

# **SISTEMA JSFC AND SUBSIDIARIES**

## **Unaudited Condensed Consolidated Financial Statements**

As of June 30, 2014 and December 31, 2013  
and for the Six Months Ended  
June 30, 2014 and 2013

# SISTEMA JSFC AND SUBSIDIARIES

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## INDEPENDENT AUDITORS' REVIEW REPORT

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

We have reviewed the accompanying condensed consolidated statement of financial position of Sistema Joint-Stock Financial Corporation and subsidiaries (the "Group") as of June 30, 2014, and the related condensed consolidated statements of operations and comprehensive income and cash flows for the six months ended June 30, 2014 and 2013 (the "interim financial information").

### *Management's Responsibility for the Interim Financial Information*

The Group's management is responsible for the preparation and fair presentation of the interim financial information in accordance with accounting principles generally accepted in the United States of America; this responsibility includes the design, implementation, and maintenance of internal control sufficient to provide a reasonable basis for the preparation and fair presentation of interim financial information in accordance with accounting principles generally accepted in the United States of America.

### *Auditors' Responsibility*

Our responsibility is to conduct our reviews in accordance with auditing standards generally accepted in the United States of America applicable to reviews of interim financial information. A review of interim financial information consists principally of applying analytical procedures and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States of America, the objective of which is the expression of an opinion regarding the financial information. Accordingly, we do not express such an opinion.

### *Conclusion*

Based on our reviews, we are not aware of any material modifications that should be made to the interim financial information referred to above for it to be in conformity with accounting principles generally accepted in the United States of America.

### *Report on Condensed Consolidated Statement of Financial Position as of December 31, 2013*

We have previously audited, in accordance with auditing standards generally accepted in the United States of America, the consolidated statement of financial position of the Group as of December 31, 2013, and the related consolidated statements of operations and comprehensive income, cash flows and changes in shareholders' equity for the year then ended; and we expressed an unmodified opinion on those consolidated financial statements in our report dated April 1, 2014 (not presented herein). In our opinion, the accompanying condensed consolidated statement of financial position of the Group as of December 31, 2013 is consistent, in all material respects, with the audited consolidated financial statements from which it has been derived.



Moscow, Russia  
August 26, 2014

## SISTEMA JSFC AND SUBSIDIARIES

### UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF JUNE 30, 2014 AND DECEMBER 31, 2013 (Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	<u>June 30, 2014</u>	<u>December 31, 2013</u>
<b>ASSETS</b>			
<b>CURRENT ASSETS:</b>			
Cash and cash equivalents		\$ 3,577,178	\$ 2,059,092
Short-term investments		1,559,772	1,719,223
Assets from banking activities, current portion (including cash and cash equivalents of \$1,402,717 and 1,132,368)		3,053,772	3,898,740
Accounts receivable, net		2,243,995	2,173,972
VAT receivable		774,784	720,181
Inventories and spare parts		1,926,917	1,848,145
Deferred tax assets		372,765	390,238
Assets of discontinued operations		88,646	-
Other current assets		<u>1,727,865</u>	<u>1,756,082</u>
Total current assets		<u>15,325,694</u>	<u>14,565,673</u>
<b>NON-CURRENT ASSETS:</b>			
Property, plant and equipment, net	5	21,198,564	19,945,701
Advance payments for non-current assets		187,540	187,850
Goodwill	6	1,292,386	1,327,779
Other intangible assets, net	7	2,145,558	2,225,927
Investments in affiliates		550,849	946,759
Assets from banking activities, net of current portion		2,761,132	2,554,229
Debt issuance costs, net		86,025	87,226
Deferred tax assets		370,812	344,965
Long-term investments		607,305	249,071
Other non-current assets		<u>662,990</u>	<u>813,814</u>
Total non-current assets		<u>29,863,161</u>	<u>28,683,321</u>
<b>TOTAL ASSETS</b>		<u>\$ 45,188,855</u>	<u>\$ 43,248,994</u>

See notes to the unaudited condensed consolidated financial statements.

## SISTEMA JSFC AND SUBSIDIARIES

### UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF FINANCIAL POSITION AS OF JUNE 30, 2014 AND DECEMBER 31, 2013 (CONTINUED)

(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	June 30, 2014	December 31, 2013
<b>LIABILITIES AND EQUITY</b>			
<b>CURRENT LIABILITIES:</b>			
Accounts payable		\$ 2,221,326	\$ 3,144,233
Liabilities from banking activities, current portion		2,750,232	3,864,415
Taxes payable		1,080,885	812,880
Deferred tax liabilities		241,950	229,038
Subscriber prepayments, current portion		496,728	620,281
Accrued expenses and other current liabilities		4,085,321	2,225,913
Short-term loans payable	8	276,548	40,836
Current portion of long-term debt	9	2,583,842	2,470,058
Liabilities of discontinued operations		73,315	-
Total current liabilities		<u>13,810,147</u>	<u>13,407,654</u>
<b>LONG-TERM LIABILITIES:</b>			
Long-term debt, net of current portion	9	12,967,354	10,764,278
Subscriber prepayments, net of current portion		95,079	101,240
Liabilities from banking activities, net of current portion		396,007	772,525
Deferred tax liabilities		2,160,597	1,956,472
Asset retirement obligations		186,106	184,261
Postretirement benefits obligations		95,083	91,640
Property, plant and equipment contributions		70,838	74,174
Other long-term liabilities	10	<u>1,021,476</u>	<u>595,909</u>
Total long-term liabilities		<u>16,992,540</u>	<u>14,540,499</u>
<b>TOTAL LIABILITIES</b>		<u>30,802,687</u>	<u>27,948,153</u>
Commitments and contingencies	14	-	-
Redeemable noncontrolling interests		795,577	805,130
<b>SHAREHOLDERS' EQUITY:</b>			
Share capital (9,650,000,000 shares issued; 9,375,021,253 and 9,274,755,045 shares outstanding with par value of 0.09 Russian Rubles, respectively)		30,057	30,057
Treasury stock (274,978,747 and 375,244,955 shares with par value of 0.09 Russian Rubles, respectively)		(312,040)	(426,715)
Additional paid-in capital		2,661,102	2,616,608
Retained earnings		9,259,829	8,993,469
Accumulated other comprehensive loss		<u>(1,373,500)</u>	<u>(906,718)</u>
Total Sistema JSFC shareholders' equity		<u>10,265,448</u>	<u>10,306,701</u>
Non-redeemable noncontrolling interests		<u>3,325,143</u>	<u>4,189,010</u>
<b>TOTAL EQUITY</b>		<u>13,590,591</u>	<u>14,495,711</u>
<b>TOTAL LIABILITIES AND EQUITY</b>		<u>\$ 45,188,855</u>	<u>\$ 43,248,994</u>

See notes to the unaudited condensed consolidated financial statements.

## SISTEMA JSFC AND SUBSIDIARIES

### UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars, except share and per share amounts)

	Six months ended June 30,	
	2014	2013
Sales	\$ 16,644,455	\$ 16,426,551
Revenue from banking activities	397,597	391,682
<b>TOTAL REVENUES</b>	<b>17,042,052</b>	<b>16,818,233</b>
Cost of sales, exclusive of depreciation, depletion and amortization shown separately below	(6,372,501)	(6,330,841)
Cost related to banking activities, exclusive of depreciation and amortization shown separately below	(235,416)	(264,201)
Selling, general and administrative expenses	(1,987,015)	(2,113,420)
Depreciation, depletion and amortization	(1,501,150)	(1,615,384)
Transportation costs	(450,979)	(461,393)
Taxes other than income tax	(3,773,089)	(3,448,711)
Equity in results of affiliates	23,772	41,057
Gain on Bitel case resolution	-	346,100
Other operating expenses, net	(249,166)	(148,417)
<b>OPERATING INCOME</b>	<b>2,496,508</b>	<b>2,823,023</b>
Interest income	168,046	122,975
Change in fair value of derivative instruments	-	(1,315)
Interest expense	(572,364)	(643,255)
Foreign currency transaction loss	(42,672)	(205,076)
Income from continuing operations before income tax	2,049,518	2,096,352
Income tax expense	(564,864)	(545,950)
Income from continuing operations	\$ 1,484,654	\$ 1,550,402
Income from discontinued operations, net of tax effect of \$5,505 and nil	6,293	-
<b>NET INCOME</b>	<b>\$ 1,490,947</b>	<b>\$ 1,550,402</b>
Noncontrolling interest	(618,035)	(670,262)
<b>NET INCOME ATTRIBUTABLE TO SISTEMA JSFC</b>	<b>\$ 872,912</b>	<b>\$ 880,140</b>
Including:		
Income from continuing operations	\$ 867,374	\$ 880,140
Income from discontinued operations	5,538	-
<b>OTHER COMPREHENSIVE LOSS, NET OF TAXES</b>	<b>(696,514)</b>	<b>(955,021)</b>
<b>TOTAL COMPREHENSIVE INCOME</b>	<b>\$ 794,433</b>	<b>\$ 595,381</b>
Weighted average number of common shares outstanding – basic and diluted	9,325,172,836	9,216,877,429
Earnings per share, basic and diluted, U.S. cent		
Earnings per share from continuing operations	9.30	9.55
Earnings per share from discontinued operations	0.06	-
Total earnings per share attributable to Sistema JSFC shareholders	9.36	9.55

See notes to the unaudited condensed consolidated financial statements.

## SISTEMA JSFC AND SUBSIDIARIES

### UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars)

	Six months ended June 30,	
	2014	2013
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 1,490,947	\$ 1,550,402
Income from discontinued operations	(6,293)	-
Income from continuing operations	<u>1,484,654</u>	<u>1,550,402</u>
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation, depletion and amortization	1,501,150	1,615,384
Equity in results of affiliates	(23,772)	(41,057)
Deferred income tax expense	53,655	235,027
Foreign currency transaction loss	42,672	205,076
Gain on Bitel case resolution, net of cash received of \$125,000	-	(221,100)
(Gain)/loss on disposal of property, plant and equipment	(128,553)	6,669
Amortization of connection fees	(16,446)	(15,438)
Allowance for loan losses	111,401	133,426
Dividends received from affiliates	40,139	29,884
Non-cash compensation to employees	42,341	11,014
Other non-cash items	256,415	118,081
Changes in operating assets and liabilities, net of effects from business combinations:		
Trading securities	172,228	(182,261)
Accounts receivable	(146,485)	(472,218)
VAT receivable	(754)	37,402
Inventories and spare parts	(112,127)	(233,167)
Other current assets	21,283	(329,121)
Accounts payable	(661,014)	74,300
Subscriber prepayments	(96,910)	(49,935)
Taxes payable	216,708	46,699
Long-term prepayment on the oil supply agreement	515,810	-
Accrued expenses and other liabilities	<u>624,631</u>	<u>63,921</u>
Net cash provided by operating activities of continuing operations	3,897,026	2,582,988
Net cash used in operating activities of discontinued operations	<u>(3,336)</u>	<u>(17,288)</u>
Net cash provided by operating activities	<u>\$ 3,893,690</u>	<u>\$ 2,565,700</u>

## SISTEMA JSFC AND SUBSIDIARIES

### UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (CONTINUED) (Amounts in thousands of U.S. dollars)

	Six months ended June 30,	
	2014	2013
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Payments for purchases of property, plant and equipment	\$ (1,446,051)	\$ (1,283,727)
Payments for purchases of intangible assets	(189,704)	(202,447)
(Payments for)/proceeds from purchases of businesses, net of cash acquired	(1,013,559)	42,188
Purchase of investments in affiliated companies	(260,180)	(304,388)
Payments for purchases of long-term investments	(484,425)	(27,011)
Payments for purchases of short-term investments	(927,039)	(839,090)
Payments for purchases of other non-current assets	-	(7,568)
Increase in restricted cash	(9,314)	(15,049)
Proceeds from sale of subsidiaries, net of cash disposed	-	389,011
Proceeds from sale of property, plant and equipment	125,620	46,874
Proceeds from loans given to affiliated companies	89,608	-
Proceeds from sale of long-term investments	90,000	-
Proceeds from sale of other non-current assets	-	1,863
Proceeds from sale of short-term investments	857,450	676,507
Net decrease in loans to customers of the banking division	686,630	54,740
Net cash used in investing activities	<u>(2,480,964)</u>	<u>(1,468,097)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from short-term borrowings, net	225,624	25,205
Net (decrease)/increase in deposits from customers of the banking division	(1,393,962)	371,897
Proceeds from long-term borrowings	3,090,353	2,326,315
Principal payments on long-term borrowings	(1,020,963)	(2,482,583)
Acquisition of non-controlling interests in existing subsidiaries	(578,926)	(27,073)
Debt issuance costs	-	(4,690)
Dividends paid	(1,591)	-
Proceeds from capital transactions with shares of existing subsidiaries	41,142	8,623
Net cash provided by financing activities	<u>361,677</u>	<u>217,694</u>
Effect of foreign currency translation on cash and cash equivalents	<u>14,032</u>	<u>(77,294)</u>
Net increase in cash and cash equivalents	1,788,435	1,238,003
Cash and cash equivalents at the beginning of the period (including cash of discontinued operations)	3,191,460	2,629,544
Cash and cash equivalents at the end of the period (including cash of discontinued operations)	4,979,895	3,867,547
Cash and cash equivalents of discontinued operations at the end of the period	-	(1,598)
Cash and cash equivalents of continuing operations at end of the period	<u>\$ 4,979,895</u>	<u>\$ 3,865,949</u>
Including:		
Non-banking activities	\$ 3,577,178	\$ 2,056,725
Banking activities	1,402,717	1,809,224
<b>CASH PAID DURING THE PERIOD FOR:</b>		
Interest paid, net of amounts capitalized	\$ (554,977)	\$ (650,300)
Income taxes paid	(376,034)	(286,146)

See notes to the unaudited condensed consolidated financial statements.



## SISTEMA JSFC AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars, unless otherwise stated)

#### 1. DESCRIPTION OF BUSINESS

Sistema Joint-Stock Financial Corporation (the "Company", together with its subsidiaries, the "Group") invests in, and manages a range of companies which operate in the telecommunications, oil and energy, high technology, banking and other sectors. The Company and the majority of its consolidated subsidiaries are incorporated in the Russian Federation ("RF").

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

Below are the Group's significant entities and their principal activities:

Significant entities	Short name	Principal activity	Beneficial ownership as of	
			June 30, 2014	December 31, 2013
Mobile TeleSystems	MTS	Telecommunications	53%	53%
Bashneft	Bashneft	Oil and gas production	79% <sup>(1)</sup>	75% <sup>(1)</sup>
Sistema Shyam TeleServices Limited	SSTL	Telecommunications	57%	57%
MTS Bank	MTS Bank	Banking	87%	87%
RTI	RTI	Technology	85%	85%
Detsky mir-Center	Detsky mir	Retail trading	100%	100%
Medsi	Medsi	Healthcare services	75%	75%
Bashneft-Services Assets <sup>(3)</sup>	BNSA	Oil services	100%	100%
United Petrochemical Company	UPC	Petrochemical production	99%	99%
Bashkirian Power Grid Company	BPGC	Energy transmission	91% <sup>(2)</sup>	79% <sup>(2)</sup>
SG-trans	SG-trans	Transportation	50%	50%

<sup>(1)</sup> Voting interests as of June 30, 2014 and December 31, 2013 – 87% and 89%, respectively.

<sup>(2)</sup> Voting interests as of June 30, 2014 and December 31, 2013 – 93%.

<sup>(3)</sup> On July 1, 2014, Bashneft-Services Assets was renamed to Targin.

#### 2. ACCOUNTING POLICIES

**Basis of presentation** – The accompanying statements of financial position and related interim statements of operations and comprehensive income and cash flows include all adjustments, consisting only of normal recurring items, necessary for their fair presentation in conformity with accounting principles generally accepted in the United States of America ("U.S. GAAP"). Certain disclosures normally included in the Group's annual consolidated financial statements prepared in accordance with U.S. GAAP have been omitted. Interim results are not necessarily indicative of results for a full year. These unaudited condensed consolidated financial statements and accompanying notes should be read in conjunction with the Group's annual consolidated financial statements and the notes thereto for the year ended December 31, 2013.

**New and recently adopted accounting pronouncements** – In April 2014, the Financial Accounting Standards Board ("FASB") issued guidance which changes the criteria for identifying a discontinued operation. The guidance limits the definition of a discontinued operation to the disposal of a component or group of components that is disposed of or is classified as held for sale. The guidance is effective for fiscal years and interim reporting periods within those fiscal years beginning after December 15, 2014, with early adoption permitted for transactions that have not been reported in financial statements previously issued. The effect of adoption of this guidance will depend on future transactions of the Group.

## SISTEMA JSFC AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars, unless otherwise stated)

In May 2014, the FASB amended the existing accounting standards for revenue recognition. The amendments are based on the principle that revenue should be recognized to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. The Group is required to adopt the amendments in the reporting period starting after December 15, 2016. Early adoption is not permitted. The amendments may be applied retrospectively to each prior period presented or retrospectively with the cumulative effect recognized as of the date of initial application. The Group is currently evaluating the impact of these amendments and the transition alternatives on the Group consolidated financial statements.

### 3. ACQUISITIONS

**Change in control over Bashneft-Polyus** – On May 23, 2014, Bashneft, which owns 74.9% interest in Bashneft-Polyus, agreed with OJSC LUKOIL, the holder of the remaining 25.1% interest, to amend the existing shareholders agreement and change certain principles of control over the operational and financial activities of Bashneft-Polyus. The Group concluded that as a result of these amendments, the Group obtained control over Bashneft-Polyus, its former affiliate, and accounted for this business combination by applying the acquisition method. The provisional fair value of identifiable assets acquired and liabilities assumed as of the acquisition date was as follows:

<b>ASSETS</b>	
Property, plant and equipment	\$ 283,575
Trade and other receivables	450,289
Taxes receivable	68,582
Other assets	38,419
	<u>840,865</u>
<b>LIABILITIES</b>	
Trade and other payables	(134,363)
Taxes payable	(65,110)
Borrowings from OJSC LUKOIL and Bashneft	(680,684)
Other liabilities	(2,450)
	<u>(882,607)</u>
<b>Fair value of net liabilities assumed</b>	<u><b>(41,742)</b></u>
Fair value of previously held share of equity investment	13,156
Non-controlling interest	(10,473)
	<u>44,425</u>
<b>Excess of the cost of acquisition over the Group's share in the fair value of net liabilities assumed recognised in Other operating expenses</b>	<b>\$ 44,425</b>

Following the consolidation of Bashneft-Polyus, the balances payable by Bashneft to Bashneft-Polyus in the amount of \$426.0 million and loans issued by the Group to Bashneft-Polyus in the amount of \$507.0 million at the date of acquisition, were eliminated in full as intra-group balances.

Bashneft-Polyus contributed \$32.8 million of revenue and \$1.4 million of income before tax from the date of acquisition till June 30, 2014.

**Acquisition of Burneftegaz** – On March 26, 2014, the Group acquired a 100% stake of Burneftegaz, a company engaged in exploration and production of crude oil in the Tyumen District for a total cash consideration of \$1,001.6 million. The entity was accounted for and consolidated in the consolidated financial statements of the Group from the effective date of its acquisition.

## SISTEMA JSFC AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars, unless otherwise stated)

At the date of acquisition, the provisional fair value of identifiable assets acquired and liabilities assumed was as follows:

Current assets	\$	60,485
Property, plant and equipment		1,187,961
Current liabilities		(52,301)
Non-current liabilities		<u>(194,512)</u>
<b>Consideration paid</b>	<b>\$</b>	<b><u>1,001,633</u></b>

Burneftegaz contributed \$64.5 million of revenue and \$9.7 million of income before tax from the date of acquisition till June 30, 2014.

The Group's financial results if the combination had taken place at the beginning of the six months ended June 30, 2014, are not disclosed as Burneftegaz did not prepare separate financial statements in accordance with U.S. GAAP before the acquisition.

**Investment in OZON** – On April 29, 2014, the Group acquired 21.6% of ownership interest in OZON Holdings Limited (“OZON”), a leading Russian e-commerce company, through an additional share issuance for \$150 million. The Group can nominate two out of eight representatives to the board of directors. Management concluded that upon the completion of the acquisition the Group gained significant influence over OZON and therefore adopted the equity method of accounting for this investment from the acquisition date. The Group also obtained a call option for additional 4.6% stake in OZON exercisable till August 2015.

#### 4. CAPITAL TRANSACTIONS OF SUBSIDIARIES

**Bashneft-Polyus** – On 23 May 2014, in accordance with the order of Federal Agency for Subsoil Use (“Rosnedra”) Trebs and Titov oilfield license was transferred from Bashneft to its subsidiary Bashneft-Polyus. This transaction resulted in an increase in noncontrolling interest in the amount of \$113.0 million with the corresponding decrease in the Group's constructive obligation to OJSC LUKOIL in the amount of \$139.1 million and increase of additional paid-in capital by \$26.1 million.

**Sistema-Invest** – In February 2014, the meeting of shareholders of Bashneft approved its reorganization which involved the merger of Bashneft and CJSC Bashneft-Invest (“Bashneft-Invest”), its wholly-owned subsidiary created through a spinoff from CJSC Sistema-Invest (“Sistema-Invest”). As a result of the spinoff, Bashneft-Invest received 38,139,925 ordinary shares of Bashneft held by Sistema-Invest and assumed its liabilities to Bashneft.

In accordance with the Russian legislation, merging entities are required to buy their own shares back from shareholders who abstained or voted against the reorganization upon their request. Accordingly, Bashneft had to acquire its 2,724,173 ordinary shares and 8,885,866 preferred shares put by the eligible shareholders for a total cash consideration of \$494.0 million.

In May 2014, the reorganization was completed. 38,139,925 ordinary shares previously held by Bashneft-Invest and 8,885,866 preferred shares bought back from the shareholders were cancelled. The transactions were accounted for directly in equity and resulted in a decrease of noncontrolling interest by \$694.6 million and an increase of additional paid-in capital by \$199.4 million. The Group's ownership in Bashneft increased from 75.0% to 78.8% and in BPGC – from 79.3% to 91.0%.

**Mikron** – In May 2014, Mikron, a subsidiary of the Group, issued additional shares representing 25.1% of its share capital in exchange for 37.7% interest in SITRONICS-Nano, owned by OJSC RUSNANO. Upon completion of the transaction, the Group's effective ownership in Mikron decreased to 53.0%. The transaction was accounted for directly in equity and resulted in a decrease of noncontrolling interest and an increase of additional paid-in capital by \$44.1 million. Simultaneously, the Group and RUSNANO substituted their existing put and call option agreements on RUSNANO's share in SITRONICS-Nano to new put and call option agreements on its share in Mikron. The terms of the option agreements remained unchanged.

## SISTEMA JSFC AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars, unless otherwise stated)

**Business-Nedvizhimost** – In April 2014, MTS sold a 49% stake in Business-Nedvizhimost, a company which owns and manages a real estate portfolio in Moscow, to the Company for \$91.8 million. This transfer of ownership interest within the Group resulted in an increase of noncontrolling interest and a decrease of additional paid-in capital by \$47.4 million.

**Ufaorgsintez** – In March 2014, pursuant to the terms of a voluntary tender offer originally announced in December 2013, Ufaorgsintez completed the acquisition of its ordinary shares for a total consideration of \$26.5 million. As a result, the Group's ownership in Ufaorgsintez increased from 76.8% to 86.5%. The transaction was accounted for directly in equity and resulted in a decrease of noncontrolling interest by \$49.5 million and an increase of additional paid-in capital by \$22.5 million.

**Acquisition of additional stake in NVision** – In January 2014, the Group acquired an additional 38.75% stake in NVision from minority shareholders for \$82.5 million, \$37.5 million of which were paid in cash and \$45.0 million – in the Company's treasury shares. Upon completion of the deal, the Group's ownership in NVision comprised 88.75%. The transaction was accounted for directly in equity and resulted in an increase of noncontrolling interest by \$42.0 million and a decrease of additional paid-in capital by \$121.8 million.

#### 5. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net of accumulated depreciation and depletion, as of June 30, 2014 and December 31, 2013 consisted of the following:

	<u>June 30, 2014</u>	<u>December 31, 2013</u>
Switches, transmission devices, network and base station equipment	\$ 13,643,335	\$ 14,083,007
Refining, distribution and chemicals	5,288,741	5,581,517
Exploration and production assets	6,320,561	4,660,966
Buildings and leasehold improvements	2,196,149	2,166,179
Power and utilities	764,296	760,686
Other plant, machinery and equipment	2,314,945	2,276,965
Construction in progress and equipment for installation	3,159,917	2,964,278
Land	184,112	160,973
	<u>33,872,056</u>	<u>32,654,571</u>
Less: accumulated depreciation and depletion	<u>(12,673,492)</u>	<u>(12,708,870)</u>
<b>Total</b>	<u><u>\$ 21,198,564</u></u>	<u><u>\$ 19,945,701</u></u>

Depreciation and depletion expenses for the six months ended June 30, 2014 and 2013 amounted to \$1,228.8 million and \$1,359.6 million, respectively.

## SISTEMA JSFC AND SUBSIDIARIES

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#### 6. GOODWILL

The carrying amounts of goodwill attributable to each reportable segment are as follows:

	MTS	SSTL	MTS Bank	RTI	Other	Total
<b>Balance as of January 1, 2013</b>						
Gross amount of goodwill	\$ 1,441,836	339,059	67,919	278,449	81,209	2,208,472
Accumulated impairment loss	(48,261)	(339,059)	(67,919)	-	-	(455,239)
	<u>1,393,575</u>	<u>-</u>	<u>-</u>	<u>278,449</u>	<u>81,209</u>	<u>1,753,233</u>
Adjustments to preliminary allocations	-	-	-	-	(28,088)	(28,088)
Disposal of subsidiaries	-	-	-	-	(36,350)	(36,350)
Currency translation adjustment	(94,571)	-	-	(16,170)	(4,098)	(114,839)
<b>Balance as of June 30, 2013</b>						
Gross amount of goodwill	1,343,823	311,104	63,068	262,279	12,673	1,992,947
Accumulated impairment loss	(44,819)	(311,104)	(63,068)	-	-	(418,991)
	<u>\$ 1,299,004</u>	<u>-</u>	<u>-</u>	<u>262,279</u>	<u>12,673</u>	<u>1,573,956</u>
<b>Balance as of January 1, 2014</b>						
Gross amount of goodwill	\$ 1,343,717	300,047	63,068	254,291	25,693	1,986,816
Accumulated impairment loss	(44,822)	(300,047)	(63,068)	(251,100)	-	(659,037)
	<u>1,298,895</u>	<u>-</u>	<u>-</u>	<u>3,191</u>	<u>25,693</u>	<u>1,327,779</u>
Currency translation adjustment	(34,433)	-	-	(86)	(874)	(35,393)
<b>Balance as of June 30, 2014</b>						
Gross amount of goodwill	1,308,083	309,085	61,378	247,475	24,819	1,950,840
Accumulated impairment loss	(43,621)	(309,085)	(61,378)	(244,370)	-	(658,454)
	<u>\$ 1,264,462</u>	<u>-</u>	<u>-</u>	<u>3,105</u>	<u>24,819</u>	<u>1,292,386</u>

#### 7. OTHER INTANGIBLE ASSETS, NET

Intangible assets other than goodwill as of June 30, 2014 and December 31, 2013 consisted of the following:

	June 30, 2014			December 31, 2013		
	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
<b>Amortized intangible assets:</b>						
Billing and telecommunication software	\$ 843,959	(451,704)	392,255	1,053,559	(580,156)	473,403
Acquired customer base and customer relationships	450,589	(260,543)	190,046	468,497	(247,643)	220,854
Radio frequencies	287,209	(140,497)	146,712	301,042	(149,954)	151,088
Operating licenses	764,134	(173,226)	590,908	768,488	(157,778)	610,710
Software and other	1,240,287	(644,561)	595,726	1,072,779	(518,409)	554,370
	<u>3,586,178</u>	<u>(1,670,531)</u>	<u>1,915,647</u>	<u>3,664,365</u>	<u>(1,653,940)</u>	<u>2,010,425</u>
<b>Unamortized intangible assets:</b>						
Trademarks	221,498	-	221,498	206,135	-	206,135
Other	8,413	-	8,413	9,367	-	9,367
<b>Total</b>	<u>\$ 3,816,089</u>	<u>(1,670,531)</u>	<u>2,145,558</u>	<u>3,879,867</u>	<u>(1,653,940)</u>	<u>2,225,927</u>

Amortization expense recorded on other intangible assets for the six months ended June 30, 2014 and 2013 amounted to \$272.4 million and \$255.8 million, respectively.

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### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars, unless otherwise stated)

The estimated amortization expense for each of the five following years and thereafter is as follows:

Six months ending December 31, 2014	\$	276,825
Year ending December 31, 2015		460,023
Year ending December 31, 2016		354,362
Year ending December 31, 2017		240,329
Year ending December 31, 2018		117,952
Thereafter		<u>466,156</u>
	<b>\$</b>	<b><u>1,915,647</u></b>

Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

#### 8. SHORT-TERM LOANS PAYABLE

Short-term loans payable as of June 30, 2014 and December 31, 2013 consisted of the following:

	<b>Interest rate (Actual as at June 30, 2014)</b>	<b>June 30, 2014</b>	<b>December 31, 2013</b>
<i>USD-denominated:</i>			
ING Bank	LIBOR 3m +1.9% (2.13%)	\$ <u>150,000</u>	\$ <u>-</u>
		150,000	-
<i>RUB-denominated:</i>			
Sberbank	12.2%	\$ 44,602	\$ -
Nomos bank	11.0% -12.5%	21,017	19,874
Credit Bank of Moscow	13.2%	5,947	2,444
Bank of Moscow	12.5%	5,501	2,631
Unicredit	10.55%	4,745	-
Saint Petersburg Bank	11.25%	1,017	2,829
Other		<u>42,680</u>	<u>11,928</u>
		125,509	39,706
Denominated in other currencies		1,039	1,130
<b>Total</b>		<b>\$ <u>276,548</u></b>	<b>\$ <u>40,836</u></b>

#### 9. LONG-TERM DEBT

Long-term debt as of June 30, 2014 and December 31, 2013 consisted of the following:

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
Loans from banks	\$ 9,127,245	\$ 6,758,129
Notes and corporate bonds	5,940,940	6,333,809
Capital leases	250,210	80,506
Vendor financing	29,951	31,871
Other borrowings	<u>202,850</u>	<u>30,021</u>
	<b>15,551,196</b>	<b>13,234,336</b>
Less: amounts maturing within one year	<u>(2,583,842)</u>	<u>(2,470,058)</u>
<b>Total</b>	<b>\$ <u>12,967,354</u></b>	<b>\$ <u>10,764,278</u></b>

## SISTEMA JSFC AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars, unless otherwise stated)

The schedule of repayments of long-term debt over the five-year period and thereafter beginning on June 30, 2014 is as follows:

Year ending June 30,	
2015	\$ 2,583,842
2016	2,651,152
2017	3,086,917
2018	1,841,197
2019	2,696,090
Thereafter	2,691,998
<b>Total</b>	<b>\$ 15,551,196</b>

**Loans from banks** – Loans from banks as of June 30, 2014 and December 31, 2013 consisted of the following:

	Maturity	Interest rate (as at June 30, 2014)	June 30, 2014	December 31, 2013
<i>USD-denominated:</i>				
Calyon, ING Bank N.V, Nordea Bank AB, Raiffeisen Zentralbank Osterreich AG	2014-2020	LIBOR+1.15% (1.48%)	\$ 736,069	\$ 798,440
Syndicated loan to Bashneft (Barclays Bank PLC, BNP Paribas S.A., Citibank N.A. and other)	2014-2016	LIBOR+1.7% (1.86%)	575,000	600,000
China Development Bank	2014-2018	LIBOR+1.5% (1.83%)	184,271	187,497
Bank of China	2014-2021	LIBOR+1.5%-3.5% (1.83%-3.83%)	175,098	170,615
Skandinaviska Enskilda Banken AB	2014-2017	LIBOR+0.23%-1.8% (0.55%-2.13%)	110,741	129,494
Bank of Moscow	2014-2018	LIBOR+7.5% (7.73%)	82,552	82,552
Deutsche Bank	2014	LIBOR+1.55% (1.71%)	25,000	100,000
HSBC Bank plc and ING BHF Bank AG	2014	LIBOR+0.3% (0.63%)	2,151	12,022
Other			17,470	27,223
			1,908,352	2,107,843
<i>EUR-denominated:</i>				
Credit Agricole Corporate Bank and BNP Paribas	2014-2018	EURIBOR+1.65% (1.95%)	42,461	47,574
Bank of Moscow	2014-2017	EURIBOR+6.2% (6.5%)	36,790	-
LBWW	2014-2017	EURIBOR+1.52% (1.82%)	22,240	25,630
Bank of China			-	74,403
Other			14,280	14,398
			115,771	162,005
<i>RUB-denominated:</i>				
Sberbank	2014-2020	8.35%-11%	4,795,203	3,228,355
VTB	2014-2019	9.75%-10.55%	1,014,108	77,571
Gazprombank	2014-2019	8.85%-11.45%	646,145	599,977
		CBR+3.0% (11.25%); Mosprime+4.5%-7.25% (13.95%-16.7%);		
Bank of Moscow	2014-2018	8.85%-10.25%	233,163	256,258
		Mosprime+3%-5.25%		
Raiffeisenbank	2014-2016	(12.17%-14.7%),9.45% Mosprime+5.2% (14.37%);	226,283	71,891
Unicredit	2014-2016	10.1%	78,706	73,248
Alfa bank	2014-2015	9.9%-10.99%	45,405	92,486
Credit bank of Moscow			-	30,554
Other			64,109	53,560
			7,103,122	4,483,900
Denominated in other currencies			-	4,381
<b>Total</b>			<b>\$ 9,127,245</b>	<b>\$ 6,758,129</b>

## SISTEMA JSFC AND SUBSIDIARIES

### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars, unless otherwise stated)

As of June 30, 2014 and December 31, 2013, the fair value of loans from banks and financial institutions, including the current portion, approximates their carrying value.

**Notes and corporate bonds** – Notes and corporate bonds as of June 30, 2014 and December 31, 2013 consisted of the following:

	Currency	Interest rate (June 30, 2014)	Fair value as of June 30, 2014	Carrying value as of	
				June 30, 2014	December 31, 2013
MTS International Notes due 2020	USD	8.625%	\$ 805,936	\$ 677,912	\$ 747,634
MTS International Notes due 2023	USD	5.00%	472,776	486,500	500,000
Sistema International Funding S.A Bonds due 2019	USD	6.95%	513,730	485,503	487,854
MTS OJSC Notes due 2020 (series 08)	RUB	8.15%	440,670	446,022	458,306
Sistema JSFC Bonds due 2016 (series 03)	RUB	8.75%	321,064	323,035	329,790
Sistema JSFC Bonds due 2016 (series 04)	RUB	7.65%	307,724	309,924	406,985
Bashneft Bonds due 2022 (series 04)	RUB	9.00%	300,321	297,348	305,538
MTS OJSC Notes due 2023 (series 5O-01)	RUB	8.25%	297,407	297,348	305,538
Bashneft Bonds due 2024 (series 5O-05)	RUB	10.70%	297,348	297,348	-
Bashneft Bonds due 2023 (series 06)	RUB	8.65%	294,286	297,348	305,538
Sistema JSFC Bonds due 2014 (series 02)	RUB	8.35%	287,193	286,049	296,544
MTS OJSC Notes due 2017 (series 07)	RUB	8.70%	283,545	286,699	294,191
Bashneft Bonds due 2023 (series 07)	RUB	8.85%	275,187	284,401	291,623
MTS OJSC Notes due 2015 (series 02)	RUB	7.75%	223,190	224,312	230,567
SSTL Bonds due 2019	INR	15.75%	213,002	213,002	206,795
Bashneft Bonds due 2023 (series 08)	RUB	8.65%	147,187	148,674	152,769
Bashneft Bonds due 2023 (series 09)	RUB	8.85%	130,280	135,427	136,177
MTS OJSC Notes due 2018 (series 03)	RUB	7.00%	113,724	114,295	117,442
Bashneft Bonds due 2014 (series 5O-01)	RUB	0.10%	86,987	89,677	92,147
Bashneft Bonds due 2016 (series 01)	RUB	8.35%	58,231	59,663	61,307
MTS OJSC Notes due 2016 (series 05)	RUB	8.75%	53,381	53,163	54,627
Bashneft Bonds due 2016 (series 03)	RUB	8.35%	50,781	51,103	52,511
Bashneft Bonds due 2016 (series 02)	RUB	8.35%	45,403	46,320	47,596
Detskiy Mir -Center Bonds due 2015 (series 01)	RUB	8.50%	28,231	28,801	35,137
MTS OJSC Notes due 2014 (series 04)			-	-	416,098
Other			936	1,066	1,095
<b>Total</b>			<b>\$ 6,048,520</b>	<b>\$ 5,940,940</b>	<b>\$ 6,333,809</b>

All Group's RUB-denominated notes and corporate bonds are traded on the Moscow Exchange. MTS International Notes due 2020 and 2023, and Sistema International Funding S.A Bonds due 2019 are traded on the Irish Stock Exchange. The fair values of notes and corporate bonds are based on the market quotes as of June 30, 2014 at the exchanges where they are traded.

In certain instances the Group has an unconditional obligation to repurchase notes at par value if claimed by the noteholders, where a subsequent sequential coupon is announced. The notes therefore can be defined as callable obligations under the FASB authoritative guidance on debt, as the holders have the unilateral right to demand repurchase of the notes at par value upon announcement of new coupons. The FASB authoritative guidance on debt requires callable obligations to be disclosed as maturing in the reporting period when the demand for repurchase could be submitted disregarding the expectations of the Group about the intentions of the noteholders. The Group discloses such notes in the aggregated maturities schedule in the reporting periods when the noteholders have the unilateral right to demand repurchase. The dates of the announcement for each particular note issue are as follows:

MTS OJSC Notes due 2018 (series 03)	December 2014
Bashneft Bonds due 2022 (series 04)	February 2015
MTS OJSC Notes due 2020 (series 08)	November 2015
MTS OJSC Notes due 2023 (series 5O-01)	March 2018
Bashneft Bonds due 2023 (series 06)	February 2018
Bashneft Bonds due 2023 (series 07)	February 2020
Bashneft Bonds due 2023 (series 08)	February 2018
Bashneft Bonds due 2024 (series 5O-05)	November 2018
Bashneft Bonds due 2023 (series 09)	February 2020



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**Available credit facilities** – As of June 30, 2014, the Group's total available unused credit facilities amounted to \$2,886.4 million and related to the following credit lines:

	<u>Maturity</u>	<u>Interest rate</u>	<u>Available till</u>	<u>Available amount</u>
Sberbank	2014-2018	9-12%	2014-2018, automatic prolongation	\$ 832,322
Gazprombank	2015-2018	9-10%	2015-2018, automatic prolongation	725,015
VTB	2014-2018	9-10.35%	2014-2018, automatic prolongation	554,934
CitiBank Europe	2015	LIBOR + 0.9%	April 2015	299,995
Alfa Bank	2015	9,9% - 10,99%	December 2015	133,004
Russian Agricultural Bank	2014	6.66%	2014, automatic prolongation	95,000
ING Bank Eurasia	2014	MosPrime + 1.50%	July 2014	74,337
Rosbank	2014	MosPrime/LIBOR/	July 2014	74,337
Bank Zenit	2015	EURIBOR + 0.75%	July 2015	48,732
Bank of Moscow	2015	10.3-12.3%	July 2015	29,871
Other		MosPrime + 5-6%	July 2015	18,870
<b>Total</b>				<b>\$ 2,886,417</b>

**Covenants** – Loans and notes payable by the Group are subject to restrictive covenants, including, but not limited to compliance with certain financial ratios, limitations on dispositions of assets and transactions within the Group, retention of telecom licenses. As of June 30, 2014, the Group had \$399.6 million of RUB-denominated long-term debt that was presented within short-term liabilities in the statement of financial position because of non-compliance with certain financial ratios by its subsidiaries. Management believes that the Group is in compliance with all restrictive financial covenants relating to other long-term debt as of June 30, 2014.

## 10. OTHER LONG-TERM LIABILITIES

Other long term liabilities as of June 30, 2014 and December 31, 2013 consisted of the following:

	<u>June 30, 2014</u>	<u>December 31, 2013</u>
Long-term prepayment on the oil supply agreement	\$ 515,810	\$ -
SSTL payable for 800 MHz spectrum	379,479	351,608
Constructive obligation to OJSC LUKOIL (Note 4)	-	145,669
Other	126,187	98,632
<b>Total</b>	<b>\$ 1,021,476</b>	<b>\$ 595,909</b>

In April 2014, Bashneft entered into a long-term oil supply agreement and subsequently received a prepayment to be settled through physical deliveries of oil products. The total minimum delivery volume approximates 3,150 thousand tons until July 2019. The agreement stipulates pricing calculated with the reference to market quotes. The outstanding balance is subject to interest at LIBOR + 1.5% per annum.

The prepayments will be settled starting from 2016. The Group considers this agreement to be a regular way sale contract which was entered into for the purpose of the delivery of a non-financial item in accordance with the expected sale requirements of Bashneft.

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### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars, unless otherwise stated)

#### 11. FAIR VALUE MEASUREMENTS AND DERIVATIVE FINANCIAL INSTRUMENTS

The following fair value hierarchy table presents information regarding Group's assets and liabilities measured at fair value on a recurring basis as of June 30, 2014 and December 31, 2013:

	Fair value measurements using			Total fair value
	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	
<i>June 30, 2014</i>				
<b>Assets at fair value:</b>				
Trading securities	\$ 865,998	\$ -	\$ -	\$ 865,998
Available-for-sale securities	412,949	182,804	5,741	601,494
Derivative instruments	-	111,892	-	111,892
<b>Total assets</b>	<b>1,278,947</b>	<b>294,696</b>	<b>5,741</b>	<b>1,579,384</b>
<b>Liabilities at fair value:</b>				
Derivative instruments	-	(27,984)	-	(27,984)
Contingent consideration	-	-	(153)	(153)
Redeemable noncontrolling interests	-	-	(64,030)	(64,030)
<b>Total liabilities</b>	<b>\$ -</b>	<b>\$(27,984)</b>	<b>\$(64,183)</b>	<b>\$(92,167)</b>
<i>December 31, 2013</i>				
<b>Assets at fair value:</b>				
Trading securities	\$ 1,050,950	\$ -	\$ -	\$ 1,050,950
Available-for-sale securities	315,432	253,255	7,405	576,092
Derivative instruments	-	56,127	-	56,127
<b>Total assets</b>	<b>1,366,382</b>	<b>309,382</b>	<b>7,405</b>	<b>1,683,169</b>
<b>Liabilities at fair value:</b>				
Derivative instruments	-	(12,863)	-	(12,863)
Contingent consideration	-	-	(336)	(336)
Redeemable noncontrolling interests	-	-	(89,583)	(89,583)
<b>Total liabilities</b>	<b>\$ -</b>	<b>\$(12,863)</b>	<b>\$(89,919)</b>	<b>\$(102,782)</b>

#### 12. SEGMENT INFORMATION

As a diversified holding company, the Company invests in a range of companies which meet its investment and return criteria. The Chief Operating Decision Maker is the Company's Management Board. Information reported to the Company's Management Board for the purpose of resource allocation and the assessment of segment performance is focused on each individual investment holding. The Group's reportable segments are MTS, Bashneft, SSTL, MTS Bank, RTI and Corporate. The Other category includes other operating segments including BNSA, UPC, BPGC, Sistema Mass-media, Detsky mir, Intourist, Medsi, Binnopharm, NIS and Leader-Invest, none of which meets the quantitative thresholds for determining reportable segments.

See Note 1 for a description of the activities of each operating segment of the Group. The accounting policies of the reportable segments are the same as the Group's accounting policies described in the notes to the Group's annual consolidated financial statements for the year ended December 31, 2013. Segment profit represents the operating income/(loss) before certain corporate expenses.

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Financial information by reportable segment is presented below:

For the six months ended June 30, 2014	MTS	Bashneft	SSTL	MTS Bank	RTI	Corporate	Total		Total
							reportable segments	Other	
Net sales to external customers <sup>(a)</sup>	5,592,737	8,652,349	107,541	397,597	635,596	22,487	15,408,307	1,633,745	17,042,052
Intersegment sales	22,580	205,630	-	3,173	119,628	17,166	368,177	116,316	484,493
Equity in net income/(loss) of affiliates	32,970	1,683	-	-	-	-	34,653	(10,881)	23,772
Net interest expense <sup>(b)</sup>	-	-	-	(27,913)	-	-	(27,913)	-	(27,913)
Depreciation, depletion and amortization	1,016,169	288,472	29,531	9,531	40,433	8,397	1,392,533	108,617	1,501,150
Operating income/(loss)	1,432,251	1,192,372	(68,100)	(38,375)	123,689	(149,074)	2,492,763	36,008	2,528,771
Interest income	66,219	70,424	3,937	-	23,405	55,215	219,200	36,231	255,431
Interest expense	229,034	142,626	44,677	-	69,908	93,007	579,252	35,631	614,883
Income tax expense/(benefit)	361,785	238,271	-	(13,481)	29,845	(69,883)	546,537	18,327	564,864
Segment assets	15,831,335	14,968,735	897,389	6,221,894	3,191,016	4,515,362	45,625,731	5,257,318	50,883,049
Indebtedness <sup>(c)</sup>	6,652,102	4,889,863	600,657	-	1,323,867	1,774,721	15,241,210	586,534	15,827,744
Capital expenditures <sup>(d)</sup>	824,882	542,834	14,719	12,331	50,102	28,099	1,472,967	162,788	1,635,755

For the six months ended June 30, 2013	MTS	Bashneft	SSTL	MTS Bank	RTI	Corporate	Total		Total
							reportable segments	Other	
Net sales to external customers <sup>(a)</sup>	6,125,868	8,394,627	116,868	391,682	690,446	22,037	15,741,528	1,076,705	16,818,233
Intersegment sales	9,638	3,483	-	17,908	235,189	19,040	285,258	73,659	358,917
Equity in net income/(net loss) of affiliates	22,495	4,602	-	-	(13,819)	-	13,278	19,053	32,331
Net interest expense <sup>(b)</sup>	-	-	-	(29,551)	-	-	(29,551)	-	(29,551)
Depreciation, depletion and amortization	1,152,150	289,045	33,600	9,676	47,807	7,907	1,540,185	75,199	1,615,384
Operating income/(loss)	1,898,972	1,144,162	(111,866)	(40,444)	(41,212)	(71,774)	2,777,838	70,142	2,847,980
Interest income	48,228	82,685	5,022	-	17,874	43,393	197,202	6,166	203,368
Interest expense	273,370	156,786	68,246	-	67,493	80,046	645,941	57,839	703,780
Income tax expense/(benefit)	323,787	239,367	-	(8,224)	(23,837)	2,114	533,207	12,743	545,950
Segment assets	16,012,426	14,756,183	917,573	7,520,115	3,569,388	3,203,095	45,978,780	3,986,727	49,965,507
Indebtedness <sup>(c)</sup>	7,531,759	3,223,608	692,743	-	1,441,156	1,746,834	14,636,100	302,040	14,938,140
Capital expenditures <sup>(d)</sup>	841,282	460,413	9,575	11,991	46,219	68,224	1,437,704	48,470	1,486,174

(a) Interest income and expenses of MTS Bank are presented as revenues from financial services and cost of financial services, correspondingly, in the Group's consolidated financial statements.

(b) Represents the net interest result of the Group's banking activities. In reviewing the performance of MTS Bank, the chief operating decision maker reviews the net interest result, rather than the gross interest amounts.

(c) Represents the sum of short-term and long-term debt.

(d) Represents purchases of property, plant and equipment and intangible assets.

The following table summarizes dividends to Corporate, declared during the six months ended June 30, 2014 and 2013:

	Six months ended June 30,	
	2014	2013
Bashneft	\$ 818,456	\$ 83,277
MTS	566,806	465,887
Other	56,920	20,643

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The reconciliation of segment operating income to the consolidated income from continuing operations before income tax expense and a reconciliation of segment assets to the consolidated segment assets are as follows:

	<b>Six months ended June 30,</b>	
	<b>2014</b>	<b>2013</b>
Operating income – reportable segments	\$ 2,492,763	\$ 2,777,838
Operating income – other	36,008	70,142
	<u>2,528,771</u>	<u>2,847,980</u>
Intersegment eliminations	(32,263)	(24,957)
<b>Operating income</b>	<b>\$ 2,496,508</b>	<b>\$ 2,823,023</b>
Interest income	168,046	122,975
Change in fair value of derivative financial instruments	-	(1,315)
Interest expense	(572,364)	(643,255)
Foreign currency transaction (loss)	(42,672)	(205,076)
<b>Income from continuing operations before income tax</b>	<b>\$ 2,049,518</b>	<b>\$ 2,096,352</b>

  

	<b>June 30, 2014</b>	<b>June 30, 2013</b>
Total assets – reportable segments	\$ 45,625,731	\$ 45,978,780
Total assets – other	5,257,318	3,986,727
	<u>50,883,049</u>	<u>49,965,507</u>
Intersegment eliminations	(5,694,194)	(5,557,212)
<b>Total assets</b>	<b>\$ 45,188,855</b>	<b>\$ 44,408,295</b>

### 13. RELATED PARTY TRANSACTIONS

The Group sells goods and provides services to and purchases goods and services from its related parties, all of which are Group affiliates, on normal commercial terms. During the six months ended June 30, 2014 and 2013, the Group entered into transactions with related parties as follows:

	<b>Six months ended June 30,</b>	
	<b>2014</b>	<b>2013</b>
Sales	\$ 29,539	\$ 61,193
Cost of sales	(61,474)	(25,385)
Cost of banking activities	(20,600)	(12,182)
Selling, general and administrative expenses	(1,284)	(1,664)
Transportation costs	(58,452)	(68,043)
Interest income	19,509	12,405

As of June 30, 2014 and December 31, 2013, the related party balances were as follows:

	<b>June 30, 2014</b>	<b>December 31, 2013</b>
<b>Assets:</b>		
Short-term investments	\$ 9,239	\$ 9,840
Accounts receivable, net	7,817	35,825
Other current assets	60,441	30,204
Long-term investments	25,064	18,515
<b>Liabilities:</b>		
Accounts payable	\$ (6,929)	\$ (515,987)
Accrued expenses and other current liabilities	(13,217)	(23,614)
Liabilities from banking activities	(518,971)	(526,056)

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#### 14. COMMITMENTS AND CONTINGENCIES

**Operating leases** – The Group leases land, buildings and office space mainly from municipal organizations through contracts which expire in various years through 2063.

Rental expense under operating leases amounting to \$342.3 million and \$372.2 million for the six months period ended June 30, 2014 and 2013, respectively, and is included in selling, general and administrative expenses. Rental expense under operating leases amounting to \$109.5 million and \$121.7 million for the six months period ended June 30, 2014 and 2013 respectively, is included in cost of sales.

Future minimum rental payments under operating leases in effect as of June 30, 2014, are as follows:

During six months ending December 31, 2014	\$	289,500
In the year ending 2015		327,997
In the year ending 2016		305,911
In the year ending 2017		307,686
In the year ending 2018		313,822
Thereafter		802,458
<b>Total</b>	<b>\$</b>	<b><u>2,347,374</u></b>

**Capital commitments** – As of June 30, 2014 the Group had executed purchase agreements of approximately \$2,788.4 million to acquire property, plant and equipment and intangible assets.

**Guarantees** – As of June 30, 2014, MTS Bank and its subsidiaries guaranteed loans for several companies, including related parties, which totaled \$367.6 million. These guarantees would require payment by the Group only in the event of default on payment by the respective debtor. As of June 30, 2014, no event of significant default has occurred under any of the guarantees issued by the Group.

**Commitments on loans and unused credit lines** – As of June 30, 2014, MTS Bank and its subsidiaries had \$183.8 million of commitments on loans and unused credit lines available to its customers.

**Taxation** – Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include VAT, corporate income tax, a number of turnover-based taxes, and payroll (social) taxes. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that are more significant than those typically found in countries with more developed tax systems.

Generally, according to Russian tax legislation, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of June 30, 2014, tax declarations of the Group in Russia for the preceding three fiscal years were open for further review.

The Group purchases supplemental software from foreign suppliers of telecommunications equipment in the ordinary course of business, which is subject to customs regulation. In addition pricing of revenue and expenses between each of the Group's subsidiaries and various discounts and bonuses to the Group's subscribers in the course of performing its marketing activities may be subject to transfer pricing rules. Management believes that it has adequately provided for tax and customs liabilities in the accompanying consolidated financial statements.

As of June 30, 2014 and December 31, 2013, the provision accrued for taxes other than income tax and customs settlements amounted to \$73.7 million and \$69.6 million, respectively. In addition, the accrual for unrecognized income tax benefits, potential penalties and interest recorded in accordance with the authoritative guidance on income taxes totaled \$11.8 million and \$18.8 million as of June 30, 2014 and December 31, 2013, respectively. However, the risk remains that the relevant tax and customs authorities could take differing positions with regard to interpretive issues and the effect could be significant.

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### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 (Amounts in thousands of U.S. dollars, unless otherwise stated)

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**Operating environment** – Emerging markets such as Russia, Ukraine and other CIS countries are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. Laws and regulations affecting businesses in such countries continue to change rapidly, tax and regulatory frameworks are subject to varying interpretations. The future economic direction of Russia and other CIS countries, which are the main markets of the Group's operations, is heavily influenced by the fiscal and monetary policies adopted by their governments, together with developments in the legal, regulatory, and political environment.

Starting from March 2014, sanctions have been imposed in several packages by the U.S. and E.U. on certain Russian officials, businessmen and companies. In addition, in April 2014 credit agency Standard & Poor's downgraded Russia's long-term foreign currency sovereign rating from BBB to BBB- with a negative outlook. Previously, Fitch credit agency has also revised Russia's creditworthiness outlook from stable to negative. These events, including official sanctions, particularly if further extended, may adversely affect the Russian economy through reduced access of the Russian businesses to international capital and export markets, capital flight, weakening of the Russian Ruble and other negative economic consequences. The impact of these developments on the operations and financial position of the Group is at this stage difficult to predict.

During 2014 the political tension in Ukraine remained high and key aspects of its economy continued to deteriorate. On August 12, 2014, the Parliament of Ukraine adopted a draft law allowing for the imposition of sanctions against countries, persons and companies deemed by the Ukrainian government to threaten Ukrainian national interests or the territorial integrity of Ukraine. As of the reporting date, it is unclear whether or how these sanctions might influence the Group. These circumstances, combined with continuing political and economic instability in the country, could result in a negative impact on the Group's business in Ukraine, including its financial position and results of operations, and such impact, if any, could be significant.

**LTE license** – In July 2012, MTS was allocated a license and frequencies necessary to provide LTE telecommunication services in Russia. Under the terms and conditions of the LTE license, the Group is obligated to deploy LTE networks within seven years commencing January 1, 2013 and deliver LTE services in each population center with over 50,000 inhabitants in Russia by 2019. Also, the Group is obligated to invest at least RUB 15 billion (\$446.0 million at the exchange rate as of June 30, 2014) annually toward the LTE roll-out until the network is fully deployed. Management believes that as of June 30, 2014 the Group is in compliance with these conditions.

**Operations in Uzbekistan** – In 2012 the Group filed a claim against the Republic of Uzbekistan in the International Center for Settlement of Investment Disputes ("ICSID"), which is part of the World Bank Group. The tribunal was formed on August 29, 2013 and first procedural hearings took place in November 2013. In July 2014, the Group signed a settlement agreement with the Republic of Uzbekistan ("the Settlement agreement"). According to its terms, the Group intends to resume operations in Uzbekistan through a joint venture ("the Operator") with the government of Uzbekistan. The parties intend to finalize all procedures stipulated in the Settlement agreement and to ensure the commercial launch of the Operator's mobile network by the end of 2014. Within the scope of fulfillment of the terms and conditions set out in Settlement agreement and transfer of a stake in the Operator to MTS the parties will submit a joint application to discontinue ongoing legal proceedings in the ICSID.

**Other litigations** – 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 fiscal and regulatory environments in which the Group operates. In the opinion of management, the Group's liability, if any, in all pending litigation, other legal proceedings or other matters will not have a material effect upon the financial condition, results of operations or liquidity of the Group. Management estimates the range of reasonably possible losses, if any, in all pending litigations or other legal proceedings being up to \$62.5 million.

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### NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS FOR THE SIX MONTHS ENDED JUNE 30, 2014 AND 2013 *(Amounts in thousands of U.S. dollars, unless otherwise stated)*

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#### 15. SUBSEQUENT EVENTS

For the purpose of the accompanying condensed consolidated financial statements, subsequent events have been evaluated through August 26, 2014.

***Restriction on transactions with the shares of Bashneft and Ufaorgsintez*** – In July 2014, the Group received notices about restrictions on transactions with its shares of Bashneft and Ufaorgsintez by the Court of Moscow Basman District at the request of the Investigative Committee. These restrictions do not however limit the Group's voting rights, rights to receive dividends or any other shareholder rights.

***Claim from a minority shareholder*** – In July 2014, a minority shareholder of Bashneft filed a claim against Bashneft and the Rosnedra. In this claim the minority shareholder contested the changes in the license agreement for the deposits of Trebs and Titov and the transfer of the license from Bashneft to Bashneft-Polyus. Management believes that it is not probable that the claim will be satisfied.

***Acquisition of a network of filling stations*** – In August 2014, the Group acquired a 100% interest in a network of filling stations operating under the OPTAN brand name for a total cash consideration of approximately \$225 million.