31 December 2017	2016
Mobile TeleSystems PJSC (Note 9)	MTS	Telecommunications	50.25%	50.03%
Sistema Shyam TeleServices Limited	SSTL	Telecommunications	56.68%	56.68%
MTS Bank PJSC	MTS Bank	Banking	86.66%	86.66%
RTI JSC (Note 9)	RTI	Technology	87.00%	87.00%
Detsky mir PJSC	Detsky mir	Retail trading	52.10%	72.63%
Medsi Group JSC	Medsi	Healthcare services	100%	100%
Bashkirian Power Grid Company JSC (1)	BPGC	Energy transmission	90.96%	90.96%
Segezha Group LLC	Segezha Group	Pulp and paper	100%	100%
Leader-Invest JSC	Leader-Invest	Real estate	100%	100%
Agroholding Steppe JSC (Note 9)	Steppe	Agriculture	90.50%	88%

(1) Voting interests as of 31 December 2017 and 2016 – 93%.

The table below shows details of non-wholly owned subsidiaries of the Group that have material non-controlling interests:

Name of subsidiary	Principal place of business	Profit / (loss) allocated to non-controlling interests 2017	2016	Accumulated non-controlling interests 2017	2016
MTS	Russia	28,004	23,097	57,880	67,301
SSTL	India	(1,736)	(1,791)	-	(28,953)

The difference between the accumulated non-controlling interests of SSTL and the net assets of SSTL multiplied by the beneficial ownership as of 31 December, 2017 is due to the following factors:

- 17.14% of the SSTL loss is allocated to the owners of the Company because this share is owned by the Federal Agency for State Property Management (Rosimushchestvo) and an agreement was reached with Rosimushchestvo in 2016. According to this agreement, after the liability is repaid in full, the Group will acquire 17.14% of SSTL. The liability is repayable in installments between 2016 and 2020. The Group reflects this liability in separate lines of the consolidated statement of financial position as at 31 December 2017, reflecting the current and non-current portions.
- 26.28% of the SSTL loss is allocated to the owners of the Company because this share is owned by other non-controlling shareholders and they have the right to exchange their shares of SSTL for shares of RCOM as a result of the deal with RCOM (Note 6).

Summarised financial information in respect of each of the Group's subsidiaries that has material non-controlling interests is set out below. The summarised financial information below represents amounts before intragroup eliminations. The consolidated financial information presented below is indicative of pre-exclusion of intra-group transactions. The consolidated financial information for SSTL for the year 2017 is not provided, because as of 31 December 2017, the accumulated non-controlling interests of SSTL equal zero.

(Amounts in millions of Russian Rubles, unless otherwise stated)

	2017	2016	
	MTS	MTS	SSTL
Current assets	146,032	90,188	4,425
Non-current assets	405,038	453,413	20,303
Total assets	**551,070**	**543,601**	**24,728**
Current liabilities	156,671	126,584	14,673
Non-current liabilities	270,194	274,034	29,830
Total liabilities	**426,865**	**400,618**	**44,503**
Equity attributable to shareholders of Sistema	62,246	70,968	(9,178)
Non-controlling interests	61,959	72,014	(28,953)
Revenue	442,910	435,692	12,466
Expenses	(386,320)	(387,242)	(19,268)
Profit/ (loss) for the year	**56,590**	**48,450**	**(6,802)**
Profit/(loss) attributable to shareholders of Sistema	28,586	25,353	(5,012)
Profit/(loss) attributable to the non-controlling interests	28,004	23,097	(1,791)
Other comprehensive (loss)/income attributable to shareholders of Sistema	(1,413)	(8,861)	5,356
Other comprehensive (loss)/income attributable to the non-controlling interests	(1,413)	(8,946)	1,913
Other comprehensive (loss)/income for the year	**(2,826)**	**(17,807)**	**7,269**
Total comprehensive income attributable to shareholders of Sistema	27,173	16,492	344
Total comprehensive income attributable to the non-controlling interests	26,592	14,151	123
Total comprehensive income for the year	**53,765**	**30,643**	**467**
Dividends paid to non-controlling interests	26,584	25,415	-
Net cash inflow/(outflow) from operating activities	144,640	130,565	(8,947)
Net cash outflow from investing activities	(81,510)	(57,302)	(137)
Net cash (outflow)/inflow from financing activities	(50,445)	(83,038)	7,165
Net cash inflow/(outflow)	**12,685**	**(9,775)**	**(1,919)**

(Amounts in millions of Russian Rubles, unless otherwise stated)

36. NON-CASH TRANSACTIONS

The Group entered into the following non-cash investing and financing activities which are not reflected in the consolidated statements of cash flows:

	2017	2016
Equipment and licenses acquired under capital leases	2,628	505
Change in amounts payable for capital expenditures	2,715	(15,285)
Payables related to business acquisitions	270	501
Payables related to purchases of non-controlling interests in subsidiaries	-	6,186

37. RECONCILIATION OF LIABILITIES ARISING FROM FINANCING ACTIVITIES

	1 January 2017	Cash flows from financial activities	Non-cash changes					31 December 2017
			Disposal of subsidiaries (Note 6)	New financial lease arrangements	Currency exchange	Changes of the share capital	Other changes	
Borrowings	478,126	65,488	(5,107)	2,628	(4,880)	(11)	(425)	535,819
Capital transactions of subsidiaries	-	(33)	-	-	-	3,499	(3,466)	-
Operations with own shares	-	(1,481)	-	-	-	1,481	-	-
Liability to Rosimushchestvo	33,065	(8,532)	-	-	(1,446)	-	(59)	23,028
Dividends payable	249	(38,792)	-	-	-	43,121	-	4,578
Other financial liabilities	33,499	(4,320)	(19,840)	-	(308)	-	3,542	12,573
Total	**544,939**	**12,330**	**(24,947)**	**2,628**	**(6,634)**	**48,090**	**(408)**	**575,998**

38. CONTINGENCIES AND COMMITMENTS

In addition to contingencies described in Note 7, the Group has the following contingencies and commitments.

Capital commitments – A capital commitment is a contractual obligation to make payment in the future, mainly in relation to buy assets such as network infrastructure. These amounts are not recorded in the consolidated statement of financial position since the Group has not yet received goods or services from suppliers. At 31 December 2017, the Group had capital commitments of RUB 42,323 million (31 December 2016: RUB 45,017 million) relating to the acquisitions of property, plant and equipment.

Operating lease commitments – The Group enters into various agreements to lease space for telecommunications equipment, transmission channels, mobile towers, retail outlets and offices. The leases have various terms and renewal rights, none of which is individually significant to the Group. Future minimum lease payments under non-cancellable operating leases comprise:

Payments due in	
2018	20,141
2019	13,193
2020	12,578
2021	12,290
2022	12,246
Thereafter	18,227
Total	**88,675**

Commitments on loans and unused credit facilities – As of 31 December 2017, MTS Bank and East-West United Bank had RUB 16,051 million of commitments on loans and unused credit facilities available to its customers (31 December 2016: RUB 6,891 million).

Guarantees – At 31 December 2017, MTS Bank and East-West United Bank guaranteed loans for several companies which totalled RUB 5,580 million (31 December 2016: RUB 3,921 million), including related parties of RUB 1,113 million (31 December 2016: RUB 234 million). These guarantees would require payment by the Group in the event of default on payment by the respective debtor. Such guarantee contracts issued by the Group are initially measured at their fair values and are subsequently measured at the higher of the amount of the obligation under the contract, as determined in accordance with IAS 37, and the amount initially recognised less, where appropriate, cumulative amortisation recognised in accordance with the revenue recognition policies.

Telecommunication licenses – In 2012, the Federal Service for Supervision in the Area of Communications, Information Technologies and Mass Media allocated MTS the necessary license and frequencies to provide LTE telecommunication services in Russia. Under the terms and conditions of the LTE license, MTS is obligated to fully deploy LTE networks within seven years, commencing from 1 January 2013, and deliver LTE services in each population center with over 50,000 inhabitants in Russia by 2019. Also, MTS is obligated to invest at least RUB 15 billion annually toward the LTE roll-out until the network is fully deployed.

In May 2007, the Federal Service for Supervision in the Area of Communications, Information Technologies and Mass Media awarded MTS a license to provide 3G services in Russia. The 3G license was granted subject to certain capital and other commitments.

In March 2015, upon winning a tender, CJSC "VF Ukraine", a subsidiary of MTS, has acquired a nationwide license for the provision of UMTS (3G) telecommunications services. The license with the cost of UAH 2,715 million (RUB 6,015 million at the acquisition date) has been granted for 15 years. In accordance with the terms of the license CJSC "VF Ukraine" is required provide coverage across Ukraine by April 2020.

In accordance with the terms of the license, CJSC "VF Ukraine" also concluded agreements on the conversion of provided frequencies with the Ministry of Defense of Ukraine, Ministry of Internal Affairs of Ukraine and State Service of Special Communications and Information Protection of Ukraine. As of 31 December 2017, CJSC "VF Ukraine" has paid UAH 358 million (RUB 865 million as of the payment date) for the conversion of frequencies and is liable to pay UAH 323 million (RUB 476 million as of 31 December 2017) adjusted for the rate of inflation in the years 2017-2018.

Management believes that as of December 31, 2017 the Group complied with the conditions of the aforementioned licenses.

Agreement with Apple – In April 2017, MTS entered into an unconditional purchase agreement with Apple Rus LLC to buy 615,000 iPhone handsets at list prices at the dates of respective purchases over a period ending 30 June 2019. Pursuant to the agreement, MTS is also required to incur certain iPhone advertising and promotion costs. As of December 31, 2017 MTS made 44% of its total purchase installment contemplated by the agreement.

Restriction on transactions with the shares of BPGC – In 2014, in the course of litigation, which the Group is not a party to, the court imposed restrictions on transactions with the shares of BPGC owned by the Group. The restrictions do not limit the Group's voting rights, rights to receive dividends or any other shareholders rights.

Taxation – Laws and regulations affecting business in the Russian Federation continue to change rapidly. Management's interpretation of such legislation as applied to the activity of the Group may be challenged by the relevant regional and federal authorities. Recent events suggest that the tax authorities are taking a more assertive position in their interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. Fiscal periods generally remain open to tax audit by the authorities in respect of taxes for three calendar years preceding the year of tax audit. Under certain circumstances reviews may cover longer periods. Management believes that it has provided adequately for tax liabilities based on its interpretations of tax legislation. However, the relevant authorities may have different interpretations, and the effects on the financial statements could be significant.

(Amounts in millions of Russian Rubles, unless otherwise stated)

Where uncertainty exists, the Group has accrued tax liabilities as management's best estimate of the probable outflow of resources which will be required to settle such liabilities. As of 31 December 2017, provisions for additional taxes and customs settlements comprised RUB 1,216 million (31 December 2016: RUB 1,213 million).

The Group also assesses the following contingent liabilities in respect of additional tax settlements:

	December 31, 2017	**December 31, 2016**
Contingent liabilities for additional taxes other than income tax	732	354
Contingent liabilities for additional income taxes	2,591	2,588

In 2015, amendments were introduced into the Russian tax legislation in respect of taxation of profit of controlled foreign companies. According to these changes, undistributed profits of the Group foreign subsidiaries, qualifying as controlled foreign companies, should be included in the income tax base of the controlling entities in particular cases. The management of the Group does not expect any significant effect of these changes on the consolidated financial statements of the Group.

Potential adverse effects of economic instability and sanctions in Russia – Starting from 2014, sanctions have been imposed in several packages by the U.S. and the E.U. on certain Russian officials, businessmen and companies. This led to reduced access of the Russian businesses to international capital markets.

The impact of further economic and political developments on future operations and financial position of the Group might be significant.

Political and economic crisis in Ukraine – During 2014, a deterioration in the political environment of Ukraine has led to general instability, economic deterioration and armed conflict in eastern Ukraine. The deterioration has further exacerbated the country's already weak macroeconomic trends, which have led to reduced credit ratings, significant depreciation of its national currency and increased inflation. During 2014, the Ukrainian Parliament adopted a law allowing for the imposition of sanctions against countries, persons and companies deemed by the Ukrainian government to threaten Ukrainian national interests, national security, sovereignty or the territorial integrity of Ukraine. The National Bank of Ukraine ("NBU") passed a decree prohibiting Ukrainian companies to pay dividends to foreign investors. The decree was extended for a few times and its edition effective as of December 31, 2017 allows payment of dividends from the profit earned in 2014-2015, subject to certain restrictions, as well as payment of the whole amount of dividends accrued from the profit earned before 2014 that was earlier prohibited. These circumstances, combined with continued political and economic instability in the country, could result in further negative impact on the Group's business including our financial position and results of operations.

Such risks especially apply to funds deposited in Ukrainian banks, whose liquidity is affected by the economic downturn. As of 31 December 2017, the Group's held RUB 3,617 million in current accounts and deposits in Ukrainian banks.

Anti-terror law – On 7 July 2016, a series of anti-terror laws (also known as "Yarovaya-Ozerov packet of laws") was enacted. The laws provide for mandatory storage of recorded phone conversations, text messages of subscribers, images, sounds, video and other types of messages by telecommunications operators for certain periods of time. These requirements become effective starting 1 July 2018. Compliance with laws will require construction of additional storage, processing and indexing centers and significant increase in the Group capital expenditures. This may adversely impact Group's financial indicators.

The requirements of the anti-terror laws in respect of the data storage volume are to be determined by legal acts that have not been adopted yet. The Group will estimate the potential impact of the laws on the Group's consolidated financial statements, including additional provisions, once requirements are approved and come into force.

(Amounts in millions of Russian Rubles, unless otherwise stated)

Legal proceedings – In the ordinary course of business, the Group is a party to various legal proceedings, and subject to claims, certain of which relate to the developing markets and evolving regulatory environments in which the Group operates. At 31 December 2017, management estimates the range of possible losses in all pending litigations or other legal proceedings, other than the litigations in Notes 5 and 7, being up to RUB 8,697 million.

In August 2017, Federal Antimonopoly Service of the Russian Federation (FAS Russia) has charged MTS with violation of antimonopoly laws in respect to establishing and maintaining monopolistically high prices for communication services in national roaming. In February 2018 FAS Russia found MTS responsible for the aforementioned violation. 5 March 2018 FAS Russia has initiated the case in relation to MTS. As result of the hearing, administrative fine might be imposed on MTS in the amount of illegally obtained income. The amount of illegally obtained income is determined as the difference between the amount of revenue received by MTS as a result of applying monopolistically high prices and the amount of revenue that could be received as a result of applying prices which are considered by FAS Russia reasonable. As there is no information regarding the level of prices that FAS Russia considers economically justified, it is not possible to make a reliable estimation of the adverse effects of the fine that will be potencially imposed.

39. APPLICATION OF NEW AND REVISED INTERNATIONAL FINANCIAL REPORTING STANDARDS (IFRSS)

Amendments to IFRSs that are mandatorily effective for the current year

In the current year, the Group has applied a number of amendments to IFRSs issued by the International Accounting Standards Board (IASB) that are mandatorily effective for a period that begins on or after 1 January 2017:

Amendment	Description	Impact
Amendments to IAS 7 Disclosure Initiative	The amendments require an entity to provide disclosures that enable users of financial statements to evaluate changes in liabilities arising from financing activities, including both cash and non-cash changes.	The Group's liabilities arising from financing activities consist of borrowings (Note 26) and certain other financial liabilities (Note 28). A reconciliation between the opening and closing balances of these items is provided in Note 37. Consistent with the transition provisions of the amendments, the Group has not disclosed comparative information for the prior period.
Amendments to IAS 12 Recognition of Deferred Tax Assets for Unrealised Losses	The amendments clarify how an entity should evaluate whether there will be sufficient future taxable profits against which it can utilise a deductible temporary difference.	The application of these amendments has no material impact on the Group's consolidated financial statements as the Group already assesses the sufficiency of future taxable profits in a way that is consistent with these amendments.
Annual Improvements to IFRSs 2014-2016 Cycle	IFRS 12 states that an entity need not provide summarized financial information for interests in subsidiaries, associates or joint ventures that are classified as held for sale or included in the disposal group. The amendments clarify that this is the only concession from the disclosure requirements of IFRS 12 for such interests.	The application of these amendments has no material impact on the Group's consolidated financial statements as none of the Group's material interests in these entities are classified, or included in a disposal group that is classified, as held for sale.

(Amounts in millions of Russian Rubles, unless otherwise stated)

New and revised IFRSs in issue but not yet effective

The Group has not applied the following new and revised IFRSs that have been issued but are not yet effective:

Standard or amendment	Effective date[1]
IFRS 15, Revenue from Contracts with Customers	1 January 2018
IFRS 9, Financial Instruments	1 January 2018
IFRIC 22, Foreign Currency Transactions and Advance Consideration	1 January 2018
Amendments to IFRS 2 – Classification and Measurement of Share-based Payment Transactions	1 January 2018
Amendments to IAS 40 – Transfers of Investment Property	1 January 2018
Amendments to IFRS 4 – Applying IFRS 9 Financial Instruments with IFRS 4 Insurance Contracts	1 January 2018
Annual Improvements to IFRSs 2014-2016 Cycle	1 January 2018
IFRS 16, Leases	1 January 2019
Amendments to IFRS 10 and IAS 28 – Sale or Contribution of Assets between an Investor and its Associate or Joint Venture	Postponed
IFRIC 23, Uncertainty Over Income Tax Treatments	1 January 2019
Amendments to IFRS 9 – Prepayment Features With Negative Compensation	1 January 2019
Amendments to IAS 28 – Long-Term Interests in Associates and Joint Ventures	1 January 2019
Annual Improvements to IFRSs 2015-2017 Cycle	1 January 2019
IFRS 17, Insurance Contracts	1 January 2021

(1) Effective for annual periods effective on or after that date, with earlier application permitted.

The Group is currently implementing IFRS 9, Financial Instruments, and IFRS 15, Revenue from Contracts with Customers, as well as IFRS 16, Leases, which it intends to early adopt as of 1 January 2018, concurrent with the adoption of the new standard related to revenue recognition.

IFRS 9, Financial Instruments – The standard replaces IAS 39, Financial Instruments: Recognition and Measurement, and brings together the following aspects of accounting for financial instruments: classification and measurement, impairment, derecognition and general hedge accounting.

The Group estimates that the main impact of IFRS 9 will be in the way the Group accounts for the impairment of financial assets. In general, the Group anticipates that the application of the expected credit loss model of IFRS 9 will result in earlier recognition of credit losses for its customer loan portfolio and trade receivables and will increase the amount of loss allowance recognized for these items.

The Group will take advantage of the exemption allowing it not to restate comparative information for prior periods with respect to classification and measurement (including impairment) changes. Differences in the carrying amounts of financial assets and financial liabilities resulting from the adoption of IFRS 9 as at 1 January 2018 will be recognized in equity and are currently estimated being insignificant.

IFRS 15, Revenue from Contracts with Customers – This standard provides a single, principles-based five-step model for the determination and recognition of revenue to be applied to all contracts with customers. It replaces the existing standards IAS 18, Revenue, and IAS 11, Construction Contracts, and related interpretations.

The Group will adopt IFRS 15 from 1 January 2018 using the modified retrospective method, with the effect of initially applying this standard recognized in equity at the date of initial application. As a result, the Group will not apply the requirements of IFRS 15 to the comparative period presented.

The Group currently anticipates that the main effect from the adoption of IFRS 15 on the Group's consolidated financial statements will be a recognition of contract costs – costs of obtaining a contracts (such as sales commissions) and costs of fulfilling a contract – which, under the new standard, are required to be capitalized and amortized over the period expected to benefit from the contract. The Group will use the practical expedient allowed by of IFRS 15 whereby such costs may be expensed if the amortization period is one year or less. The Group estimates the additional asset stemming from the capitalization of contract costs to amount to RUB 5.9 billion as at 1 January 2018.

Other anticipated impacts of the standard includes delayed recognition of revenue in cases where "material rights" (such as offering additional products and services free of charge) are granted to customers, and reallocation of remuneration between the components of contracts with customers. The estimated effect of such reallocations on equity and deferred revenue as of 1 January 2018 is estimated being insignificant.

IFRS 16, Leases – This standard requires lessees to adopt a uniform approach to the presentation of leases. Correspondingly, assets must be recognized for the right of use received and liabilities must be recognized for the payment obligations entered into for all leases. The Group will be making use of relief options available for short-term leases. The Group will transition to IFRS 16 in accordance with the modified retrospective method. For leases that have to date been classified as operating leases in accordance with IAS 17, the lease liability will be carried at the present value of the remaining lease payments discounted using the lessee's incremental borrowing rate at the time the standard was first applied. The right-of-use asset will generally be measured at the amount of the lease liability. The prior period figures will not be restated.

The analysis conducted Group-wide indicated the probable recognition of right-of-use assets and lease liabilities in the balance sheet totaling around not less than RUB 176 billion as of 1 January 2018. In terms of the future effects on the statement of profit and loss, in contrast to the presentation of operating lease expenses to date, the Group will be recognizing depreciation charges on right-of-use assets and the interest expense from the unwinding of the discount on the lease liability.

The above assessment for IFRS 9, 15 and 16 is preliminary because not all transition work has been finalized. The actual impact of adopting the new standards on 1 January 2018 may change because their adoption will require the Group to revise its accounting processes and internal controls and these changes are not yet complete, while the new accounting policies, assumptions, judgements and estimation techniques employed are subject to changes until the Group finalizes its first consolidated financial statements that include the date of initial application.

The Group does not anticipate that the application of other revised IFRSs effective 1 January 2018 will have a material impact on the Group's consolidated financial statements. In respect of new and revised IFRSs effective 1 January 2019 and afterwards, the Group is still evaluating their impact.

40. EVENTS AFTER THE REPORTING DATE

Proceeds from new borrowings – In February and March 2018, the Company raised loans of the total amount of RUB 80 billion from Gazprombank and Sberbank which are secured by 52.09% of the shares of Detsky mir and shares of MTS, which are recorded as collateral in proportion to the drawdown of the loan from Sberbank.

Acquisition of MDTZK LLC and Kulturnaya Sluzhba LLC – In the first quarter of 2018, the MTS acquired 100% stake in MDTZK LLC (operating under the trademark Ticketland.ru) and a 78.2% stake in Kulturnaya Sluzhba LLC (operating under the trademark Ponominalu.ru), the leading players in the Russian e-ticketing industry. The acquisitions allow MTS to enter the event ticket market (both online and offline) and establish itself as a leading ticket operator in Russia, while broadening MTS's suite of digital services and integrating a key new product into its existing loyalty program and mobile app ecosystem.

(Amounts in millions of Russian Rubles, unless otherwise stated)

The preliminary distribution of the acquisition price for MDTZK and KS is presented in the table below:

	MDTZK	**KS**
Cash consideration	3,250	399
Recognised amounts of identifiable assets acquired:		
Property, plant and equipment	128	25
Other non-current assets	75	95
Current assets	484	192
Other non-current liabilities	(78)	(108)
Current liabilities	(639)	(474)
Goodwill	**3,280**	**669**

Goodwill is mainly attributable to the expected synergies.

Investments in the development of OZON – In March 2018, MTS invested RUB 1.15 billion in the development of Ozon Holdings Limited through an additional share issuance.

Early repayment of credit facilities **–** In March 2018, MTS made partial early repayment of the 10-year credit facility from Calyon, ING Bank N.V., Nordea Bank AB and Raiffeisen Zentralbank Osterreich AG in the amount of USD 224.7 million (RUB 12,668 million). The early repayment of the loan is a part of the debt portfolio optimization strategy aimed at decreasing of the overall cost of debt and increasing its overall tenor.

Ruble bonds placement – In March 2018, MTS issued two series of exchange-traded bonds totaling RUB 20 billion with a semi-annual coupon rate of 7.10% and 7.25% and a maturity of 3.5 years and 7 years respectively. In March and January 2018, Sistema issued two series of exchange-traded bonds totaling RUB 25 billion with a coupon rate of 9.25% and 9.80% respectively and a maturity of 10 years.

MTS shares tender offer under share repurchase plan – Since the end of the reporting period the Group acquired 27,059,204 MTS shares of common stock representing 1.35% of share capital issued by MTS including purchase of 17,339,848 shares from Sistema Finance S.A., a subsidiary of the Group. The Group purchased MTS shares of common stock under the share repurchase plan announced in 2017.