

**ANNUAL REPORT**  
**of Sistema Public Joint-Stock Financial Corporation**  
**2016**

This report was compiled pursuant to the requirements of the Federal Law *On the Securities Market*.

Financial information provided in this Annual Report is based on statutory accounts prepared in compliance with Russian law and contains elements of consolidated financial statements prepared according to international standards.



**Moscow, 2017**

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## OPENING LETTER FROM THE PRESIDENT OF SISTEMA PJSFC

Dear shareholders,

In 2016, Sistema demonstrated significant progress in the implementation of strategic objectives, as well as steady growth in key financials. Despite challenging macroeconomic conditions, we delivered robust growth at our portfolio companies, successfully monetised a number of investments, reduced the debt burden and increased payouts to the Corporation's shareholders.

Sistema's consolidated revenue and adjusted OIBDA increased by 2.8% and 5.7%, respectively, in 2016. We continued to use the advantages of MTS's leading position in the Russian market, the stability of the operator's cash flow and its focus on shareholder returns. Amid tough competition in the market and complex operating environment, MTS increased its subscriber base to 109.9m subscribers and increased its revenue by 2.1% due to the implementation of its 3D strategy (Data, Differentiation and Dividends).

At the same time, we have further diversified the portfolio and significantly improved other assets of Sistema, which together provided 39% of consolidated revenues, over 15% of our portfolio's total OIBDA and more than 35% of all dividends and regular cash returns to the level of the Corporate Centre.

Detsky Mir continued to successfully implement the strategy of aggressive organic development and market consolidation, demonstrating a 31.4% increase in revenue as a result of a 12.3% growth in like-for-like sales, completion of ramp-up of stores opened in previous years and continued expansion of the retail chain. The group opened 101 new stores in 2016, increasing its retail chain up to 525 stores. It is also worth noting that Detsky Mir continued to improve performance. In particular, SG&A expenses as a percentage of revenue further decreased due to continued automation of key business processes.

Our timber holding Segezha Group achieved high operating and financial results due to the increase in production capacity and sales in almost all key segments. In 2016, the group sold a record number of paper sacks and more than doubled the production of sawn timber through the acquisition and successful integration of Lesosibirsk Woodworking Plant No. 1, Russia's largest vertically integrated woodworking enterprise located in the Krasnoyarsk region. Segezha Group is implementing a large-scale investment programme under which the company carries out overhaul of Segezha Pulp and Paper Mill and increases production capacity for paper sacks and birch plywood.

Sistema continued to actively invest in the agricultural business in order to create one of the largest and most efficient agricultural holdings in the Russian market. In 2016, our agricultural assets included in Steppe Agro Holding increased the land pool by 2.3 times to 315,000 ha, quickly scaled up the main business lines and achieved high operating results, reporting an all-time high crop yield – more than 1m tonnes of grain, about 46,000 tonnes of tomatoes and

cucumbers, as well as more than 16,000 tonnes of apples. Milk production within the dairy farming segment exceeded 36,000 tonnes.

In 2016, the aggregate OIBDA of agricultural assets reached RUB 4bn, and their OIBDA margin exceeded 34%. We are confident that the Corporation's agricultural holding is working in the most promising segments of the agricultural business and is managed by one of the best teams in this fast-growing market, so in 2017 Sistema will continue to actively invest in this business.

Another area that has become an important part of our portfolio is the real estate sector, and the main priority of our assets there is the effective monetisation of the Group's real estate properties and a number of new investments. As of the end of 2016, the project portfolio of our property development company Leader Invest amounted to about 3m sq m, and the total area of rental assets exceeded 470,000 sq m.

One of the key priorities of the Corporation during 2016 and the first quarter of 2017 was the effective monetisation of investments. We are proud that in February 2017 Sistema reopened the Russian market of initial public offerings for foreign investors, successfully completing the IPO of Detsky Mir with a total placement volume of approximately RUB 19.2bn. As a result of this transaction, the asset achieved a solid valuation of roughly 9 EV/2016 EBITDA, representing a fivefold increase in the company's value since 2012. Along with other notable monetisation projects, including the sale of stakes in MTS in 2016 and 2017 and the successful disposal of 50% in SG-trans in September 2016, this IPO allowed us to raise additional funds for the implementation of our strategic objectives.

In 2016, the Corporation fulfilled plans to reduce and optimise the debt burden, significantly increasing financial stability of its business. The total financial liabilities of the Sistema's Corporate Centre decreased by 33% in 2016 to RUB 135.4bn as a result of early repayment of the debt of the Corporation's Indian subsidiary SSTL, as well as the restructuring of the put option for SSTL shares and related payments to the Russian budget. At the same time, the share of FX-denominated debt in the total financial liabilities decreased from 61% to 46% as of 31 December 2016.

We have devoted considerable attention to the improvement of corporate governance and the creation of optimal incentive system within our business model. This is why in May 2016 the Board of Directors adopted a programme introducing the practice of co-investment in the equity of Sistema and its subsidiaries by the Corporation's management. Under this programme, the heads of Sistema's functions and departments annually invest portions of their total annual income in the shares of the Corporation, whereas Sistema's investment portfolio managers invest portions of their total annual income in the shares of existing assets in their portfolios, as well as in each new asset acquired by Sistema and placed in their charge. We are confident that this system ensures the unity of interests of the shareholders and the management of Sistema, and facilitates the adoption of the best management decisions by our team.

Progress in the implementation of the strategy allowed Sistema to continue increasing payouts to the shareholders. Last year, we adopted a new dividend policy, which significantly increases the transparency and predictability of our dividend payments. In accordance with this policy, the Corporation's dividends will correspond to the largest of the dividend amount corresponding to

the minimum annual dividend yield, or the minimum dividend per share. In April 2017, the Board of Directors of Sistema updated the dividend policy, increasing the level of the minimum annual dividend yield on our shares from 4% to 6% and the minimum dividend per share from RUB 0.67 to RUB 1.19, which confirms our confidence in the chosen strategy, our assets and the market where Sistema operates.

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he second quarter of 2017, the Corporation faced a number of serious challenges related to the claims of Bashneft and its current shareholder, which had a negative impact on the market capitalisation of Sistema and its key subsidiaries. We adhere to the policy of open dialogue with all parties in this situation and intend to continue moving forward in order to maximise the shareholder value and develop the Corporation for the benefit of the Russian economy and all of Sistema's stakeholders.

Mikhail Shamolin  
President of Sistema PJSFC

## 1. SISTEMA'S POSITION IN THE INDUSTRY

### 1.1. Profile of Sistema PJSFC

#### Overview

Sistema PJSFC (“the Corporation”) is Russia's largest private investor in the real sector of economy. Sistema's investment portfolio mostly comprises Russian companies operating in various sectors of the economy, including telecom, power industry, retail, hi-tech, etc. Sistema holds controlling interests in most of its portfolio companies.

Sistema's strategic goal is to grow shareholder value by boosting return on investment in the existing assets and reinvesting available cash in new investment projects to achieve diversification and growth of capital returns.

Sistema's expertise focuses on improving the operational efficiency of its assets through restructuring and cooperation with partners to enhance competitiveness and mitigate financial risks.

#### Key performance indicators in 2016

Revenue, RUB bn	698
Cash inflows from investments, RUB bn	~100
Share of non-public companies and Detsky Mir in consolidated OIBDA	15.2%
Dividend yield on Sistema shares in 2016	6%

#### Sistema's fastest growing assets<sup>1</sup>

Asset	Revenue growth in 2016
Steppe Agro Holding	4.2x
Real estate portfolio	2.8x
Detsky Mir Group	31%
Segezha Group	29%
Binnopharm	17%

The Company's shares are traded on the London Stock Exchange (LSE) in the form of global depository receipts (GDRs) under the ticker symbol "SSA". One GDR represents 20 ordinary shares. The company's shares are also traded on the Moscow Stock Exchange under the ticker symbol "AFKS".

#### Sistema is a reliable partner for foreign businesses and states

Partner: Allianz

Investment: ROSNO

In 2002 Sistema partnered with Allianz to develop ROSNO, an insurance holding company. In 2007 Allianz bought Sistema's interest in ROSNO based on a total equity valuation for ROSNO of USD1.58bn.

Partner: Thomas Cook

Investment: Intourist

In 2011 Sistema partnered with Thomas Cook to develop Intourist, a travel agency. The partnership resulted in Thomas Cook acquiring 75% of shares in the joint venture.

Partner: Deutsche Telecom

Investment: MTS

Sistema struck a partnership with Deutsche Telecom during the first years of MTS, a major telecom operator.

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<sup>1</sup> Year-on-year revenue growth in 2016.

Partner: Russian government

Investment: SSTL

In 2011 Sistema partnered with the Russian Government's Federal Agency for State Property Management (Rosimushchestvo), which bought 17% in Sistema's Indian subsidiary SSTL, a telecom operator.

Partner: Luis Dreyfus

Investment: RZ Agro

In 2012 Sistema and the Luis Dreyfus family set up RZ Agro, an agricultural business owning more than 100,000 ha of land. Sistema PJSFC and members of the Luis Dreyfus family are jointly developing an agricultural business in Russia.

## 1.2. Structure of shareholders' equity

Sistema PJSFC has 9,650,000,000 ordinary shares outstanding with a nominal value of RUB 0.09 each. Charter capital amounts to RUB 868,500,000.

In February 2005, Sistema held an IPO on the London Stock Exchange (LSE). Its shares are traded on the LSE in the form of global depository receipts (GDRs) under the ticker symbol SSA. One GDR represents 20 ordinary shares. Sistema's ordinary shares are listed on Moscow Exchange (MOEX) under the ticker symbol AFKS. GDRs traded on LSE represent about 17.6% of Sistema's equity, and shares traded on MOEX account for about 15.3%.

Moscow Exchange includes Sistema's shares when calculating its key indices (MOEX Russia Index, formerly known as MICEX, and RTS), as well as its Banks and Finances Index.

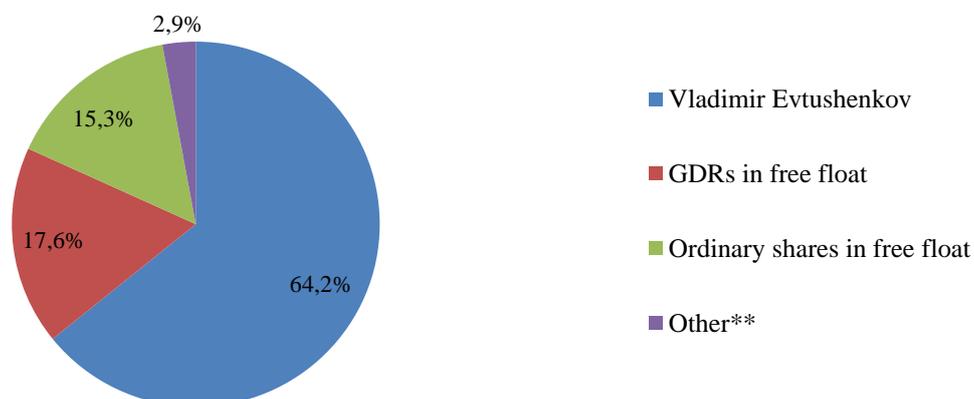
Sistema's GDRs are included in the MSCI Russia Index, one of the MSCI Emerging Markets indices. Inclusion in the MSCI indices testifies to the company's international recognition and promotes the issuer's good reputation among major institutional investors that use these indices when selecting securities.

Shares of PJSC MTS, a Sistema subsidiary, are traded on MOEX under the ticker MTSS and on the New York Stock Exchange (NYSE) in the form of American Depository Receipts (ADRs) under the ticker MBT.

Shares of PJSC Detsky Mir, a Sistema subsidiary, began trading on MOEX in February 2017 under the ticker DSKY in.

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

*Sistema's shareholding structure\**



\*As of 31 March 2017.

### ***1.3. Sistema GDR and ordinary share prices performance***

Sistema's GDRs rose at the same rate as the market in 2016, growing by 52.5%, while its ordinary shares increased by 31.3%. Growth of Sistema's market capitalisation during the year was driven mostly by higher valuations of non-public assets, selective monetisations, adoption of a new dividend policy and increased dividend payments.

On the first trading day of 2016, Sistema's GDRs on the LSE closed at USD 6.04, for a total market capitalisation of USD 2,914.3m. On the last trading day of the year, the closing price was USD 9.00, for a total market capitalisation of USD 4,342.5m.

The highest GDR closing price of 2016, USD 9.00, was achieved on the final trading day of the year. On 8 December, ordinary shares rose to a maximum of RUB 23.49. The lowest GDR closing price was seen on 21 January 2016 (USD 5.06), while the lowest price for the ordinary shares was registered on 7 April 2016 (RUB 16.99). The average daily trading volume on the LSE was 395,144 GDRs, while the average trading volume on MOEX was 6,891,000 ordinary shares.

## 2. PRIORITY BUSINESS AREAS AND DEVELOPMENT STRATEGY

### *Mission*

Sistema's mission is building a first-rate Russian investment company that can ensure long-term growth of shareholder value through efficient management of the asset portfolio and achievement of high returns on investment.

### *Value creation model*

The model selected by Sistema as an investment company envisages portfolio monetisation by accumulation of cash from incoming dividends and sale of assets at their peak value, and further

- (i) distribution of profit among Sistema's shareholders through dividends;
- (ii) investment in the development of existing assets to increase their value;
- (iii) investment in new, promising investment projects which are capable of providing high return on capital.

### *Sistema's goals for the next three to five years*

- Maximising total shareholder return (TSR)
- Creating undisputed leaders in key industries, in particular agriculture, forest products, healthcare, etc.
- Dividend yields for shareholders above the market average
- Raising and managing external capital
- Increasing the share of assets other than MTS to approximately 70% of the portfolio
- Reducing market capitalisation discount to NAV

### *Medium-term goals of Sistema as an investment company*

- Consistent implementation of portfolio strategy:
  - Generating substantial cash flows to Sistema through portfolio monetisation and higher dividends from portfolio companies
  - Diversifying the asset portfolio by acquiring large and medium-sized export-oriented companies in Russia capable of generating revenues in foreign currencies for Sistema's benefit
- Creating value in current portfolio companies:
  - Transforming existing assets into new industry leaders by applying best business practices
  - Restructuring and supporting portfolio companies operating in segments that are most vulnerable to negative macroeconomic factors and are struggling to implement their strategies
  - Implementing best corporate governance practices at subsidiaries, including appointing independent directors to their boards
- Developing international investment platforms in Europe, Asia and the US to:
  - Raise funds from co-investors
  - Ensure extra points of growth for the asset portfolio by entering export markets

### *Basic principles of the investment strategy*

- Generation of returns on investment above the long-term cost of capital ( $IRR > WACC$ ), with a five to seven-year payback period
- Focus on investments with a positive net cash flow
- Acquisition of assets with acceptable debt levels (Debt/OIBDA of the acquired asset  $< 3.0x$ )
- Maintaining the consolidated debt/EBITDA ratio at 2.5x or less
- Substantial dividend payouts pursuant to dividend policy

### *Investment criteria set forth by Sistema's portfolio strategy*

- Sectors and industries: The Corporation mostly buys assets in sectors that are complementary to the ones in which it already operates and that allow available competences to be used and synergies with

the existing portfolio to be unlocked. It also invests in new economically attractive industries, including export-oriented ones, where it has expertise or industrial partners.

- Geography: The Corporation sees Russia and other CIS countries as top-priority investment locations, and also remains open to opportunities to further expand its business geography for the sake of diversification of its currency and country risks
- Asset size: Sistema focuses on large and mid-size assets with the potential to become market leaders through synergies, industry consolidation, and efficient investment and operational strategies.

#### *Asset management principles*

- Sistema improves assets' operational efficiency through restructuring, implementing corporate governance best practices and working with industrial partners to enhance expertise and mitigate financial risks;
- The Corporation aims to maintain a balanced portfolio of stable core assets paying dividends and developing assets at active stages of growth;
- Sistema oversees the implementation of the strategies of its portfolio companies through involvement in their governance bodies and by appointing industrial experts as members of their boards of directors.
- The assets are split into separate portfolios based on deal originators and the industrial expertise of the portfolio managers. The most important key performance indicator (KPI) used to assess management performance is total shareholder return (TSR).

### **3. BOARD REPORT ON THE DEVELOPMENT STATUS IN PRIORITY BUSINESS AREAS**

#### **3.1. Key events of 2016**

##### ***Corporate events***

###### *New progressive dividend policy*

In April 2016, the Board of Directors of Sistema PJSC (“Sistema” or “the Company”, together with its subsidiaries, “the Group”) adopted a new dividend policy. The new policy stated that dividends recommended for each reporting year would be, at a minimum, the higher of either an amount equivalent to a dividend yield of at least 4%, or RUB 0.67 per ordinary share.

In April 2017, the Board of Directors approved amendments to the dividend policy: total dividends recommended for each reporting year will be, at a minimum, the higher of either an amount equal to a dividend yield of at least 6%, or RUB 1.19 per ordinary share.

Sistema will seek to distribute dividends twice per year, based on its results for the first nine months and the full year.

Sistema’s calculation of the dividend yield on its ordinary shares shall use the weighted average price of one ordinary share of the Company traded on Moscow Exchange in the relevant reporting year.

In July 2016, Sistema paid dividends for 2015 in the amount of RUB 6.47bn (RUB 0.67 per ordinary share or RUB 13.4 per GDR).

In October 2016, Sistema distributed RUB 3.667bn in dividends for H1 2016 (RUB 0.38 per ordinary share or RUB 7.6 per GDR).

In April 2017, the Board of Directors recommended that the AGM approve a final dividend for the 2016 financial year of RUB 7.8bn. As a result, the total amount of the interim and final dividends paid for 2016 will be RUB 11.5 billion, which is equivalent to a dividend yield of 6% based on the weighted average price of Sistema’s shares in 2016.

###### *Co-investment Programme*

In May 2016, Sistema adopted a programme for senior management of the Company to participate in the share capital of Sistema and Group companies (“the Programme”). Under the Programme, heads of Sistema’s investment portfolios have the obligation to make a one-off investment equal to a substantial part of their total annual income in shares and participatory interests of existing assets under their management. Heads of investment portfolios also invest a portion of their total annual income in shares and participatory interests of each of new assets acquired under their management during a year. Heads of Sistema’s functional subdivisions invest a substantial part of their total annual income in the Company’s shares.

##### ***Monetisation of investments***

###### *Detsky Mir Group’s IPO*

- ✓ The transaction represented the first Russian IPO with full-scale international marketing in three years
- ✓ The order book was 2x oversubscribed
- ✓ More than 90% of the final offering went to foreign investors
- ✓ The EV/EBITDA’2016 ratio for 2016 was ~9x comparable to the multiples of the largest food retail companies in Russia

In February 2017, Detsky Mir’s shares were listed on the Moscow Exchange. The offering price was set at RUB 85 per share corresponding to the company’s market capitalisation of approximately RUB 62.8bn. The shares WERE admitted to Level 1 of the List of Securities Admitted to Trading on Moscow Exchange under the ticker DSKY. Sistema owned 72.57% of the company’s shares before the Offering and sold 151,301,256 shares, which corresponds to approximately 20.5% of Detsky Mir’s share capital. Following the offering Sistema’s stake in Detsky Mir amounted to 52.1% . As a result of the transaction, Sistema raised ~RUB 12.9bn (before underwriting fees and other expenses).

### *Sale of the stake in SG-trans*

In August 2016, Sistema sold 50% of SG-trans to a group of non-affiliated buyers for RUB 6.0bn. The Corporation remains the owner of assets previously spun off from SG-trans, including SG-trading and real-estate assets.

### ***New projects***

#### *Development of Sistema's land bank*

Sistema continues to make significant investments in agricultural assets. During 2016, Sistema's agricultural business increased its total land bank 2.3 times to 315,000 hectares adding 176,000 hectares of land with acquisitions in May, November and December of 2016 in the Rostov and Stavropol regions.

#### *Acquisition of Lesosibirsk LDK No. 1*

In 2016, Segezha Group, Sistema's pulp and paper holding, acquired a 99% stake in Lesosibirsk LDK No. 1 ("LDK"), one of the largest vertically integrated wood processing enterprises in Russia, based in Krasnoyarsk region. LDK is Russia's leading producer of lumber, fibre board, planed mouldings and furniture made from Angara pine. The acquisition allowed Segezha Group to more than double sales of lumber during the year. In 2016, LDK delivered strong operational and financial performance, contributing RUB 5.7 billion in revenue.

#### *Merger of SSSL's telecommunications business with RCom*

In 2016, Sistema and Reliance Communications Ltd ("RCom") continued to work towards the merger of SSSL's telecommunications business with RCom. The transaction has been approved by India's two main stock exchanges (NSE and BSE), the Securities and Exchange Board of India (SEBI), the Competition Commission of India (CCI), and the Bombay and Rajasthan High Courts. All necessary shareholder and creditor approvals have also been properly secured.

At the moment Sistema and RCom are in discussions with the Department of Telecommunication of India (DoT) and other regulatory and judicial bodies regarding final conditions of the potential transaction.

#### *Development of the hotel business*

In November 2016, Sistema's subsidiary Sistema Hotel Management agreed to acquire nine Regional Hotel Chain (RHC) hotels from VIYM, a company managing the private equity funds in the CIS and Europe, for RUB 2.6bn. The hotels include Courtyard by Marriott Paveletskaya (Moscow), Holiday Inn Express (Voronezh) and seven Park Inn hotels in Astrakhan, Volgograd, Izhevsk, Kazan, Novosibirsk, Sochi, and Yaroslavl, and have a total of 1,379 rooms with floor space of 87,613 sq m. The hotels have total external debt of RUB 4bn. All of the hotels were built over the past five years and do not currently require any capital investments. The hotels opened in 2014-2015 – Holiday Inn Express (Voronezh), Park Inn (Volgograd), Park Inn (Novosibirsk) and Park Inn (Sochi) – have significant potential for increased profitability when they achieve their target performance indicators. For more details about Sistema's hotel business see: Other Investments.

### ***Other events***

#### *Changing ownership stake in MTS*

During 2016, Sistema conducted a number of transactions to sell MTS shares, bringing Sistema's effective stake in MTS's share capital to 50.03%. As a result of the sales, Sistema raised RUB 18.1bn in 2016; an additional RUB 4.7bn was received in the first quarter of 2017 from participating in MTS's share buyback programme.

### 3.2. Key financials

#### RAS

	RUB thousand	
	2016	2015
Revenue, thousand RUB	36,665,582	30,843,245
Income from sales, thousand RUB	25,205,282	20,632,717
Net income (loss) in the reporting period, thousand RUB	(37,372,723)	34,461,228

The core business of Sistema PJSFC is management of interests in commercial organisations.

Revenue structure:	RUB thousand	
	2016	2015
Equity holdings in other companies	36,635,669	30,794,973
Other operating income (property rent, agency services and sureties)	29,914	48,272
TOTAL:	36,665,582	30,843,245

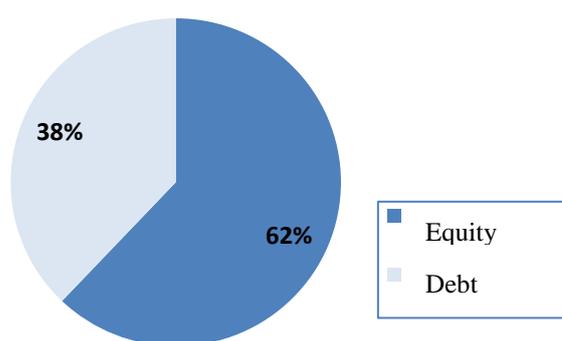
Structure of other incomes and expenses:	RUB thousand	
	2016	2015
Interest receivable	5,285,355	8,908,439
Interest payable	(11,362,516)	(9,073,920)
Other incomes	81,398,676	97,047,630
Other expenses	(138,572,228)	(71,367,743)
TOTAL:	(63,250,713)	25,514,406

Performance indicators:	RUB thousand	
	2016	2015
Productivity, RUB thousand per full time employee	124,290.1	109,762.4
Debt to equity ratio	0.610	0.451
Long-term debt to the sum of long-term debt and equity	0.328	0.240
Debt service coverage ratio	1.11	0.21
Overdue debt, %	0	0

Financial stability indicators:	RUB thousand	
	2016	2015
Net working capital	12,641,154	59,739,476
Current ratio	1.42	2.50
Quick ratio	1.41	2.50

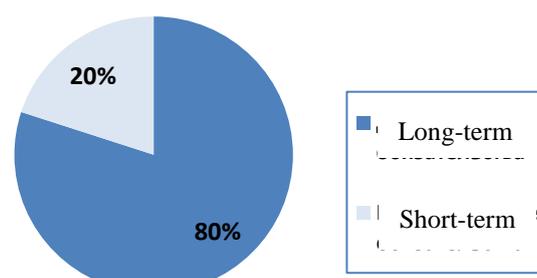
Sistema generally possesses considerable amounts of equity along with the ability to raise debt funding without creating the risk of doubt about its ability to repay such loans. Most of the Group's borrowed funds are long-term liabilities. Neither receivables nor payables are overdue.

### Equity capital and liabilities



Share of equity in the Company's liabilities is 62%

### Structure of liabilities



Share of long-term liabilities in total liabilities of the Company is 80%

## IFRS

### KEY FINANCIALS AND OVERVIEW OF THE GROUP'S OPERATIONS UNDER IFRS

(RUB m)	2016	2015	Change
Revenue	697,705	678,821	2.8%
Adjusted OIBDA	183,719	173,826	5.7%
Operating income	79,844	68,387	16.8%
Net (loss) / income attributable to Sistema	(11,758)	28,799	-
Adjusted net (loss)/ income attributable to Sistema	1,702	(5,852)	-

In 2016, the Group's revenue increased by 2.8%, driven by Detsky Mir's further expansion in the Russian market, acquisitions and organic growth in the agricultural business, the consolidation of Kronstadt Group and strong results at Segezha Group. Lower revenues of RTI, in particular due to the disposal of NVision in 2015, partially offset the Group's strong growth in 2016.

Selling, general and administrative expenses (SG&A) growth was contained to 5.9% year-on-year, generally in line with the inflation rate in Russia over the same period, despite organic growth at MTS and Detsky Mir and an acquisition by Segezha Group driving SG&A higher. Depreciation and amortisation expenses increased by 9.1% year-on-year in 2016.

Despite a modest decline in adjusted OIBDA at MTS, the Group's adjusted OIBDA increased by 5.7% year-on-year in 2016, mainly due to a reduction in provision charges and continued improvements in asset quality at MTS Bank, as well as OIBDA growth at Detsky Mir, Steppe and Segezha.

Adjusted consolidated profit attributable to Sistema was RUB 1.7 billion, compared to a net loss in 2015, largely due to improved results at MTS Bank.

### 3.3. Credit ratings

Sistema PJSC	S&P	BB / stable	24 July 2015
	FITCH	BB- / stable	20 May 2016
MTS	S&P	BB+ / positive	21 March 2017
	FITCH	BB+ / stable	20 May 2016
MTS Bank	Fitch	B+ / stable	10 March 2017
Detsky Mir	S&P	B+ / stable	21 March 2017

In November 2016, Sistema terminated its contractual relationship with Moody's on the grounds that two international ratings is sufficient for creditors and investors in the Corporation's debt securities. Moody's has revoked all of Sistema's ratings. Any ratings assigned by Moody's to Sistema Group companies from now on will be based exclusively on public information and issued at the sole discretion of the agency.

### 3.4. Dividends

#### *Dividend policy*

In 2016, Sistema's Board of Directors approved a revised dividend policy. In line with the new policy, total dividends recommended for each reporting year will be, at a minimum, the higher of either an amount equivalent to a dividend yield of at least 4%, or RUB 0.67 per ordinary share. The Corporation also set itself the goal of paying dividends twice a year: for the first half of a reporting year and for a full reporting year.

In April 2017, after the end of the reporting period, the Board of Directors made further amendments to the Dividend Policy and approved increases of minimum annual dividend yield to 6% from 4% and minimum dividend per share to RUB 1.19 from RUB 0.67. This revised approach to distribution of dividends allows the Corporation to increase the total amount of dividends paid, thereby increasing shareholder returns and strengthening the Corporation's investment case.

In April 2017, the Board of Directors recommended that the AGM approve a final dividend for the 2016 financial year of RUB 7.8bn. As a result, the total amount of the interim and final dividends paid for 2016 will be RUB 11.5bn, which is equivalent to a dividend yield of 6% based on the weighted average price of Sistema's shares in 2016.

#### *Dividends distributed for FY 2015*

On 25 June 2016, the AGM approved a dividend payment of RUB 6,465,500,000.00 in dividends, or RUB 0.67 per ordinary share. As of 31 December 2016, the total amount of dividends distributed was RUB 6,465,433,999.64. Withholding tax on dividends distributed to foreign shareholders totalled RUB 2,383,622.00.

#### *Dividends distributed for the first six months of 2016*

On 23 September 2016, an EGM approved the distribution of RUB 3,667,000,000.00 in dividends, or RUB 0.38 per ordinary share in Sistema PJSFC. As of 31 December 2016, the total amount of dividends distributed was RUB 3,666,960,913.20. Withholding tax on dividends distributed to foreign shareholders totalled RUB 1,337,413.00.

#### *Omitted dividends*

Omitted dividends as of 31 December 2016 totalled RUB 899,034.32, including RUB 105,087.16 due in 2016. These dividends were declared but unpaid due to lack of necessary information about the recipients to make the cash transfers.

	2012	2013	2014	2015	2016 (for FY 2015)	2016 (H1 2016)
Total dividends, RUB	2,702,000,000	9,264,000,000	19,879,000,000	4,535,500,000	6,465,500,000	3,667,000,000
Dividend per share, RUB	0.28	0.96	2.06	0.47	0.67	0.38
Date of dividend announcement	30.06.2012	29.06.2013	28.06.2014	27.06.2015	25.06.2016	23.09.2016

Payable date	24.08.2012	26.08.2013	31.07.2014	29.07.2015	27.07.2016	20.10.2016
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## 4. DEVELOPMENT PROSPECTS AND STRATEGY OF SISTEMA GROUP

### 4.1. MTS

PJSC Mobile TeleSystems is a leading telecom operator in Russia and the CIS. MTS Group has over 109m mobile subscribers in Russia, Armenia, Ukraine, Turkmenistan and Belarus. The company also provides fixed-line telephony, broadband Internet access and television services in Moscow (through its subsidiary MGTS) and all federal districts of Russia. In 2015, MTS entered the market of system integration and satellite TV. The number of its retail outlets in Russia exceeds 6,000. MTS also offers financial services, including the MTS Wallet application.

#### **Sistema's stake**

50.03%

#### **Management**

President: Andrey Dubovskov, Chairman of the Board of Directors: Ron Sommer.

#### *Sector overview<sup>1</sup>*

According to preliminary estimates, revenue growth in the Russian telecom market slowed down from 0.8% in 2015 to 0.6% in 2016, due to the ongoing decline in revenue of fixed-line telephony, zero growth of mobile revenue and slowdown of significant market segments: land-line Internet access and pay television.

The decline of Russian mobile operators' revenue slowed down to approximately 0.3% in 2016 vs. 0.7% in 2015. It was caused by macroeconomic factors, which, among other things, affected revenue from roaming, and also by high competition in retail among telecom operators.

In 2016, Russian telecom operators' revenue from international roaming fell by 13% (vs. a drop of 23% in 2015) due to a decline in foreign travel. By the end of 2016, the fall of revenue slowed down. At the same time, mobile web traffic consumption in roaming per subscriber grew 2-2.5-fold in Q3 2016 year-on-year, which made up for the decrease in consumption of traditional telecom services.

The aggregate number of mobile subscribers in Russia grew by 1.5% over the year to 255.6m people. Mobile Internet remains the main driver of revenue growth. In 2016, leading operators tested and launched into commercial operation IMS-based services (VoLTE and Wi-Fi calling)<sup>2</sup> in the Moscow region, which they later plan to roll out to other regions of Russia. At present, one of the main barriers for mass use of VoLTE technology is low penetration of smartphones supporting this technology - max. 5% at the end of H1 2016. In 2015-2016, mobile operators launched their own web messengers<sup>3</sup> to increase subscribers' loyalty and encourage consumption of services, including web traffic.

The fixed BBA market remains promising, revenue from BBA growing by 3.8% in 2016, while the number of subscribers increased by 4% and exceeded 31m people. An increasing number of subscribers have a high-speed Internet connection due to growing penetration of GPON technology. The main supplier of this service in Moscow is MGTS (a subsidiary of MTS), and its share of the BBA market is 33% (as of Q4 2016).

The number of smartphones sold in Russia in 2016 was 5% higher than in 2015. Revenue from smartphone sales grew by 26.3%, while the average check increased by 20.3% to RUB 12,295. Smartphones accounted for 71% of all mobile phones sold in Russia in 2016 (vs. 67% in 2015).

The telecom market is projected to demonstrate a steady growth in the next five years with a CAGR of 0.4%. Revenue from new business segments (financial services, M2M, cloud services, Big Data, e-commerce, system integration) is so far is not so significant compared to revenue from MTS's traditional telecom services, however, they have a positive effect on customers' loyalty and should later become strong growth drivers (as envisaged by the operator's digital strategies).

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<sup>1</sup> Sources: ACM-Consulting (report 2016), J'Son&Partners Consulting, articles in Vedomosti and Kommersant dd 16 January 2017, reports of MTS, Euroset, Svyaznoy, TMT Consulting, Comnews

<sup>2</sup> VoLTE (Voice over LTE) and Wi-Fi calling (Voice over Wi-Fi) technologies.

<sup>3</sup> MTS launched the MTS Connect application based on Rich Communications Suite, and Megafon the MultiFon/eMotion service.

Stronger competition between Russian mobile operators was the main factor for their falling OIBDA margins. Suboptimal retail structure created as a result requires significant investment for maintaining, while at the same time does not increase any operator's advantage over the others.

#### *Business development in 2016*

MTS remains the leader among the Russian Big Three operators by revenue and OIBDA in absolute terms. In 2016, MTS' active mobile subscriber base grew by 3.5%. The share of mobile Internet users in its active one-month subscriber base reached 49%. Growth of the number of mobile web users continues to be driven by: increased penetration of smartphones into MTS's subscriber base, competitive bundle plans, development of own retail chain. The share of smartphones in MTS's sales reached 76% as of the end of 2016.

In 2016, MTS Russia maintained a positive revenue growth rate, 2.4% YoY, while its revenue from mobile business remained approximately the same as in 2015.

MTS's share in the aggregate Russian mobile revenue of the Big Three operators grew by 0.4 p.p., from 37.7% to 38.1%. In 2016, voice traffic grew by 3.2%, while data traffic generated by owners of smartphones more than doubled.

As to its investment programme, MTS allocated significant amounts for network construction (CAPEX to revenue in Russia amounted to 20% in 2016). The company continued building 2G/3G/4G networks throughout the year. The number of its 4G base stations exceeded 28,000, covering all 83 regions of its operations. Therefore, MTS does not plan any significant spending on network construction in the next few years and sees a potential for CAPEX reduction in future periods.

In December 2015, MTS and Vimpelcom signed an agreement on sharing 4G spectrum in 20 regions of Russia, which supplements the agreement on joint planning, development and operation of LTE networks. The number of such regions was later increased to 31.

In the financial services sector, MTS successfully implemented projects of money transfers between cards using the platforms of MTS Bank, the Russian Post and Western Union; SMS transfers to subscriber's account; the Troika mobile ticket project, and also micro loans for m-commerce services.

In September, MTS, MTS Bank and Samsung Electronics launched Samsung Pay for contactless payments with Samsung phones. Apple Pay was launched in October. Payment services allow adding MTS Bank cards. The MTS Wallet application, launched in February 2017, offers a broad range of financial services.

#### *Business development strategy*

The strategic goal of MTS is to preserve its share of the traditional market (voice communications and mobile data transfer, as well as text messages), monetise the growing consumption of web traffic and new business segments (digital projects). The business growth potential lies in the optimal use of the frequencies, development of data-oriented networks, advanced technologies (VoLTE, Wi-Fi calling, IMS, 5G) and development of a portfolio of digital products.

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 guaranteed minimum payout of RUB 20 per ordinary share and RUB 40 per ADR per calendar year. Dividends paid for calendar year 2016 amounted to RUB 52bn. The board of directors of MTS asked the management to consider the possibility of organising buy-back of shares and their subsequent redemption to ensure shareholder returns for three years (2016-2018) in the amount of up to RUB 30bn. The first buy-back programme was announced in Q4 2016, and MTS bought 3,069,409 shares to an aggregate amount of RUB 747m. In Q1 2017, it announced another buy-back and acquired 32,061,256 shares for RUB 9.3bn.

## 2016 financial performance

<i>(RUB m)</i>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Revenue	435,692	426,639	2.1%
Adjusted OIBDA <sup>1</sup>	167,647	173,255	(3.2%)
Operating income	86,065	90,198	(4.6%)
Net income attributable to Sistema	25,377	26,460	(4.1%)
Net debt	265,850	310,937	(14.5%)
CAPEX	86,149	106,537	(19.1%)

The company's revenue in 2016 grew by 2.1% YoY. Growing consumption of data services and phone sales offset the decline of roaming consumption and lower contribution from foreign subsidiaries. Despite the ongoing macroeconomic volatility and spending on expansion of the retail chain, adjusted OIBDA slumped just by 3.2% in 2016. The adjusted OIBDA margin remained at a high level of 38.5% for FY 2016. The margin was affected by growing sales of mobile phones with relatively low margins. The minor decline of net income in 2016 was due to OIBDA dynamics.

### 4.2. Detsky Mir

Detsky Mir Group is the largest children's goods retailer in Russia and Kazakhstan, comprising Detsky Mir and ELC stores, which offer toys, products for pregnant women and infants, children's apparel and footwear, stationery, arts and crafts kits, and sporting goods.

#### Sistema's stake

72.6%<sup>2</sup>

#### Management

CEO: Vladimir Chirakhov; Chairman of the Board of Directors: Christopher Alan Baxter.

#### Sector overview<sup>3</sup>

The size of Russia's children's goods market in 2016 was RUB 519.5bn. Analysts project that the market will grow by an average of about 1.5% per year, and will reach RUB 554.4bn by 2020. After double-digit growth in 2011-2013, the market found itself in a period of long-term stagnation. The current economic situation has forced Russians to reconsider their approach to purchases of children's goods. Since 2015, price has become the most important factor, and consumer behaviour shifted, with a greater emphasis on cheaper products. This resulted in consumer demand moving from the premium and mid-price segments to the mass market and low-price segments. Russian-made and private label products became very popular, as they were priced lower than similar foreign or branded goods. Online stores have also become an increasingly popular sales channel, offering both a wide range of products and good prices, as well as giving buyers time to evaluate, select and consult. At the same time, the children's goods market is among the most resilient to crises (together with FMCG), and showed growth after both the crisis of 2008-2009 and the crisis of 2014-2015.

In 2016, several children's goods retailers left the market, which led to a short-term drop in the market share of specialised retailers; however, specialised retailers remain the main sales channel for this segment, along with hyper- and supermarkets. The share of e-commerce is steadily growing and expected to exceed 9% in 2017.

The sales of children's goods in Russia varies depending on the region and income levels. The highest levels of per capita spending on children's goods in 2016 were recorded in Moscow (RUB 11,400 versus RUB 6,900 for all of Russia). Detsky Mir Group's expansion is most active in the Moscow region (with

<sup>1</sup> Incl. share in MTS Bank's net loss

<sup>2</sup> Sistema's stake after Detsky Mir's IPO in February 2017: 52.1%

<sup>3</sup> According to data from Ipsos Comcon and Detsky Mir Group

40 new stores opened in 2016) and in St Petersburg. As of the end of 2016, the chain had a total of 147 stores in the Moscow region and 33 stores in St Petersburg.

Detsky Mir's 2016 market share for children's goods in Russia in terms of revenue was 17% overall (up from 13% in 2015) and 6% in terms of online sales (vs. 3% in 2015). Detsky Mir Group is the undisputed leader among specialised children's goods retailers, having three times the market share of the nearest competitor.

### *Business development in 2016*

In February 2017, Detsky Mir completed its IPO on the Moscow Exchange. The share offering was 2.1x oversubscribed, with a placement price RUB 85 per share, implying a market capitalisation of RUB 62.8bn and an EV/EBITDA multiple of 9x. Trading commenced on 10 February 2017 under the ticker symbol DSKY. The success of Detsky Mir's IPO can be seen as recognition of the company's outstanding performance in recent years.

As of 31 December 2016, Detsky Mir Group had 525 stores (480 Detsky Mir stores and 45 ELC stores) in 171 Russian cities and seven cities in Kazakhstan. The company delivered significant growth during the past two years, opening 103 new Detsky Mir stores and 1 ELC in 2015, and another 100 Detsky Mir stores and 1 ELC store in 2016. The Group's total selling space as of 31 December 2016 was 596,000 sq m. The company is the leader in terms of chain size and turnover in the highly-fragmented Russian children's goods market. Detsky Mir's market share in Russia's specialised children's goods retail was 44% in 2016 (compared to 32% in 2015), while the company had 17% of Russia's total market for children's goods including non-specialised hyper- and supermarkets (vs. 13% in 2015).

Successful measures and projects aimed at improving operating efficiency helped to bring down SG&A expenses as a percentage of revenue from 28.2% in 2014 to 23.7% in 2016.

Transition to a single SAP platform played an important role in improving efficiency, helping not only to ensure the creation of a unified information space and the ability to obtain real time analytical information, but also significantly optimising key business processes through automation.

Further centralisation via Detsky Mir's own warehouse in the village of Bekasovo (Moscow region) was another key business development project during 2016. This new warehouse enabled the company to reduce logistics costs, increase centralisation of supplies, improve inventory management and, ultimately, increase turnover.

In 2016, Detsky Mir's online store (<http://www.detmir.ru>) became the largest retailer in terms of online sales in the specialised children's goods market. Over the past few years, the online store has demonstrated unprecedented growth in sales. Revenue grew more than two-fold in 2016, supported by improved services and expanded product mix. The share of the online store in Detsky Mir Group's total revenue was 2.1% in 2015, and grew to 3.5% by the end of 2016.

One of the key drivers of revenue growth was the in-store pick-up feature launched in June 2015: around 50% of online orders in 2016 were picked up in Detsky Mir stores. In addition, orders can be collected at Ozon.ru pick-up points under a partnership agreement. The Detsky Mir online store had a total of 1,387 own and partner pick-up points as of 31 December 2016.

One of Detsky Mir Group's strategic priorities is the development of its private labels. The company currently owns 25 labels in the clothing and footwear categories. Each of them has its own target audience, product mix and price positioning.

Detsky Mir Group also seeks to sign exclusivity agreements with suppliers. Such agreements help to increase traffic, grow like-for-like sales, improve customer loyalty and protect against price competition in the pre-sale period. In 2016, new exclusivity agreements were signed with such companies as Mattel, Hasbro, Lego, Maclaren and Artsana.

### *Business development strategy*

Detsky Mir intends to continue its rapid development in Russia and Kazakhstan, with a focus on increasing the number of stores in the Moscow region, St Petersburg, and cities with populations over 50,000 and a high potential for business growth.

Detsky Mir strives to further enhance its flexible logistics and distribution model, combining (1) a centralised platform based on two distribution centres in the Moscow region (Bekasovo and Krekshino) and (2) direct distribution of products to stores by suppliers.

The company has already increased the share of centralised supplies from 20% of purchase costs for goods that passed through the warehouses in 2013 to 65% of the purchase costs for goods that passed through the warehouses in 2016, and intends to continue increasing the share of centralised supplies to 75-80% of the purchase costs for goods that passed through the warehouses by 2019.

### *2016 financial performance*

<i>(RUB m)</i>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Revenue	79,547	60,544	31.4%
Adjusted OIBDA	8,203	6,185	32.6%
Operating income	6,620	3,805	74.0%
Adjusted net income attributable to Sistema	2,775	2,167	28.0%
Net debt	12,193	16,425	(25.8%)

Detsky Mir's revenue grew by 31.4% year-on-year in 2016, driven by 12.3% growth in like-for-like<sup>1</sup> sales, completion of ramp-up of stores opened in previous years and continued expansion of the retail chain. The online store remains the fastest-growing sales channel, with more than two-fold growth in sales in 2016.

Adjusted OIBDA increased by 32.6% in 2016 on the back of improved operating efficiency. SG&A expenses as a percentage of revenue decreased from 27.7% in 2015 to 23.7% in 2016 due to further automation of key business processes. Since Detsky Mir is an anchor tenant in most shopping malls where its stores are located, the company managed to significantly reduce rental costs as a percentage of revenue and to improve the operating efficiency of the chain's stores.

Adjusted net income attributable to Sistema grew by 28.0% year-on-year in 2016, to RUB 2.8bn. Detsky Mir paid record-high dividends of RUB 4.4bn for 2016, including RUB 3.0bn to Sistema.

### **4.3. Segezha Group**

Segezha Group is Russia's largest vertically integrated forest holding with a full cycle of logging and advanced wood processing; it has a global presence and a diversified product portfolio. The Group comprises forest, wood processing and pulp & paper assets in Russia and Europe. Its production facilities are located in 8 countries and 6 regions of Russia. Segezha's products are available in 88 countries. Its enterprises employ 13 thousand people.

#### **Sistema's stake**

100%

#### **Management**

President: Kamil Zakirov (as of 31 December 2016 - Sergey Pomelov), Chairman of the Board of Directors: Sergey Pomelov (as of 31 December 2016 - Ali Uzdenov).

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<sup>1</sup> like-for-like growth includes only DM stores in Russia that have been in operations for at least 12 full calendar months.

## *Sector overview<sup>1</sup>*

### *Sack paper*

The global market of unbleached sack paper continues growing steadily. The projected global consumption CAGR till 2020 is 2.3%. The growth will be mostly driven by demand from Asian countries. The anti-dumping duties introduced by China in April 2016 (for virtually all producers from Europe, North America and Japan) have created advantages for paper sack producers from Russia and Canada.

Throughout 2016, the dollar-denominated markets of Africa, America and Asia saw a decline in consumption due to the falling demand for cement. In Europe, demand for paper recovered (growing by 1.2% vs. 2015), and the production output of all the key international players increased after a drop in the previous year. In 2017, we expect the prices of sack paper to remain just above the average price of 2016.

### *Paper sacks*

Segezha Group's sack business can be divided into two business units - Russia and Europe. The European market of paper sacks is saturated, with the consumption CAGR till 2020 projected at 1%. Europe currently has a surplus of production capacity, while growth of sack prices in the construction segment has slowed down due to consolidation of the global cement industry, which has had a negative impact on sack prices.

Paper sack consumption in Russia grew by 2% in 2016 to 826m sacks. In H2 2016, with stabilisation of the euro rate and aggressive import substitution efforts of Russian manufacturers (the share of imports went down by 8 p.p. year -on-year to 22%), there was no pressure on prices from importers.

### *Birch plywood*

Birch plywood is a high-margin product for Segezha Group. The biggest consumers of birch plywood are Europe and Russia, their aggregate share of the global market in 2016 being 67%. Global consumption CAGR till 2020 is estimated at 2.6%.

Russia is the world's No.1 producer of birch plywood, accounting for 71% of the total output. In 2016, Russian exports of plywood grew by 11.3% year-on-year, accounting for 65.8% of the country's total plywood output. As a result, there was a deficit in the domestic market, which provoked a 1.3% growth of imports year-on-year. The birch plywood market is likely to remain balanced in 2017, with supply and demand remaining unchanged.

In August 2017, new regulations of the US Environmental Protection Agency and the European Panel Federation will come into force in the United States and Europe. The new standards may have a positive impact on imports to the US and Europe, since they will limit supply of low-quality cheap plywood, which may push up the prices of higher-quality birch plywood.

### *Sawn timber*

The global market of sawn softwood timber grew by 1.5% YoY in 2016. Consumption in Asia Pacific, Central Asia and some Middle Eastern countries (the key markets of Segezha Group) is expected to grow by 1%-3% per annum till 2020. The biggest consumers of sawn timber are the United States and China. The US gets sawn timber mostly from Canadian producers. China (the world's second biggest market) has been demonstrating one of the highest growth rates of demand for sawn timber. In 2016, it continued increasing supply from Russia, and the share of Russian producers reached 50% of its total imports. Deficit of own wood resources, quotas on industrial logging, ban on logging in natural forests and growing demand from the housing construction sector suggest that China's demand for imported sawn softwood timber will remain high in the medium and long term.

## *Business development in 2016*

### *Paper and Packaging*

In 2016, Segezha exported paper and packaging to 53 countries. Paper supplies to South Africa grew 6-fold, to South Korea 4-fold, to Saudi Arabia, Mexico, China, Turkey and Kuwait - 2-fold. While the Russian market of industrial sacks was shrinking, Segezha Group increased its market share thanks to a more successful pricing policy compared to its foreign competitors. In 2017, the Group plans to start

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<sup>1</sup> Sources: Indufor, FAO

selling sacks in some new countries in the Middle East, Africa and Latin America, while maintaining its current share of the European market.

Last year, the company began modernising Segezha Pulp and Paper Mill. It is Russia's first investment project in the last 25 years that envisages installation of a new paper-making machine (PMM No.11). The project is divided into three stages and will be completed in 2018. During the first stage, in autumn 2016, digester No. 4 was upgraded, which increased the capacity of the pulp production facility by 28%, to 1,150 t daily.

Segezha PPM is the world's No.4 and Russia's No.1 producer of unbleached sack paper, accounting for 70% of Russia's total output. Exports account for 92% of paper sales, without intra-group supply (Russia, Europe).

#### *Wood processing (sawn timber)*

Exports account for 99% of Segezha Group's sawn timber sales. The geographical footprint of sales was expanded from 11 to 14 countries. The biggest growth of exports was seen in the following markets: China, United Kingdom, France, Egypt, Estonia, Germany, Belgium and the Netherlands.

Lesosibirsk Woodworking Plant No.1, which was acquired in early 2016, demonstrated strong financial and operational performance during the year. The plant modernised its production facilities, optimised business processes and improved management efficiency. Segezha Group is beginning to work with new timber species, which are in demand on the market - larch and Angara pine. After acquisition of Lesosibirsk WP, Segezha Group has become Russia's biggest exporter of sawn timber.

The company achieved its annual target for sawn timber production ahead of schedule, reaching an all-time high of 2.3m cu m. In 2016, Segezha expanded its fleet of logging machines and timber trucks. The share of own resources in the total raw wood consumed by the Group reached 63%. The area of leased forests now equals 6.8m ha.

#### *Plywood and wood boards*

In 2016, with domestic demand declining and demand on foreign markets rising, Segezha increased the share of export in its sales from 71% to 77%. The company's products in this segment are now available in 59 countries (vs. 46 in 2015). In 2017, the Group plans to develop its customer base, and to enter new markets and consumption segments, such as car-making and shipbuilding.

Last year, it began the construction of a new plywood facility at the Vyatka Plywood Mill in Kirov, which, in addition to short-grain plywood, will manufacture long-grain plywood, a new product for the company. Long-grain plywood has a more appealing look due to position of wood fibres and is in high demand for furniture manufacturing, interior decoration and design works. Introduction of the new product will allow Segezha to increase its presence on the markets with the highest demand, i.e. Asia, United Kingdom and the United States.

#### *Prefab houses*

Segezha Group remained Russia's No.1 producer of prefabricated log houses (30,300 cu m) in 2016. In order to increase its share of the domestic market in 2017, the company plans to develop a sales force in regions, and set up an in-house architectural and design unit and a customer support service. It will also build a large timber-processing cluster around the Sokol Woodworking Plant in the Vologda region.

### **Production parameters**

Sales:	Units	2016	2015	%
Paper sacks	m pcs	1,269.8	1,125.0	12.9%
Paper and cardboard	K t	169.9	185.6	-8.5%
Sawn timber	K cu m	912.0	389.7	134.0%
Laminated wooden structures	K cu m	21.9	5.8	275.3%
Prefab glulam houses	K cu m	30.3	23.9	26.6%
Birch plywood	K cu m	92.1	89.9	2.5%
Fibreboards	K sq m	49.3	24.2	103.6%
Share of self-supplied wood	%	63%	57%	6 p.p.
Round timber production	million cu m	3.8	3.0	25.5%

- Sales of paper sacks grew in 2016 vs. previous year thanks to the commissioning of a new production facility. As

a result, Segezha Group beat its own record and manufactured 1.2bn paper sacks last year. This was made possible by installation of a new production line in Segezha at the end of 2015, launch of a facility in Salsk, which in 2016 produced 54m sacks, and implementation of the "Off Season" programme. This programme envisages full utilisation of capacity during the low season in order to sell products during the high season.

- Expanding paper sack production, the Group increased consumption of own paper for their manufacturing. As a result, sale of sack paper to outside buyers fell year-on-year. In 2016, Segezha Group manufactured 286,400 t of paper, the same amount as in 2015, despite the stoppage at the Segezha PPM for modernisation works.
- Sawm timber sales surged by more than 100% YoY thanks to acquisition of Lesosibirsk WP and increased output of other enterprises, which was achieved through a set of measures aimed at enhancing efficiency. The division demonstrated an all-time high output in 2016, producing 875,300 cu m of sawn timber.
- Sales of birch plywood grew in 2016 vs. 2015. The slump in sales in Q4 2016 was due to a temporary decline of demand from customers following a rise in demand in Q2 and Q3 caused by the rouble's strengthening. Sales of fibreboards almost doubled as a result of the acquisition of Lesosibirsk WP and growth of demand vs. the previous year, due to Belarusian producers leaving the Russian market. Birch plywood production totalled 95,100 cu m, the same as in 2015 due to full utilisation of capacity.
- Logging in Q4 grew by 62.2%, thanks to the takeover of LWP's logging area, upgrade of the logging fleet with machines with higher productivity, and the management's efforts to encourage logging increase.

### *Business development strategy*

Segezha Group's top strategic goal is to become a leader for efficiency among Russian and global players in the pulp&paper and timber processing sectors and expand into the most profitable and growing markets.

One of the company's focus areas is increasing the share of raw materials supplied from own woodland to 80%. As part of the investment project to modernise Segezha PPM, the capacity of its digester will be increased to 380,000 t of pulp p.a., and a new paper-making machine will be launched, with a capacity of 110,000 t of sack paper p.a.

Segezha Group will continue optimising its production facilities in Europe (Segezha Packaging) and will create new conversion facilities on growing markets with a high share of imported sack paper in order to increase vertical integration and guarantee sales of sack paper.

It also intends to commission a new plywood mill in Kirov later this year. The company is currently considering construction of another plywood mill in Sokol, the Vologda region, with a capacity of 130,000 cu m.

Simultaneously with the increase of the plywood production capacity, Segezha Group will continue developing sales in high-margin segments (transport, LNG, and casing) and launching new products by working with customers and setting up a plywood R&D centre in Kirov.

### *2016 financial performance*

(RUB m)	2016	2015	Change
Revenue	43,018	33,436	28.7%
Adjusted OIBDA	8,655	6,289	37.6%
Operating income	5,165	4,123	25.3%
Adjusted net income attributable to Sistema	1,961	2,289	(14.3%)
Net debt	23,715	698	x34
CAPEX	9,555	4,648	x2

Segezha Group's revenue grew by 28.7% in 2016, which was achieved through increase of production capacity, expansion of the geography of paper sack sales, and acquisition of Lesosibirsk Woodworking Plant No.1 Lesosibirsk WP contributed RUB 5.7bn to the Group's revenue in 2016.

Adjusted OIBDA grew by 37.6%, mainly due to Lesosibirsk WP and the launch of the new paper sacks production facility in Salsk, the Rostov region.

Adjusted net income attributable to Sistema decreased due to higher depreciation costs as a result of implementation of the investment programme, and due to increased interest expenses.

In 2016, Segezha Group took out its first EUR 383.6m syndicated loan. The money is provided for five years and will mostly be used to finance the company's large-scale investment programme.

#### **4.4. Steppe Agro Holding**

JSC Steppe Agro Holding is a major player in the Russian agricultural sector and owns a diversified portfolio of assets in four key segments: crop farming, dairy farming, fruit growing and vegetable growing. Agro Holding's assets are located in South Russia, in the most favourable regions in terms of climate, crop yields and logistics: the Krasnodar, Stavropol, and Rostov regions and the Republic of Karachay-Cherkessia. Steppe Agro Holding holds a 50% equity stake in RZ Agro<sup>1</sup>, a joint venture with the Louis Dreyfus family.

##### **Sistema's stake**

88.13%

##### **Management**

CEO - Konstantin Averin, Chairman of the Board of Directors - Ali Uzdenov.

##### *Sector overview<sup>2</sup>*

###### *Crop farming*

Crop farming demonstrated a substantial growth in 2016: Russia harvested 119m tons of grains and grain legumes, the biggest crop in its post-Soviet history. Wheat production reached an all-time high of 73.3m tons, having grown by 19% from 2015. Wheat exports in 2016/2017 crop year are projected at 28.5m tons, which will make Russia the world's leading wheat exporter.

International prices on agricultural produce continued falling in 2016, which is a serious negative factor for the industry. International wheat prices hit a low vs. the ten-year average, but the rouble's depreciation eliminated the negative effect from the decline of international prices for Russian agricultural producers.

The Russian government's decision to establish zero export duties on wheat from September 2016 till July 2018 had a positive impact on export dynamics.

The significant growth of agricultural crops and crop yields in Russia in the last three years has led to a surge of investment activity and a high demand for land assets on the part of investors. Plenty of and assets have been consolidated in the last three years, with prices of agricultural land growing significantly.

###### *Dairy farming*

Russia has been witnessing a gradual decline of milk output in the last five years. The main reason is the decline in output of household farms (which in 2016 accounted for 44% of Russia's total milk output). The share of marketable milk in Russia's total milk output was estimated at 66% in 2016. The low share of marketable milk results in a deficit of milk suitable for processing, growth of milk prices and the need to import milk. The share of imports in Russia's total milk consumption is estimated at 20%.

The total number of lactating cows in Russia in 2016 was 8.3 million, having fallen by 8% in the last five years, mainly due to the reduction of livestock kept by household farms and inefficient producers leaving the market. The decrease is offset by the gradual growth of milk yield per cow: in 2016, the average milk yield at agricultural companies reached 5,500 l a year, hitting a 15-year high.

###### *Fruit growing*

Fruit growing in Russia has been demonstrating positive dynamics, including apple production. However, despite the increasing output and introduction of the food embargo, dependence on imports remains high: imported apples account for about 36% of consumption in Russia.

Fruit growing has a substantial growth and import substitution potential through planting of new intensive-type orchards. The average apple yield of Russian agricultural enterprises is about 11 t/ha, while the yields of intensive-type orchards is 40-50 t/ha. Fast development of the fruit growing segment in Russia is hindered by its high capital intensity and fairly long payback periods.

###### *Vegetable growing*

Production of protected-ground vegetables in Russia has grown substantially in 2013-2016, reaching 783,000 t in 2016, the highest result in the last 20 years.

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<sup>1</sup> RZ Agro's results are not consolidated into Steppe's financial results.

<sup>2</sup> Sources: the Russian Federal Statistics Service, USDA, FAO, the Russian Federal Customs Service

Development of vegetable production was to a large extent spurred by introduction of the food embargo in 2014 and the subsequent ban on imports of tomatoes and cucumbers from Turkey, as well as the rouble's depreciation, which made imported vegetables more expensive and less competitive.

#### *Business development in 2016*

Steppe Agro Holding is a large agricultural holding with 315,000 ha in land assets, operating in four high-potential agricultural segments: crop farming, dairy farming, fruit growing and vegetable growing.

Steppe Agro Holding operates in the following regions: the Krasnodar, Rostov, and Stavropol regions and the Republic of Karachay-Cherkessia, which are among Russia's most favourable areas for agricultural development. Soil quality and the optimal amount of precipitation in these regions make it possible to achieve high yields, while the short transportation distance creates advantages in terms of logistics costs.

#### *Crop farming*

Steppe Agro Holding's land assets totalled 315,000 ha as of the end of 2016, including 99,000 ha of RZ Agro. In 2016, the company acquired 178,000 ha of land.

In 2016, it reported an all-time high grain crop - 1.04m tons. The substantial increase was achieved thanks to acquisition of new land assets and introduction of state-of-the-art agri technologies and agronomic discipline.

#### **Steppe Agro Holding's gross harvest (incl. RZ Agro), K t (incl. assets acquired in May 2016)**

Crop	2014*	2015*	2016**	2016 / 2015
Winter wheat	297.1	269.7	485.6	+80%
Winter barley	19.8	17.2	21.9	+27%
Sugar beet	303.8	252.2	339.5	+35%
Sunflower	21.8	29.4	31.9	+9%
Grain corn	35.5	52.1	40.5	-22%
Other	124.8	133.4	121.8	-9%
<b>Total</b>	<b>802.9</b>	<b>754.0</b>	<b>1,041.0</b>	<b>+38%</b>

\* *pro forma incl. the results of 5 farms in the Krasnodar region and OJSC Rodina*

\*\* *net of assets acquired in November and December 2016*

#### **Average yields of Steppe Agro Holding's main crops (incl. RZ Agro), t/ha (incl. assets acquired in May 2016)**

Crop	2014*	2015*	2016**	2016 / 2015
Winter wheat	5.1	4.8	5.1	+7%
Winter barley	5.5	6.0	5.5	-9%
Sugar beet	52.5	46.8	60.0	+28%
Sunflower	2.3	2.4	2.5	+7%
Grain corn	5.4	6.9	6.0	-13%

\* *pro forma incl. the results of 5 farms in the Krasnodar region and OJSC Rodina*

\*\* *net of assets acquired in November and December 2016*

In May 2016, Steppe Agro Holding acquired 110,000 ha of land in the Stavropol and Rostov regions. The assets were fully integrated in the holding and included in the harvesting campaign of 2016. Gross wheat harvest of the new assets was 171,800 t, an increase of 65% from 2015 results. The substantial growth of gross collection and yield was achieved by using the required amount of fertilisers and optimising the time of harvesting.

At the end of 2016, Steppe Agro Holding acquired another 68,000 ha of land, which is currently being integrated into the company.

#### *Dairy farming*

Steppe Agro Holding achieved a substantial improvement of the segment's operational results vs. 2015.

#### **Operational results of dairy farming**

	<b>2014</b>	<b>2015</b>	<b>2016</b>	<b>2016/2015</b>
Number of lactating cows	3,084	3,272	3,700	13%
Gross milk yield, K t	27.9	30.2	36.2	20%

The key event of 2016 for the dairy farming segment was receipt of a certificate confirming the farms' compliance with European standards, allowing Steppe to supply milk for manufacturing of dairy products to be exported to the EU.

#### *Fruit growing*

Steppe Agro Holding owns two fruit growing assets - OJSC Trudovoye and LLC Sady Kubani. At the time of acquisition, the area of intensive orchards was 630 ha. In 2016, the company planted another 150 ha of orchards, which are expected to reach their projected yields in 2018. Thus, the total area of the holding's orchards reached 780 ha by the end of 2016.

Gross apple output by Steppe's farms grew by 5% in 2016 to 15,900 t. The orchard yield also grew by 5%, to 42.1 t/ha.

#### **Operational results of fruit growing**

	<b>2014*</b>	<b>2015</b>	<b>2016</b>	<b>2016/2015</b>
Area under orchards, ha	630	630	780	+24%
Gross harvest, K t	11.6	15.1	16.4	+5%
Orchard yield, t/ha	32.7	40.2	42.1	+5%

\* Based on management accounts

#### *Vegetable growing*

Yuzhny Agricultural Complex (which was acquired by Steppe Agro Holding in December 2015) is Russia's biggest producer of protected-ground vegetables, with 144 ha of greenhouses. In 2016, its gross harvest of tomatoes and cucumbers grew by 22% to 45,800 t due to increase of land used for production from 118.5 ha in 2015 to 130.5 ha in 2016, and increase of the average yield from 31.6 kg/sq m in 2015 to 35.1 kg/sq m in 2016.

#### **Operational results of vegetable growing**

	<b>2014*</b>	<b>2015</b>	<b>2016</b>	<b>2016/2015</b>
<b>Gross harvest, K t</b>	<b>33.4</b>	<b>37.5</b>	<b>45.8</b>	<b>+22%</b>
Tomatoes	20.4	19.6	21.3	+9%
Cucumbers	12.9	17.9	24.5	+37%
<b>Yield, kg/sq m</b>	<b>29.7</b>	<b>31.6</b>	<b>35.1</b>	<b>+11%</b>
Tomatoes	34.0	32.6	35.6	+9%
Cucumbers	24.7	30.6	34.8	+14%

\* Based on management accounts

In 2016, Yuzhny began implementing a programme for enhancing operational efficiency: it expanded the area of land under seedlings from 6 to 12 ha, which enabled it to start planting earlier and begin harvesting in November.

#### *Business development strategy*

Steppe Agro Holding's development strategy is focused on building a leading agricultural company, which would be one of Russia's Top 5 producers in each of the four segments of its operations. It plans to continue increasing its land holdings and livestock, building new dairy farms, planting orchards and upgrading greenhouses.

The operational strategy envisages increase of the assets' efficiency and full unlocking of their production potential:

- Crop farming: through introduction of new agricultural technologies, optimisation of crop rotation, expansion of the fleet of high-power machines and increase of land in freehold;
- Dairy farming: through maintaining yield per cow at >10,000 p.a. and ensuring compliance with European standards;
- Fruit growing: through achieving maximum yields of intensive orchards and increasing the share of produce sold packaged under own brand;
- Vegetable growing: through optimisation of the variety split, increase of the share of produce sold during the high season (November-May) and the share of produce sold packaged under own brand.

#### *Financial results of Steppe Agro Holding*

<i>(RUB m)</i>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Revenue	8,358	2,122	293.8%
Adjusted OIBDA	2,857	674	323.9%
Operating income	2,941	548	436.2%
Adjusted net income attributable to Sistema	871	136	540.5%
Net debt	8,265	1,549	x5

#### *Financial results of RZ Agro*

<i>(RUB m)</i>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Revenue	3,164	2,266	39.6%
OIBDA	1,134	1,189	-4.6%
Net income	965	941	2.6%
(Net cash position) / Net debt	(291)	62	-

#### **4.5. Bashkir Power Grid Company**

JSC Bashkir Power Grid Company (BPGC) is one of Russia's largest regional energy companies. It manages distribution and transmission grid assets in the Republic of Bashkortostan. The aggregate installed capacity of its substations is 22,048.12 MVA. BPGC owns 100% of equity in LLC Bashkirenergo, LLC BGC and LLC BPGC Engineering.

##### **Sistema's stake**

90.96%

##### **Management**

CEO: Dmitry Sharovатов; Chairman of the Board of Directors: Vadim Pavlus.

##### *Sector overview*

For an overwhelming majority of territorial grid operators in Bashkortostan, 2016 was the first year of a new long-term regulation period. The gross revenue requirement and long-term regulation parameters for these TGOs were set using peer benchmarking in accordance with current legislation. Bashkirenergo (a subsidiary of BPGC) will continue using the regulated asset base (RAB) method of tariff regulation (applicable from 2014 till 2023).

According to the Russian Federal Anti-Monopoly Service, the net supply growth rate will decline to 0.6% in 2017 due to widespread introduction of energy saving technologies and an overall slump in power consumption.

In 2016, the number of TGOs was reduced further, in accordance with the Russian government's development strategy for the sector. In Bashkortostan, 6 companies lost the status of a territorial grid operator, their total number down to 46.

The key changes in power grid regulations in 2016 included:

- introduction of standard tariff rates, determining the amount of utility connection fee that is calculated using benchmarking and set equal for all TGOs in an administrative area;
- permission to regional regulators to transfer reasonable expenses (and withdrawals) for five years for big TGOs with at least 10% share in regional revenue;
- toughening of criteria for granting the TGO status.

In 2017, we expect tariff regulation to become even more stringent, with the government introducing the "inflation minus" principle for the earnings forming process, toughening requirements to reliability and quality of services provided and criteria for granting the TGO status.

The key macroeconomic factor having impact on the business of BPGC Group is inflation. The main customers of grid transmission services in Bashkortostan are large industrial enterprises and, given that the Russian government expects the country's economic growth to resume, net power supply may grow in 2017. The important tax factors include the plans to introduce a corporate tax on movables in Bashkortostan, which will create additional costs for companies.

### *Business development in 2016*

BPGC is an innovative, efficient and dynamic company, which dominates the power grid market in the Republic of Bashkortostan. BPGC is well-positioned among neighbouring inter-regional grid companies in terms of the size of power grid infrastructure and is one of the leaders for the amount of uniform (common pot) tariffs.

BPGC owns 82,000 km of 0.4-500 kV trunk and distribution grids, three 500 kV substations, 12 220 kV substations, 250 110 kV substations, 334 35 kV substations and 22,894 6-10/0.4 kV transformer stations.

Based on the tariff and balance decisions for 2017, BPGC's share in the total amount of gross revenue requirement for maintenance of power grids in Bashkortostan grew to 80%.

In 2016, the company's investment programme was increased by 24% due to implementation of a large project - construction of the Gvardeiskaya 220 kV substation with a 220 kV supply main worth RUB 801.9m. Last year, the company also put into operation the following large grid infrastructure facilities:

- the Zubovo 110 kV substation (with transformer capacity of 2\*40 MVA) with a 110 kV supply main in the village of Zubovo. The cost of the project was RUB 374m. Its goal was to provide reliable power supply to Zubovo, Chesnokovka, Nizhegorodka, Taptykovo and Lekarevka.
- the Irek 110 kV substation (with transformer capacity of 2\*25 MVA) with a 110 kV supply main in the village of Chishmy. Investment in the project totalled RUB 290m. The substation will supply power to four new districts of the town.
- Investment in the project of comprehensive reconstruction of power grids in Ufa (Smart Grid) amounted to RUB 796.2m in 2016. Financing for 2017 is projected at RUB 967m.

The number of new customers connecting to power grids continues growing. The number of utility connections grew by 11.3% in 2016 to 24,232. Power losses remained the same as in 2015, despite connection of new TGOs.

### **Production parameters**

Indicator	UoM	2016		2015		%	
		Bashkirenergo	BGC	Bashkirenergo	BGC	Bashkirenergo	BGC
Power losses	%	8.2%	1.3%	8.2%	1.4%	-	-
Power in	m kWh	22,285.8	24,978.7	21,805.9	21,796.9	+2.2%	+14.6%
Net supply from distribution grids	m kWh	20,451.6	24,657.9	20,012.5	21,500.16	+2.2%	+14.7%
Number of new connections, incl.:	pcs	24,232	2	21,765	1	+11.3%	+200%
Connected capacity	MW	393.9	4	454.3	3.6	-13.3%	+11%

### *Business development strategy*

BPGC's key strategic focus areas with regard to development of the regulated business are optimisation of the investment programme and overhaul of its grids using state-of-the-art innovative and intelligent solutions, including implementation of the programme of comprehensive reconstruction of power grids in Ufa using Smart Grid technology. Preliminary results of the programme's implementation show its high efficiency and allow expecting a substantial decrease of electricity losses and of the number of accidents and interruptions in power supply to consumers, as well as a 20% reduction of maintenance costs.

The experience gained from the Smart Grid project and manufacturing of equipment adapted for Russian grids that was set up together with Siemens form the basis for promoting BPGC's subsidiary, BPGC Engineering, which offers turn-key overhaul of power grids, on external markets.

### *2016 financial performance*

<i>(RUB m)</i>	<b>2016</b>	<b>2015</b>	
Revenue	16,052	14,816	8.3%
OIBDA	5,636	4,331	30.1%
Operating income	3,404	2,094	62.6%
Net income attributable to Sistema	2,706	2,027	33.5%

The company's revenue in 2016 grew by 8.3% YoY. OIBDA increased by 30.1%. BPGC continues using the regulated asset base (RAB) method of tariff regulation (applicable from 2014 to 2023). OIBDA margin grew by 5.9 p.p. over the year to 35.1%. OIBDA margin growth was mostly driven by a decrease in provisions made for potential disputes with counterparties in relation to power transmission and sales.

## **4.6. RTI**

RTI is a major holding company in the field of defence and microelectronic solutions, which integrates high-tech research and manufacturing companies. RTI's enterprises have their own R&D infrastructure and implement projects in radio and space technologies, security and microelectronics that are unique in terms of their scale and complexity. RTI comprises OJSC RTI Systems Concern and PJSC Mikron.

### **Sistema's stake**

87.00%

### **Management**

Igor Bevzyuk, CEO; Sergey Boev, Chairman of the Board of Directors

### *Industry<sup>1</sup>*

#### *Defence Solutions*

One of the main trends in the defence sector is the optimisation of State budgets; however, RTI's key segment (radars) was affected to a lesser extent by this trend due to its high priority for national defence. In 2016, the technological focus was on improving high-precision weapons systems and increasing the effectiveness of decision support information systems. The company continued to aim at import independence of the entire manufacturing chain, including components and firmware.

#### *Microelectronics*

The demand for microelectronics is growing in the global market, which creates opportunities for increasing the sales of chips, diodes and sensors produced by the Group. A continuing shift from architecture of systems and services to cloud and distributed solutions creates additional demand for

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<sup>1</sup> Source: Ministry of Finance of the Russian Federation

telecommunications microchips, solid-state memory and microprocessors suitable for the processing of Big Data.

The adoption of the Governmental decree on the procedure for designation of chips as products of Russian origin has created new opportunities for enforcement of this procedure to protect certain markets, and to ensure subsidies and preferences for Mikron's products. In particular, the supplies of Russian-made chips for Mir cards will be subsidised under the programme of the Ministry of Industry and Trade.

### *Business development in 2016*

#### *Defence Solutions*

In 2016, the defence business of RTI was focused on state defence contracts, most of which were for radars.

As part of the creation of a continuous radar field for the missile warning system, RTI Group companies have completed testing of three new radar stations in Orsk, Barnaul and Yeniseysk, and also commissioned radar stations in Irkutsk and Kaliningrad.

The next step will be the radar station Voronezh-VP, also being developed by RTI Group. It is expected that the first Voronezh-VP will be deployed in the Kola Peninsula, replacing the currently operational Dnepr radar.

In addition, the company is working on a next generation of mobile rapid-deployment radars and radars using new types of radio photons.

Also, one of the key tasks of the defence division for 2017-2018, given the State's revision of expenditures on national defence, is the expansion of international military-technical cooperation. RTI is planning to monetise its competences and in-house solutions on foreign markets on the basis of existing technologies in the field of mobile radars and radar stations for all environments, systems and control and decision-making support tools.

#### *Microelectronics*

In 2016, Mikron Group reaffirmed its status of Russia's largest producer of microelectronic products and a technological leader, and made a breakthrough in the field of import independence for Russia's strategic industries and expansion of exports.

Mikron remains the undisputed market leader in terms of sales and technological sophistication. With the only functioning production facility at the level of 180-90 nm in Russia, Mikron provides more than 30% of all supplies of Russian microelectronics manufacturers. The importance of having its own component base for Russia's technological independence and cybersecurity strengthens Mikron's position in the public sector and expands opportunities in the formation of protected markets and PPPs for developing next-generation microchips for the energy sector, healthcare and distributed computing systems.

In the domestic market, the key event of 2016 for Mikron was the approval of a plan for guaranteed purchases of Russian civilian microelectronic products in the medium term<sup>1</sup>.

The main mass-delivered microchips of Mikron were granted the status of 1st category microcircuits, which opens up opportunities for using preferences in state and municipal purchases.

In 2016, Mikron began supplying chips for third-generation navigation satellites Glonass-K.

Mikron-produced microchips will replace foreign counterparts in units performing information processing and communications functions.

Mikron's main achievement in the area of bank cards was the development and production of a 100% Russian-made microchip with proprietary operating system for the national bank cards Mir. Mikron produced more than 600,000 integrated circuits in 2016 as part of the Mir project. In 2017, the company plans to reach the level of 15 million microchips for bank cards. Mikron managed to establish close cooperation with MTS Bank, KS Bank and a number of other financial institutions.

Mikron identified the Internet of Things as a new promising market where RFID chips will be used as part of Sensor Fusion technologies.

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<sup>1</sup> In accordance with the orders of the President of the Russian Federation Vladimir Putin and Prime Minister Dmitry Medvedev

## *Strategy*

The strategy of RTI is creating a strong investment profile and financially stable company, a high-tech leader in Russia's defence and microelectronics markets.

The main task of Mikron is to expand the scope of its business by further commercialising new technological opportunities. In addition to promoting sales of Mikron's new competitive products in the Russian and global markets, and providing Russian design centres with broad opportunities for localisation of their production in Russia, plans to reach a new level of integration through the transition from traditional serial sales of microcircuits to development and delivery of finished system solutions based on domestic microelectronics.

In 2017, in the defence industry segment, RTI will continue to work within the approved National Arms Programme through 2020, increasing the share of own production.

RTI's investment programme will amount to RUB 2.7 bn in 2017. The main focus areas of the programme include the creation of a shop for the production of new types of space products, revamping of the Mikron plant, a project to develop and organise the production of new types of electric motors and other construction and installation works.

### **4.7. Real estate assets**

This segment is represented by a number of companies, the key ones being Leader Invest (property development), Business Nedvizhimost and Mosdachtrest (rental assets). Sistema's strategy in real estate is focused on increasing portfolio value with a view to its subsequent monetisation through rental income, property development and sales.

#### *Key companies:*

Leader Invest is a development company carrying out housing and commercial real estate projects in Moscow. The portfolio includes 45 projects with a total area of roughly 3.0 million sq m. The priority segment is housing construction – both small infill construction projects and large-scale comprehensive development projects.

Business Nedvizhimost is managing, leasing and operating commercial real estate. The company owns over 300,000 sq m of real properties in Moscow, and also has assets in Saint Petersburg.

#### **Sistema's stake in JSC Leader Invest, JSC Business Nedvizhimost**

100%

#### **Management**

JSC Leader Invest: Yevgeny Rubtsov, CEO; Felix Evtushenkov, Chairman of the Board of Directors.

JSC Business Nedvizhimost: Stanislav Khatskevich, CEO (as of 31 December 2016: Igor Shabdurasulov); Leonid Monosov, Chairman of the Board of Directors.

#### *Sector overview<sup>1</sup>*

##### **Residential properties**

In 2016, the new housing market was marked by high activity of both property developers and buyers. Twenty-one new projects in the business class segment and 14 new projects in the comfort class segment were started in the past year. The number of apartments on sale grew by 27% year-on-year in the comfort class and remained unchanged in the business class. As of the end of the year, the average price of sq m of new business class housing increased by 5%, while the prices in the comfort segment remained the same as a year before.

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<sup>1</sup> Sources: Rosreestr, Metrium Group, JLL, Knight Frank, ILM and NAI Becar

Moscow's market of existing housing has stabilised after a record plunge in 2015. The number of concluded sale and purchase agreements increased by 11%. As for the market of new housing, the number of concluded construction participation agreements (off-plan sales) almost doubled. It was largely a result of the extension of the government's programme supporting mortgage interest rates, as well as sales promotion by developers through special offers and discounts.

Given the prospects of launch of projects and new stages in existing housing projects, an increase in the volume of supply can be expected in 2017. Growing competition amid a decline in purchasing power will restrict price growth. Only developers of the most high-quality and high-demand projects will be able to raise prices.

### **Commercial real estate**

Roughly 350,000 sq m of office facilities were commissioned in the past year, which is less than half of the volume of new construction last year. This is the lowest result of the past 10 years in Moscow's market of office real estate. The total amount of quality office space in Moscow reached 19.8m sq m, with class A offices accounting for 21% and class B+ offices accounting for 38%.

There is a continued trend of tenants moving to high-quality A/B+ class offices that are getting cheaper.

The vacancy rate in class A was 20.3%, down 5.7% year-on-year. The share of vacant premises in B+ class in December was 19.4%, down 0.3% year-on-year.

The average rent rates of high-quality offices kept slumping in 2016.

A significant part of owners, trying to reduce the vacancy rate, is making concessions to tenants, offering more attractive conditions. The real rent rate on concluded contracts is very different from initial conditions: the discount that a large tenant can negotiate reaches 25-30% in most cases.

### *Business development in 2016*

#### **JSC Leader Invest**

In 2016, the company shifted its focus from infill construction, where it has certain experience, to comprehensive development projects. Diversification of the portfolio through the inclusion of large-scale projects ensures the company's continuous operations until at least 2019. Infill development is represented by 42 projects with a total area of 520,000 sq m. The average area of one project is small and amounts to 12,000 sq m, with the implementation period of 2.5 years.

In 2016, the competence of in-house sales service was significantly strengthened – most of the services of brokerage companies were replaced by own resources in 2016, and four additional sales offices were opened on the construction sites.

Comprehensive development is represented by three projects: ZIL Yug (872,000 sq m), Nagatino i-Land (472,000 sq m) and 120 Lobachevskogo St. (243,000 sq m). The company's total project portfolio doubled in 2016, reaching 3.1 million sq m.

Largest completed projects:

<b>Project</b>	<b>Area, K sq m</b>	<b>Date of commissioning</b>
Lyusinovskaya	12.1	24 March 2016
Nagatinskaya	36.2	07 October 2016
Rogozhsky	19.6	30 September 2016
Dekart Business Centre	31.0	25 January 2016

Largest projects with launched construction:

<b>Project</b>	<b>Area, K sq m</b>
Premium class residential project at Pokrovsky Bulvar	9.8
Business class residential project at Usievicha St.	14.1
Comfort class residential project in Kuzminki	15.2
Business class residential project in Mnevniki	13.5
Business class residential project in Olympic Village	10.8
Comfort class residential project at 10 Abramtsevsкая St.	13.1
Comfort class residential project at Chertanovskaya St.	11.3
Business class residential project in Kuskovo	8.9
Comfort class residential project at Skhodnenskaya St.	12.0
Comfort class residential project at Veshnyakovskaya St.	10.5

An architectural concept was developed for ZIL Yug, and an urban planning project was submitted for approval to the Moscow government. In 2017, the first lots will be designed.

Nagatino i-Land's urban planning project was also submitted for approval to the Moscow government, and the designer and general contractor were selected. Construction of the first stage of the project will start in 2017.

In 2017, JSC Leader Invest will continue to focus on residential properties, the most liquid real estate segment, maintaining a steady portfolio of projects.

### **JSC Business Nedvizhimost**

Business Nedvizhimost has a unique pool of properties: mansions in the centre of Moscow, office and commercial space, business centres located almost in each district of the capital, and manufacturing and storage facilities in Moscow and the Moscow region. The restructuring of Business Nedvizhimost, during which it was merged with Rent Nedvizhimost, was completed in H1 2016. As of the end of 2016, the merged company managed a portfolio of properties with a total area of over 440,000 sq m.

In accordance with the approved work plan for 2016, the company leased out 29,703 sq m and sold three real estate properties. At the end of 2016, the company agreed the principal terms of the framework agreement with X5 Retail Group on the organisation of stores on the first floors of former ATS buildings. The first pool of properties for the conclusion of the lease agreements was determined.

In 2017, Business Nedvizhimost plans to develop a chain rental product on the basis of its own properties. The company developed a work plan providing for the commercial use of each property released by MGTS and partially renovated six properties. To attract the largest number of potential tenants, the company plans to start a complete renovation of seven properties with a total area of 28,500 sq m in 2017. In 2015, 16 properties with a total area of 75,500 sq m were transferred to Leader Invest for development of residential projects; 16 more properties with a total area of 69,000 sq m are expected to be transferred in 2017.

### *Business development strategy*

In the medium term, Leader Invest will continue to build a strong and recognisable brand with a view to achieve leading positions in Moscow. Further organic growth and development of the company will be achieved, in particular, through attraction of strategic partners and co-investors.

Business Nedvizhimost plans to sell to Leader Invest 16 land plots for the construction of residential properties. Monetisation of other properties in 2017-18 will be considered only if it is not possible to effectively use the properties for commercial purposes in another way (by leasing out or implementing a joint investment project).

### *Financial performance (Leader Invest, Business Nedvizhimost and Mosdachtrest)<sup>1</sup>*

<i>(RUB m)</i>	<b>2016</b>	<b>2015</b>	<b>Change</b>
Revenue	12,810	4,532	182.6%
Adjusted OIBDA	5,237	659	694.2%
Operating income	7,757	116	6,575.2%
Adjusted net income / (loss) attributable to Sistema	2,877	(362)	-
Net cash position	666	632	-

Leader Invest's revenue grew 9-fold in 2016 and reached RUB 8.8bn. This was mostly due to recognition of revenues from the sale of apartments in Moscow's apartment buildings Lyusinovskaya, Nagatinskaya, Samarinskaya, Rogozhsky and Izumrudnaya.

Leader Invest's OIBDA amounted to RUB 3.0bn in 2016, which corresponds to an OIBDA margin of 34.2%. The company reported a net income of RUB 2.3bn in 2016.

In December 2016, Leader Invest issued a RUB 3bn worth of registration-exempt bonds. The issue provides for the payment of semi-annual coupons and a 1.5 year put option. The rate for coupons 1-3 was set at 13.5% p.a.

<sup>1</sup> The results of rental assets (Business Nedvizhimost and Mosdachtrest) are presented on the basis of management reports.

In 2016, Sistema's rental assets (Business Nedvizhimost and Mosdachtrest) generated aggregate revenue of RUB 4.0bn, mainly by leasing out properties, but also by selling assets. Adjusted OIBDA of rental assets reached RUB 2.2bn.

#### **4.8. MTS Bank**

PJSC MTS Bank was established in 1993. By the end of 2016, the bank became a prominent financial institution, one of Russia's top 50 banks for the size of assets. It provides services to individuals and corporate customers in Russia. The bank has been consistently pursuing a policy based on cooperation with the mobile operator MTS in order to provide financial services of high quality.

##### **Sistema's stake**

86.66%.

##### **Management**

Chairman of the Management Board: Ilya Filatov; Chairman of the Board of Directors: Vsevolod Rozanov.

##### *Sector overview*

In 2016, most of Russia's macroeconomic parameters stabilised, with the national currency strengthening and the interest rates continuing to decline.

Positive macroeconomic trends resulted in a further decrease of credit risks both in the retail and corporate sectors. Under these circumstances, the Russian banking sector continued to successfully adapt to the new operational environment: banks revised their risk management models, and began cutting costs by optimising business processes and shutting down non-profitable segments.

Assets of Russian banks fell by 3.5% in 2016 as a result, among other things, of the rouble's strengthening against the main international currencies. Despite that, the banking sector earned RUB 930bn in income, an increase of almost 400% from 2015 (RUB 188bn) and just 8% below the all-time high of 2014 (RUB 1.0tn).

The corporate loans portfolio fell by 9.5% to RUB 30.1tn, which was to a large extent due to the rouble's strengthening.

The dynamics of provisions for potential losses stabilised. Their amount grew by 3.5% in 2016 (vs. 36% in 2015 and 31% in 2014). If the trend sustains, it will signal a lasting improvement of banks' loan portfolios and the Russian economy in general.

The amount of individual loans resumed growth, increasing by 1.1% last year to RUB 10.8tn (vs. a 6% decline in 2015).

The growth rate of individual deposits slowed down to mere 4.2%. Interest rates on rouble deposits at the largest banks moved down to 8.0%-8.5% per annum by the end of 2016.

The banking sector is expected to grow more confidently in 2017 than in 2016, supported by stabilisation of key macroeconomic indicators and ongoing optimisation of internal business processes and risk policies of Russian banks.

##### *Business development and results in 2016*

As of 31 December 2016, MTS Bank was ranked 47th among Russian banks for the size of assets, 36th for individual deposits and 38th for the size of capital.

It successfully adapted to the new macroeconomic environment. Revised lending processes allowed the bank to keep risks from new loans both in the retail and corporate segments at an extremely low level for the Russian market.

The bank is successfully optimising its retail network. In 2016, together with MTS, it opened 18 flagship integrated "Bank+Operator" offices, which feature all characteristics of an MTS outlet and simultaneously offer a broad range of banking services for individuals. In addition, 50 medium-sized MTS outlets opened financial areas of the bank to provide banking services to the population. In 2017, the bank plans to roll out the successful sales practices to over 1,000 MTS outlets.

In accordance with the strategy of cooperation with MTS, the bank launched a line of SMART debit cards, which offer free mobile communications and mobile Internet for MTS subscribers. The product has attracted over 320,000 new customers to the bank, and the accrued data on their payment behaviour will allow increasing lending to them, while controlling the risks.

The amount of unsecured consumer loans grew threefold in 2016 vs. 2015 to RUB 3bn. POS loans reached RUB 7.7bn, a surge of 330% and 167% from 2015 and 2014, respectively.

The bank's portfolio of performing loans totalled RUB 28bn at the end of 2016. Deposits and balance of individual accounts did not change substantially, equalling RUB 69bn.

Last year, the bank's corporate loan portfolio decreased, mainly due to the slowed down lending because of a more stringent credit policy. The performing portfolio totalled just below RUB 25bn at the end of 2016. Deposits and balance of corporate accounts were stable at about RUB 28bn.

MTS Bank participates in the government programme of bank recapitalisation which is carried out by the Deposit Insurance Agency (DIA) and seeks to support corporate lending. The bank is also accredited with Russia's biggest companies and regions to provide services to public sector organisations and state-owned companies.

In 2016, the bank complied with all requirements of the Russian Central Bank, including capital adequacy ratio, liquidity and risk per borrower/group of related borrowers. Shareholders increased MTS Bank's capital in the amount of RUB 15.5bn in 2016, which will ensure that it will continue to strictly abide by all of the CBR's requirements and its commitments under the recapitalisation programme of the DIA. No recapitalisation is planned for 2017.

#### *Business development strategy*

The bank's key strategic goal is to build a leading digital financial institution offering the best remote banking services and having an efficient sales network based on synergies with MTS's retail business. The bank uses its partnership with MTS as an important competitive advantage when developing its retail segment and creating new retail products. The bank's corporate business is oriented towards servicing large companies that are part of Sistema Group, and non-affiliated medium-sized companies, with a focus on transactional services.

In 2017, the bank plans to carry out the majority of measures aimed at its digital transformation, upgrade the IT infrastructure, enter new digital sales channels and optimise the management structure to accelerate decision-making. It expects that these steps will result in a substantial growth of the individual customer base and will improve the quality and efficiency of customer service.

It also plans to increase the amount of retail and corporate loans by 20%-25% and 40%-50%, respectively. This growth will be achieved through optimisation of products in the retail segment and intensive development of factoring and low-risk lending for quality corporate borrowers.

#### **MTS Bank's key operational and financial results (MTS Bank, IFRS)**

<b>Project, RUB bn</b>	<b>2016</b>	<b>2015</b>	<b>%</b>

Revenue	20,233	25,619	(21.0%)
Interest income	16,411	20,458	-19.8%
Fee income	3,242	3,416	-5.1%
Financial result before SG&A	4,834	(8,870)	-
Operating expenses (SGS&A)	(7,395)	(7,983)	-
Operating loss	(3,282)	(17,658)	-
Net loss attributable to Sistema	(2,827)	(15,282)	-
Net assets	20,238	8,743	131.5%
Retail loan portfolio	44,157	59,570	-22.5%
Capital adequacy H1.0	20.2%	18.5%	1.7 p.p.

In 2016, the bank reported an income before SG&A expenses in the amount of RUB 4.8bn, as opposed to a loss of RUB 8.9bn in 2015. Implementation of the strategy aimed at increasing revenue from low-risk transactional products resulted in an increase of the share of commission fees in revenue from 13.3% in 2015 to 16.0%.

Administrative and general expenses were reduced by 7%, or RUB 0.5bn. Net loss attributable to Sistema was significantly decreased thanks to lower reserve provisions following optimisation of the bank's lending policy and introduction of a new credit scoring system in 2015-2016.

#### **4.9. Binnopharm**

JSC Binnopharm is a Russian full-cycle pharmaceutical company with an in-house R&D division. Binnopharm operates two advanced pharmaceutical plants in the Moscow region, which comply with the international GMP (Good Manufacturing Practice) standards and produce six types of dosage forms: ampoules, syringes, aerosols, pills, capsules and solutions. The company produces and develops new medications in several treatment groups: pulmonology, neurology, cardiology, gastroenterology and infectious diseases.

#### **Sistema's stake**

74%

#### **Management**

CEO: Alexey Chupin; Chairman of the Board of Directors: Dmitry Zubov.

#### *Sector overview<sup>1</sup>*

Growth of the Russian pharmaceutical market continued to slow down in 2016 and was 4% vs. 2015 in monetary terms. At the same time, after the market's decline in physical terms in 2015, it stabilised at the same level in 2016 and totalled RUB 1,309bn.

Like in the previous year, the commercial pharma segment grew faster than the public one (5.0% and 3.8%, respectively), mostly on the back of a faster growth of retail prices.

The share of foreign medications on the Russian market slumped from 73% in 2015 to about 71% in 2016 in monetary terms. In physical terms, the share of imported drugs remained virtually unchanged at 40%. Domestic manufacturers still hold the strongest positions in the hospital segment (accounting for 36% in monetary terms and 76% in physical terms). This trend reflects the government's policy towards import substitution in the pharmaceutical market and is the first result of corresponding legislative initiatives, notably, the decree<sup>2</sup> adopted in 2015 that prohibits foreign products to participate in government tenders if there are bids from two or more Russian-made products.

<sup>1</sup> Source: DSM.

<sup>2</sup> The Russian government's decree No.1289 dd 30 November 2015 "On restrictions of and terms of access of medications manufactured in foreign countries"

The market structure in terms of prescription and over-the-counter drugs changed insignificantly compared to 2015. Like in 2015, the share of prescription drugs in monetary terms exceeded 60%, and they accounted for 48% of sales in the pharmacy segment.

Most experts expect the market's moderate growth in rouble terms (around 7%) to continue in 2017. The main growth driver will be recovery of consumption and substantial inflation in the retail segment. In the public sector, the growth rate is expected to be lower than in 2016, mainly due to a reduction of federal and regional subsidies.

### *Business development in 2016*

In 2016, Binnopharm continued implementation of its strategy of shifting sales from public procurement towards the private segment. The following steps were taken to refocus the business:

- Opening of an R&D centre with an area of 400 sq m and 7 laboratories. The centre employs over 30 people, many of them with doctoral degrees. Over 20 drugs are now at various stages of development and registration.
- Active promotion of proprietary products (Noben, Salbutamol, Beclomethasone, Theopeck, Combipex) in the retail segment. The company signed 70 contracts with pharmacy chains (32% of the market) covering 11,522 pharmacies. Binnopharm's products are now available in every fourth pharmacy in Russia.
- Acquisition of LLC Alpharm, a manufacturer of two medications of the pharmacy segment, Kipferon and Prostopin. The acquisition allowed Binnopharm to enter the OTC drugs market and secure potential commercial advantages by using own interferon substance for manufacturing of Kipferon.
- Obtaining exclusive rights for promotion and sale of third-party products in Russia. Licence agreements were signed with German Medice and Russian BIS, which provided efficient and quality drugs in such segments as neurology, pediatrics, anti-viral and cold-relief medications, for distribution and promotion.

Progress made:

- The share of proprietary drugs in revenue grew from 43% to 78%.
- The share of proprietary drugs sales in the commercial segment grew from 29% to 47%.

The main goal for 2017 is raising the share of commercial segment in revenue to 90%. The company expects proprietary products to account for 65% of sales, and products sold under licence agreements with third-party manufacturers for 35%.

Binnopharm will continue expanding its product portfolio in 2017. It expects to launch proprietary drugs that are currently undergoing market authorisation. It also plans to sign licence agreements to sell third-party products and carry out projects of contract-based manufacturing for foreign partners.

### **Production capacity**

<b>Form</b>	<b>Annual capacity, m packages</b>
Pills	1,400
Capsules	45
Ampoules	80
Aerosols	20
Syringes (a new modern line)	18
Infusion solutions, plastic bottles	14.4

### *Business development strategy*

The company's operational strategy envisages development of a proprietary portfolio of strong commercial brands focusing on neurology, pulmonology, infectious diseases, cardiology and gastroenterology. The key tool of this strategy is development and launch of new proprietary drugs.

Another component of the strategy is signing of licence agreements with large pharmaceutical companies, both for exclusive promotion of their medications in Russia and the CIS and for contract-based manufacturing at Binnopharm's production facilities.

The company's investment strategy envisages acquisition of smaller pharmaceutical producers complementary to its business or of portfolios of drugs and brands. Key criteria for selecting acquisition

targets are the drugs belonging to the commercial segment and target nosologies of Binnopharm, and the possibility to transfer manufacturing to Binnopharm and use its commercial structures for promotion.

#### *2016 financial performance*

<i>(RUB m)</i>	<b>2016</b>	<b>2015</b>	
Revenue	1,939	1,660	16.9%
OIBDA	415	193	114.7%
Operating income	219	21	931.5%
Net income (loss), attributable to Sistema	11	(68)	-
Net debt	1,548	843	83.6%

Binnopharm demonstrated strong financial results in 2016 thanks to its consistent strategy. Its revenue for FY 2016 grew by 16.9%. OIBDA increased by 114.7%. Net income totalled RUB 11m, as opposed to a net loss reported for 2015.

#### **4.10. Medsi Group**

##### **Medsi Group**

Medsi Group is Russia's largest private national healthcare chain. It offers a full range of preventive, diagnostic and treatment services, including rehabilitation for children and adults.

##### **Sistema's stake**

100%

##### **Management**

President: Elena Brusilova; Chairman of the Board of Directors: Vladimir Aleksandrovsky<sup>1</sup>

##### *Sector overview<sup>2</sup>*

Russia's private healthcare market was influenced by some opposite trends in 2016. On the one hand, insufficient financing of OMI (obligatory medical insurance) programmes and lower availability of state-financed healthcare stimulated growth in the private healthcare sector. OMI financing deficit amounted to around RUB 27bn in 2016. On the other hand, the market growth was constrained by macroeconomic factors, such as the decline of the population's real disposable income and the ongoing crisis on the VMI (voluntary medical insurance) market.

The size of the Russian private healthcare market was RUB 679.6bn in 2016. However, the growth rate fell almost by half, from 12% in 2015 to 7%, due to the slowdown both in the retail sector (fee-for-service individual customers) and the VMI sector.

The Moscow region remained the country's biggest market, accounting for 26% of Russia's private healthcare market; its share of the VMI segment grew from 64% in 2015 to 68% in 2016.

The VMI segment has grown by 50% in Russia in the last six years, but its growth rate is still behind the retail segment. Moreover, VMI demonstrated in slump in Russian regions, although growing by 6% in Moscow.

The determining factors for the sector's development next year will be: cutting of the state budget with regard to OMI liabilities and the general economic situation, which has a direct impact on the VMI segment and private healthcare services paid for by legal entities, as well as the population's income, which influences the development of the retail sector of private healthcare.

The trend towards engaging private clinics to provide services under OMI programmes and giving patients an opportunity to co-finance treatment above OMI tariffs is likely to sustain.

<sup>1</sup> As of 31 December 2016: Vasil Latsanich

<sup>2</sup> Source: mresearcher.com, Businessstat, cbr.ru, Insurance Wikipedia (Business-Service), the Federal Fund of Obligatory Medical Insurance, the Federal State Statistics Service

### *Business development in 2016*

Last year, Medsi demonstrated positive dynamics, its annual revenue growing by 14.4% year-on-year. Revenue from direct sales to individuals grew by 11%. Sales via insurance companies (including OMI) increased by 19%, supported by the 13% growth in the number of visits following occurrence of insurance events.

#### **Medsi's assets**

	Number
Clinicodiagnostic centres	3
Children's clinics	2
Primary care clinics	14
Hospitals	2
Sanatoria	2
Wellness centres	2
Regional clinics	7

An important area for Medsi in 2016 was work under the programme of state guarantees of free medical care for Russian citizens. The four-fold increase in the amount of medical services provided in the OMI sector was achieved through active involvement of in-patient facilities, which provided treatment to over 1,200 patients to an aggregate amount of RUB 154m. Besides, about 1,500 patients needing rehabilitation under OMI programmes (with the aggregate amount of quotas totalling RUB 78m) were treated at the Otradnoye sanatorium, in addition to fee-for-service customers.

Revenue of Medsi's outpatient clinics in Moscow grew by 14% in 2016 and was brought about by the 11% increase in the number of visits and 3% increase in the average transaction value.

The Clinicodiagnostic Centre at Belorusskaya again provided the biggest volume of services, its revenue up 6% year-on-year. In accordance with the general strategy, the clinic focused on increasing direct sales to individuals (non-insured), and they grew by 13% in 2016 due to a shift towards comprehensive healthcare services and packaged offers.

The new clinicodiagnostic centre in Krasnaya Presnya, which opened in December 2015, is positioned as the company's second flagship asset. In 2016, it opened consultation rooms in all medical disciplines with expert-level equipment, with consultations provided by highly qualified doctors (the centre employs 8 holders of post-doctoral and 40 of doctoral degrees in medicine). The clinic's average daily traffic in 2016 grew from 31 visits in January to around 700 in December. The centre provided services to over 38,000 unique patients in 2016. The work intensity of its doctors reached 65% by the end of the year. However, there is still a substantial potential for increasing the patient traffic through opening of new units.

#### **Operating performance**

Indicator	Units	2016	2015	%
Patient visits	K	7,314	7,266	0.7%
Services provided	K	11,483	11,403	0.7%
Area	K sq m	221	227	-3.0%
Average cheque	RUB	1,265.0	1,120.8	12.9%
Revenue per sq m	RUB K	42.55	36.18	17.6%

In 2017, the company plans to open at least two new family clinics in Moscow:

- a clinic for adults and children in the Leninsky avenue, with an area of over 3,000 sq m and a capacity of 740,000 visits per annum.
- a clinic for adults and children in the 3rd Khoroshevsky lane, with an area of about 4,000 sq m and a capacity of 790,000 visits per annum.

### *Business development strategy*

Medsi's strategic goals include organic growth through increased direct sales of services - at least 20% a year, ahead of the market. Given the slowdown in the VMI segment, the top priority of the strategy in this channel is enhancing the efficiency of partnerships with insurance companies by optimising product offers and increasing the number of visits of patients with VMI policies.

The strategy also envisages an investment programme for expanding the company's operations in Moscow and other regions. The chain aims at achieving high results of medical, operational and financial efficiency and should ensure comfortable routing of patients and provision of the full range of outpatient, hospital substitution, inpatient and rehabilitation services.

### *2016 financial performance*

<i>(RUB m)</i>	<b>2016</b>	<b>2015</b>	
Revenue	9,409	8,227	14.4%
OIBDA	813	471	72.4%
Operating loss	(432)	(161)	-
Net loss	(499)	(127)	-

The company's revenue in 2016 grew by 14.4% YoY. Revenue from direct sales to individuals grew by 11%. OIBDA increased by 72.4% year-on-year despite negative dynamics in Q4 caused by an increase in marketing expenses and non-monetary provisions. Medsi reported a net loss of RUB 499m for 2016 due to increased depreciation and amortisation expenses and the negative effect from exchange rate differences.

### **4.11. Other assets**

#### *Kronshtadt*

LLC Kronshtadt Group is a Russian high-tech company that engineers and manufactures knowledge-intensive products and solutions for the production, deployment, and safe use of sophisticated air, sea, and land-based systems. The Group's substantial intellectual and engineering potential, its portfolio of key technologies and competences and state-of-the-art manufacturing resources enable it to create high-tech products and solutions that are in demand in Russia and are also able to successfully compete on international markets. Sistema's equity holding in Kronshtadt is 83%.

In 2016, Kronshtadt Group successfully completed work under some key government contracts, including supply of correcting stations for the differential sub-system of the GLONASS/GPS global navigation satellite system, 18 module Kamaz-5350 driving simulators with a motion generation system and 14 sets of electronic conduct-of-fire trainers for the schools and training centres of the Russian Defence Ministry. Kronshtadt developed and supplied to a foreign customer a full flight simulator for the state-of-the-art transport and combat helicopter Mi-35M designed for efficient training of flight crews.

In addition to contracts with the Defence Ministry, the Group successfully completed its share of work in the large-scale reconstruction of the Aurora cruiser, which was one of the company's most important projects in 2016.

After Sistema acquired Kronshtadt in 2015, the Group sold all non-core assets, shut down loss-making projects, signed new long-term contracts and entered new markets. This has had a serious impact on its financial performance. In 2016, its revenue grew by 17% year-on-year (net of divested assets) to RUB 5.2bn, while its OIBDA margin reached 15%. The company reported a net income for the first time in a significant period.

## *Concept Group*

Concept Group has been active in the Russian market for over 10 years and is a leader in the segment of women's and children's fashion and underwear. The company has two own retail chains under the brands Acoola and Concept Club with an aggregate of over 400 stores, many of which are franchised. Concept Group operates under a multi-brand and multi-channel business model, which ensures stable revenue growth due to the diversification of proceeds. A professional team of fashion designers located in the company's head office in St Petersburg is in charge of developing collections for all brands of the Group. Manufacturing takes place at partner factories in China, Bangladesh, Uzbekistan, India, Russia and Kyrgyzstan, with mandatory quality control.

In 2016, Concept Group developed and launched production of two new wholesale brands of children's clothing - Maloo for babies and toddlers and Overmoon for children under 12. It also developed an exclusive baby clothes brand for Detsky Mir. Sales of the new brands will start in 2017. In 2016, Concept Group expanded the geography of its manufacturing, adding factories of Kyrgyzstan to its suppliers' list. At the same time, the share of supply from India grew from 1.6% in 2015 to 8.3% and from Russia from 0.4% to 2%.

Acoola and Concept Club stores are present in over 120 cities of Russia; the total number of stores is 432, out of which 60% are owned by the company and 40% are franchised. As of the end of 2016, the Acoola chain comprised 234 stores, out of which 163 were owned by the company. The Concept Club chain comprised 198 stores, including 98 own stores.

In 2017-2019, the Group plans to continue active development of the Acoola chain, investing in opening 20-30 stores per year. Concept Group's revenue in 2016 amounted to RUB 10.9bn, and the company reported a positive OIBDA.

## *Hotel assets*

Sistema's hotel business is represented by two key companies: VAO Intourist and Sistema Hotel Management. In 2016, Sistema decided to develop the segment by acquiring and building new assets, attracting management resources and refurbishing old hotels.

Development of the Russian hotel market will be driven by the country's hosting of the World Cup 2018, growth of foreign tourism (6% in 2016) and development of domestic tourism, which has been demonstrating two-digit growth (15% in 2016). Last year, hotel occupancy reached unprecedented figures, with RevPar (revenue per available room) growing by 19% to RUB 11,500. The average income per room for Moscow hotels increased by 14%, and prices are expected to continue growing in 2017. Room rates are estimated to increase by 10%-30%.

At the end of 2016, Sistema Hotel Management acquired Regional Hotel Chain for RUB 2.6bn, increasing the number of rooms under Sistema's management from 2,501 to 3,771 rooms.

### **Sistema's hotel assets:**

Hotel	Rooms in 2016	Rooms in 2015
Cosmos Hotel	1,777	1,777
Savoy Westend Hotel	116	116
Principe Forte dei Marmi	28	28
Yelets	-	131
Altay Resort	78	78
Leopard Lodge	9	9
Intourist Kolomenskoye	259	259
Onego Palace	103	103
Izumrudny Les	22	-
Park Inn Kazan	151	-
Park Inn Astrakhan	132	-
Park Inn Izhevsk	161	-
Park Inn Yaroslavl	167	-

Park Inn Sochi	153	-
Holiday Inn Express Voronezh	145	-
Park Inn Volgograd	149	-
Park Inn Novosibirsk	150	-
Brauplatz Izhevsk	-	-
Courtyard by Marriott Paveletskaya Moscow	171	-
<b>Total</b>	<b>3,771</b>	<b>2,501</b>

In November 2016, Sistema opened Izumrudny Les – an eco hotel in the Moscow region. Its investment programme for 2017 exceeds RUB 1.3bn.

Sistema's investment strategy envisages sourcing new acquisition targets, consolidation of hotel assets and simplification of the segment's organisational structure. It is constructing the Dubininskaya Plaza, a 4\* hotel in Moscow, which will be commissioned already at the end of 2017.

#### *Sistema Shyam TeleServices Ltd.*

In November 2015, Sistema signed binding documents to merge its Indian telecom business with Reliance Communications Ltd (RCom), one of India's biggest telecom operators. The deal structure has been approved by Indian courts and envisages a demerger of the telecom business from Sistema Shyam TeleServices Ltd. (SSTL) to be further merged with RCom under the RCom brand, with SSTL holding 10% of the combined company. After closing, SSTL's minority shareholders may exchange their shares in SSTL for shares in RCom pro rata to their interests in SSTL pre-closing. In Q4 2015, Sistema refinanced SSTL's debt guaranteed by the Corporate Centre.

In June 2016, Sistema acquired a 17.14% stake in SSTL from the Federal Agency for State Property Management<sup>1</sup>. It will pay for the shares to the Russian federal budget during the next 5 years in accordance with the following schedule: 30% of the amount - in 2016, 25% - in 2017 and 15% in 2018, 2019 and 2020.

In 2016, Sistema and RCom continued work on merging SSTL's telecom business with RCom. The deal was approved by India's two main exchanges (the National Stock Exchange and the Bombay Stock Exchange), the Securities and Exchange Board of India, the Competition Commission and the High Courts of Rajasthan and Mumbai. All necessary approvals from the shareholders and creditors were obtained. Sistema and RCom continue talks with the Department of Telecommunications and other regulators and judicial authorities of India with regard to final terms of the potential deal. The decisions on closing the transaction will depend on the approval timeframe and the final terms.

#### **4.12. Other investment activities of Sistema: Funds**

##### *Sistema Venture Capital*

Sistema Venture Capital is a corporate venture fund of Sistema, focused on investing in Internet companies at the growth stage. Sistema owns 100% of the fund<sup>2</sup>.

<i>Fund size</i>	<i>Fund's life</i>	<i>Investment focus</i>	<i>Investment criteria</i>
RUB 10bn	Indefinite	Cognitive technology, web projects in the sphere of communitainment, VR/AR (visual/augmented reality) projects, new generation networks	Global technology, focus on mobile devices for B2C products, proven business model or MVP demonstrating operating income, a strong team with

<sup>1</sup> The Russian government bought 17.14% of SSTL shares in March 2011 and simultaneously signed an option agreement with Sistema for the repurchase of the shares in five years for USD 777m or the market price of the shares determined by an independent appraiser, whichever is higher.

<sup>2</sup>As of 31 March 2017 Sistema's stake is 80%.

(SDN, NFV).

technological and industry expertise, founders remain in charge of operations.

*Performance in 2016:*

In 2016, the fund was active on the Russian and CIS markets. In 2017, it intends to enter the US market to become a global player and gain access to the world's leading projects.

In 2016, Sistema Venture Capital became a prominent player both on the Russian venture capital market and on the European VR/AR market (becoming one of Europe's top 3 funds investing in VR/AR by number of deals). The fund's team reviewed over 500 projects and closed 6 deals (including transfer of Sistema's stake in Ozon Holding Limited to the fund).

*Investments:*

MEL Science - an international company offering scientific and educational products based on VR/AR technology. Its flagship product is a course for independent study of chemistry, MEL Chemistry: it comprises 38 kits for chemical experiments, a learning app and VR glasses that allow users to see chemical substances and crystals "from inside". MEL Science kits are sold under a paid subscription model and delivered by post.

VisionLabs - one of the world's leaders in computer vision and machine learning. Its flagship product is a face recognition platform, VisionLabs LUNA, which enables the analysis of 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.

Segmento - Russia's biggest programmatic platform, which uses machine learning technologies for targeting digital ads. Segmento uses anonymised data of about 84m customers of Sberbank and knowledge about their online behaviour for real-time communications on all types of devices. Its solutions enable large businesses to interact with potential customers in any channel and to boost their sales.

Luden.io develops instructive games with a scientific component based on VR technologies. The best known games are InMind and InCell, devoted to studying biology while playing. The company was set up by one of Russia's oldest game developers, Nival.

YouDo.com - Russia's biggest online service connecting customers with service providers for performing household errands and business tasks. A user can publish a task on the YouDo.com website or in a mobile app (available for iOS and Android), set the price and select a provider among those who respond to the announcement. All providers are checked by the service and are assessed by users, which guarantees the high quality of their work. The project is a winner of a grant from Start Fellows, Runet and Golden Website awards, semifinalist of the Forbes' startup competition, and one of Russia's top 50 startups according to PricewaterhouseCoopers and Digital October.

Ozon - one of the biggest players in the Russian e-commerce segment, growing by 20%-30% per annum. The company's strategy is aimed at accelerating growth and building a significant market share to support a subsequent IPO. Ozon has some unique competitive advantages: its business model (an online supermarket with an extremely broad product mix; its own chain of warehouses and distribution centres, which allows for quick delivery); a strong brand, sufficient funds to implement its strategy; transparency and qualified investors/shareholders who are known to the market.

*Sistema Rusnano Capital*

Sistema Rusnano Capital is a joint private equity fund established by Sistema and the state-owned corporation Rusnano in August 2016 on a 50/50 basis.

<i>Fund size</i>	<i>Fund's life</i>	<i>Investment focus</i>	<i>Investment criteria</i>
up to USD 100m (capital	7 years (with a possibility of a	Technology, microelectronics, automated control systems, special	The average ticket is USD 5-20m; allowed targets: companies at the

will be committed to the fund in equal shares as the need to finance deals arises)	3-year extension)	communications systems, software for comprehensive security systems, robotics and on-board control systems, energy and energy efficiency. Geographically, the fund is focused on Russia, the European Union and Israel; 50% of investment will go to "Russia-related companies" that use nanotechnology.	growth stage or at the late venture stage with a working product (the latter may not take up more than 20% of the portfolio).
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*Performance in 2016:*

The fund was established in August 2016. A professional team with a track record in the venture capital industry was hired. A total of 120 projects were reviewed by the end of 2016.

*Sistema Capital Partners*

Sistema Capital Partners (SCP) is an investment arm of Sistema, which invests Russian institutional capital in developed real estate markets in Europe and the United States. The company was established in December 2015 and comprises leading professionals from the Russian and international real estate market. SCP also offers legal support for transactions and asset management for Western institutional investors looking at Russian commercial real estate. SCP manages the publicly traded Luxembourg fund Arista SICAV-SIF.

<i>Fund size</i>	<i>Fund's life</i>	<i>Investment focus</i>	<i>Investment criteria</i>
EUR 446m (AUM)	Indefinite	Real estate	Real estate in countries with a stable macroeconomic situation, high market liquidity (annual amount of transactions in the market) and competitive cost of debt. Sistema acts as an anchor investor, attracting Russian co-investors.
EUR 208m (capital invested by Sistema and co-investors)			

*Performance in 2016:*

In the reporting period, SCP set up a joint venture with the German company Corestate AG and successfully closed three acquisitions of retail real estate portfolios in Germany for a total amount of EUR 332m.

*Investments:*

High Street IV - 25 high-street retail properties in secondary cities in Germany, acquired in 2015-2016. Gross lease area: 57,700 sq m. Tenants: C&A, Saturn, H&M, Peek & Cloppenburg. Portfolio strategy: creating added value through proactive asset management (renting out vacant areas, repositioning, capital improvements).

High Street Prime I - 4 high-street retail properties in secondary cities in Germany, acquired in 2016. Gross lease area: 60,000 sq m. Tenants: Saturn, H&M, Esprit, United Cinemas, Modehaus Fischer, Cierpinski Sport. Portfolio strategy: creating added value through proactive asset management (renting out vacant areas, repositioning, capital improvements).

High Street Prime II - 2 high-street retail properties in secondary cities in Germany, acquired in 2016. Gross lease area: 37,000 sq m. Tenants: Saturn, TK Maxx, Mc Fit, Holmes Place, Apcoa. Portfolio strategy: creating added value through proactive asset management (renting out vacant areas, repositioning, capital improvements).

Arista – a Luxembourg real estate fund managed by Sistema Capital Partners. The fund manages 3 commercial properties (2 shopping malls and an office building) with a total area of 34,700 sq m, situated in Moscow and the Moscow region. The fund's shareholders are Scandinavian institutional investors. Shopping mall tenants: Perekrestok, Adidas, Levi's, l'Occitane, KFC, McDonald's, KFC. Office tenants: Volvo, SC Johnson, Yokohama. Portfolio strategy: creating added value through proactive asset

management (optimising rent payments, re-signing lease agreements and renting out vacant areas, cutting costs, refinancing).

### *Sistema Asia Fund*

Sistema Asia Fund Pte. Ltd. - is a venture fund of Sistema. The fund was established in Singapore and invests in high-tech companies in India and Southeast Asia that work in the B2C and B2B segments and have a professional team, stable sources of revenue and potential to go global. Sistema owns 100% of the fund.

<i>Fund size</i>	<i>Fund's life</i>	<i>Investment focus</i>	<i>Investment criteria</i>
USD 50m	Indefinite	High-tech companies in India and Southeast Asia at the medium development stage (Series B and later investment rounds), oriented towards mass and corporate markets.	<p>An enthusiastic, persistent and goal-oriented team with tech and industry expertise, founders with complementary skills, founders remain in charge of operations</p> <p>The market size should be minimum USD 1bn today or within three years</p> <p>Established industry leaders or companies moving towards leadership</p> <p>Positive economic performance with a large safety margin (high gross margin)</p> <p>Clear and transparent strategy for reaching investment breakeven</p> <p>Confidence about exit/obtaining liquidity through strategic sale or IPO</p>

### *Performance in 2016:*

In 2016, the fund concentrated on the Indian market; it plans to enter the Southeast Asian market in 2017, but will retain its investment focus on India. The fund's offices are situated in Singapore and New Delhi. In 2016, Sistema Asia Fund became a noticeable player on the Indian venture capital market, closing 4 deals with such renowned international investors as Accel Partners, Amazon, Mayfield, and with Indian A league funds such as Helion Ventures, and Ventureast.

### *Investments:*

Seclore - the EDRM (Enterprise Digital Rights Management) system developed by the company allows 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, resulted in its inclusion in the top 50 fast-growing tech companies according to Deloitte and brought it the Cool Vendor title from Gartner. The company has representative offices in the United States, India, the Netherlands, UAE, Saudi Arabia and Singapore.

Qwiksilver – 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. Qwiksilver has a licence from the Reserve Bank of India for using prepaid payment instruments. At the end of the 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.

Wooplr – a female fashion mobile platform. The company has developed a mobile shopping application with customised offers for users. Wooplr redefines web communication and sales of women's clothing, using a very scalable platform with a viral approach. The female fashion segment of the Indian Internet is

so far under-developed, but it is growing at an extremely rapid pace. According to some estimates, this market will amount to USD 20bn by 2020, with fast fashion accounting for 50% of it. Wooplr has created an integrated platform that brought together 200 brands, 10,000 opinion leaders and 3m female customers.

Licious – a company building India's first national brand in online meat sales. The company manages the entire value creation chain from sourcing suppliers and meat processing to delivery of meat products using a cold chain with controlled temperatures to ensure superior quality for end consumers. Licious estimates the Indian market of fresh meat and meat products at USD 7bn annually.

## **5. DESCRIPTION OF MAIN RISK FACTORS**

Sistema may face a variety of risks in the course of its business operations. They result from processes and factors that Sistema has little or no influence on. That said, the Corporation can take measures to reduce negative consequences of such factors in case a certain risk occurs. This makes efficient assessment of existing risks and probability of their occurrence and their efficient management an important part of Sistema's strategy.

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

### ***5.1. Sistema's ERM system***

As part of quarterly ERM procedures, Sistema's risk managers compile separate 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 its key trends, analyse the impact that material risks have on the financial performance of specific subsidiaries and Sistema Group as a whole using simulation and financial modelling methods.

To address the risks listed in the risk register of Sistema Group, the company has developed risk management (mitigation) and response plans covering specific mitigation measures to be taken. These plans are modified, adjusted and then approved by Sistema's Risk Subcommittee.

Risk management reports are submitted for review to the 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 (areas requiring attention) identified for future periods.

### ***5.2. 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. Additionally, many of its subsidiaries operate in transitional economies, including Ukraine, Uzbekistan, Armenia, Belarus, Turkmenistan and India, and therefore are also exposed to material external risks. A significant portion of products produced by the Group's companies is sold in the CIS, Southeast Asia, Eastern Europe and North Africa. In case of any major political turmoil in these regions, the Group's business in the regions may be discontinued or put on hold, which may lead to material losses.

#### ***Financial risks***

Sistema's business is inextricably connected to the state of the global economy and financial markets. In particular, it is sensitive to movements in prices of oil, gas, and other commodities that Russia exports. Weakening of the rouble against the US dollar and euro amid a slump in the oil prices, sanctions, and increased capital flight from Russia may result in a rise in costs and a decrease in revenues, or impede the achievement of financial targets and repayment of debt by Sistema subsidiaries.

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

The exit of foreign investors from Russia, the downgrading 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's joint ventures (partnerships) and new investment projects.

Growing inflation may result in higher expenses and therefore put pressure on profit margins, and also affect domestic demand for products and services offered by Sistema companies.

If sanctions are maintained and Russian banks' and businesses' access to foreign debt capital remains restricted in the medium term, this may significantly increase the current liquidity deficit in the market and result in further interest rate increases, making it difficult for Sistema 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 re-evaluate goodwill at some of the assets.

Currency controls and restrictions on capital repatriation may adversely affect Sistema's business by posing barriers to capital flows and reduce 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*

The significant influence of geopolitical risks on the Corporation and its portfolio companies has persisted over the reporting year as protectionism and economic sanctions are increasingly being used as tools for achieving geopolitical goals.

The risks of inter-state conflicts remain substantial, both in terms of probability and in terms of potential effect on various areas of Sistema's activities. For example, insurance companies may set higher insurance premiums for Sistema or refuse to insure against specific risks, which may lead to worsening financial performance.

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

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

The most pressing risks for Group's telecommunications business are geopolitical risks associated with a deterioration in the situation in Ukraine. The political crisis in Ukraine has led to a significant decrease in the growth rates of the telecommunications market, and continues to adversely affect the exchange rate of the national currency.

#### *Legal risks*

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

- possible discrepancies and ambiguities in: (i) federal and other laws; (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 lack of court and administrative guidelines to the interpretation of some laws, as well as conflicts between certain court guidelines and rulings;
- influence of political, social and other external factors on the judicial system;
- potential selective or arbitrary administrative decisions of government authorities.

Gaps in the corporate and securities legislation and regulations in the markets where Sistema operates may create barriers to raising funds and impair the company's ability to manage, own and oversee the activities of portfolio companies.

Lack of clarity about the applicability to Sistema's business of the Federal Law on the Procedure for Foreign Investment in Companies of Strategic Importance to National Defence and State Security and the regulations of the Customs Union of Russia, Belarus and Kazakhstan may have a negative impact on Sistema's business due to the fact that the Corporation has foreign shareholders.

There is a risk of amendments to the laws of the countries where Sistema companies operate, due to potential changes in the laws and regulations governing international trade and investments that may be introduced by foreign states or international organisations. For instance, Russia's accession to the World Trade Organization may result in certain unpredictable legislative and other changes in the markets in which Sistema's companies operate.

Since Russian corporate law provides for liability of shareholders for the obligations of its affiliates, 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 Company's transactions, which may limit Sistema's capability to complete investment transactions and restructure businesses.

If the Russian Federal Anti-Monopoly Service concludes that Sistema or one of its material subsidiaries has violated any of the existing anti-monopoly laws, 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 closing and/or delivering on certain transactions, which may also limit Sistema's capacity to do investment deals and restructure businesses.

#### *Taxation*

Tax laws, regulations, and practices of the jurisdictions where Sistema's assets operate are intricate, opaque and prone to frequent modifications and ambiguous interpretations. If the Corporation's actions are interpreted as breach of tax law, this may produce an adverse effect on the business of Sistema Group. Russian law on transfer pricing may make it necessary to introduce adjustments to price-setting practices used at Sistema Group's companies and result in additional tax liabilities related to some transactions.

On 1 January 2015, the rules were introduced relating to the taxation of undistributed profits of controlled foreign companies, the concept of a beneficiary owner and criteria to be used to establish tax residency of legal entities. Throughout 2015-2016, these rules were revised several times, with all the amendments having retroactive effect. As a result of the need to apply taxation rules, the Group's companies may face new tax liabilities arising due to the uncertainty around interpretation of tax law and lack of relevant precedents.

#### *Securities markets*

A deterioration of the geopolitical environment, the imposition of sanctions 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 2014-2016. In view of these circumstances, Sistema's access to investor funding through securities markets may be restricted further in the event of the imposition of sectoral sanctions against Russian companies in business segments where Sistema operates and/or due to investors taking a cautious approach to Russian companies in general. In particular, Sistema's ability to raise funding via bond issues may be limited, which is likely to lead to a lack of working capital and cash available for investment and affect the Corporation's financial performance.

### **5.3. 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 full or partial achievement of its established goals, efficient management of the portfolio companies, or benefits from new investment opportunities. Sistema's failure to achieve goals set in the strategy may undermine its financial results.

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 development of Sistema Group companies and the Corporation's financial results.

#### *Acquisition, integration, disposal or restructuring of assets*

Sistema PJSFC implements its strategy via acquisitions, disposals, and restructuring of assets. New investment opportunities come with certain risks, including failure to find relevant targets or their not being available for acquisition, inadequate due diligence of the target company's operations and/or financial situation, and potential overvaluation of assets. These risks can also affect Sistema's financial performance.

Acquisitions of assets 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 appeal.

Sistema may struggle with building 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 experience a deterioration in 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.

If one or several of the specified risks materialise, the Corporation may lose potential profit and thus see an impact on its 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 its financial liabilities, including repayment of debt and interest, and to make other investment activities in the future. Such cash-generation capacity may be restricted due to regulatory, tax or any other barriers, which may have an adverse effect on the 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. Therefore, any deterioration in the financial performance of MTS may have a negative impact on Sistema's financials. Any events damaging to the business of MTS may also negatively influence the current state of Sistema's business and its future prospects and worsen financial figures.

#### *Borrowings*

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

#### *Loan covenants*

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, sale of assets, and transactions with affiliates. 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*

Operations of Sistema Group's companies are regulated by different government bodies and agencies issuing and renewing licences, approvals and permits, and also depend on applicable laws, regulations and standards. Regulating authorities to a large extent rely on their own judgment 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 no guarantee either 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.

### *Privatised companies*

Sistema's portfolio contains several privatised assets including MGTS, VAO 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 of law (e.g., there are contradictions between federal and regional provisions on privatisation), privatisation of companies or assets can potentially be contested, however selectively.

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

### *Anti-corruption rules*

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. Any inability on the part of Sistema's companies to compete efficiently may have a material negative impact on Corporation's business, performance, financial situation or growth prospects.

### *Brand quality and reputation*

Developing and maintaining brand awareness for the Group's companies is crucial to shaping the public opinion about their existing and future products and services. Sistema believes that company brand becomes increasingly vital in highly competitive markets. Successful development and improvement of brand awareness depends in large part on the efficiency of marketing and ability to provide quality products and services at competitive prices. Effort and money spent on brand development may prove greater than incomes they yield, which means potential financial losses for the Group companies.

## **5.4. Risk appetite**

One of the key principles of risk management in Sistema Group is the use of risk appetite. This approach implies identifying and monitoring of the Corporation's target risk profile in accordance with its strategic goals and in the context of their integration into risk management procedures.

Sistema Group's risk appetite determines the level of risks acceptable for the shareholders, and includes the following basic provisions:

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



## 6. CORPORATE GOVERNANCE SYSTEM

### *Corporate governance principles*

High quality corporate governance and informational transparency are key principles underpinning Sistema's investment strategy. The Corporation aims to match the highest international standards of corporate governance and informational transparency, while supporting effective managerial decision-making, to increase Sistema's long-term appeal for investors.

Sistema's corporate governance system is based on the following principles:

- transparency of management processes for investors and partners;
- a predictable and progressive dividend policy;
- a professional Board of Directors that is actually involved in strategic planning, management and supervision of business processes;
- development of and compliance with investment decision-making procedures;
- particular focus by the Board of Directors on related-party transactions and conflicts of interest;
- continuous development of corporate governance at Sistema Group companies.

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 are paving the way for strengthening the Corporation's investment case.

In accordance with Russian law and international best practice, the Corporation's Charter and internal regulations underpin 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 additional commitments of the Corporation, its senior management and employees regarding social responsibility, transparency and ethical business principles.

In its corporate governance practices Sistema abides by the Corporate Governance Code recommended by the Bank of Russia (Letter of the Bank of Russia No. 06-52/2463,<sup>1</sup> dated April 10, 2014), the guidelines set out in the UK Corporate Governance Code<sup>2</sup> and Moscow Exchange's Listing Rules.

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

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

### **6.1. General Meeting of Shareholders**

#### *Principles of operation*

In line with the Federal Law on Joint-Stock Companies and Sistema's Charter, the General Meeting of Shareholders is the Corporation's supreme governance body. Its activities and authority are governed by Russian legislation on joint-stock companies, the Corporation's Charter and the Terms of Reference of the General Meeting of Shareholders.

All materials for general meetings of shareholders are made available to shareholders in Russian and in English and are published on Sistema's website ([www.sistema.ru](http://www.sistema.ru); [www.sistema.com](http://www.sistema.com)). Shareholders are notified of forthcoming meetings and are sent ballot papers for voting. Over the past four years (2013-2016) general meetings of shareholders have been held at Sistema's head office.

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<sup>1</sup> Available here: [http://www.cbr.ru/sbrfr\\_new/files/legislation/letters/2014/Inf\\_apr\\_1014.pdf](http://www.cbr.ru/sbrfr_new/files/legislation/letters/2014/Inf_apr_1014.pdf)

<sup>2</sup> Available here: <https://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-2014.pdf>

## ***Observance of shareholders' rights***

### *Participation in general meetings of shareholders and voting on agenda items*

Sistema aims to fully guarantee shareholders' right to participate in the running of the Corporation through participating in general meetings of shareholders and voting on agenda items, as well as the right to receive a share of profits as dividends.

To secure shareholders' right to take part in general meetings in accordance with the Corporation's Charter, a notice of the general meeting of shareholders and ballot papers are circulated to all shareholders at least 30 days before the meeting. All materials for the meeting are made available to shareholders in Russian and in English and are published on Sistema's website ([www.sistema.ru](http://www.sistema.ru) and [www.sistema.com](http://www.sistema.com)). Notices of general meetings of shareholders, ballot papers and all other materials are also sent to nominal shareholders in electronic form.

Ballot papers may be completed by shareholders in advance and mailed to Sistema (to the address specified in the ballot paper) before the meeting. Votes of shareholders who cast their ballots in this way will be counted during the main vote count. Shareholders are also allowed to vote in electronic form (provided that their depository offers this service).

GDR holders may vote on agenda items by proxy vote in accordance with the established procedure via a depository bank servicing Sistema's GDR programme. In 2016, Sistema's depository bank was Citibank, N.A. More information on the depository bank and voting procedures is available here: [www.citiadr.idmanagedsolutions.com](http://www.citiadr.idmanagedsolutions.com). Votes of GDR holders for whom the depository bank holds information are collected by the depository bank via clearing systems and are included in the general ballot, along with all votes cast for and against proposed draft resolutions, as well as indicted abstentions.

Shareholders can also attend general meetings in person or participate through a representative and vote on agenda items directly at the meeting (if the meeting is held with in-person attendance).

Voting results from in-person meetings are announced before the end of the meeting, and are also made available to shareholders on the Corporation's website one day after the meeting minutes have been compiled.

### *Shareholders' access to the Corporation's documentation*

An important guarantee of shareholders' right to participate in the running of the company is the right to access documents that the Corporation is obliged to keep by the Federal Law on Joint-Stock Companies. To exercise this right, shareholders can send a written request to the Corporate Secretary asking for access to the documents they wish to see. After the time for providing the documents is agreed upon, the documents will be provided to the shareholder. Shareholders granted access to confidential documents undertake a written non-disclosure obligation, in order to safeguard the rights of all the Corporation's shareholders. Shareholders who require copies of documents bear the Corporation's costs (RUB 10 per page).

### *Proposing agenda items for the general meeting of shareholders, and nominating candidates to the Corporation's governance bodies*

Owners of significant stakes (at least 2% of Sistema's authorised capital) have the right to make proposals for the agenda of the general meeting of shareholders and to nominate candidates to the Corporation's governance and control bodies<sup>1</sup>. Proposals for the agenda of the Annual General Meeting of shareholders (AGM), including any notes attached thereto in accordance with the Terms of Reference of the General Meeting of Shareholders of Sistema PJSFC and other internal regulations of the Corporation, are accepted in writing within 100 days after the end of the financial year.<sup>2</sup> Candidates nominated by shareholders to

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<sup>1</sup> Holders of 10 and more % of the Company's voting shares also have the right to request that an Extraordinary General Meeting of shareholders (EGM) be convened.

<sup>2</sup> In the event an EGM is conducted with its agenda containing an item on election of the Board of Directors, holders of sufficient blocks of shares are entitled to nominate candidates to the Board of Directors. Proposals to this effect must be received by the Company no later than 30 days before the date of such a meeting.

governance and control bodies are provisionally reviewed by the Board's Nomination, Remuneration and Corporate Governance Committee.

### *Results of general meetings of shareholders held in 2016*

On 25 June 2016, the AGM:

- I. approved the annual report and financial statements for 2015;
- II. distributed dividends for the full year 2015 of RUB 6,465,500,000.00, or RUB 0.67 per ordinary share;
- III. elected the Board of Directors and Audit Review Commission;
- IV. approved the Corporation's external auditors;
- V. approved the revised Charter and Terms of Reference of the Board of Directors.

The AGM was attended by the shareholders together holding 79% of votes.

### *Dividend policy*

To ensure shareholders' right to receive a share of the Company's profits in the form of dividends, the Corporation announces the amount of dividends recommended by the Board of Directors and the record date in advance. As a result, shareholders are able to take informed decisions with respect to disposing of their shares.

To determine the recommended amount of dividends payable for 2015<sup>1</sup>, the Board of Directors followed the dividend policy approved in October 2011. Under the policy, the amount of dividends payable was to be at least 10% of Sistema Group's net income generated during the previous financial year to International Financial Reporting Standards and at least 10% of net cash income generated by the Corporation's investment transactions over the same period (special dividend).

In 2016, Sistema's Board of Directors approved a revised dividend policy. In line with the new policy, total dividends recommended for each reporting year will be, at a minimum, the higher of either an amount equivalent to a dividend yield of at least 4%, or RUB 0.67 per ordinary share. The Corporation also set itself the goal of paying dividends twice a year: for the first half of a reporting year and for a full reporting year. This approach enables Sistema to pay predictable dividends, ensuring transparency of the procedure for determining the amount of dividend payouts and strengthening the Corporation's investment case.

In accordance with the new Dividend Policy, the Board of Directors in August 2016 recommended payment of an interim dividend for the first half of 2016.

On 23 September 2016, an EGM approved payment of RUB 3,667,000,000 in dividends, or RUB 0.38 per ordinary share.

In April 2017, after the reporting period was over, the Board of Directors of the Corporation made new amendments to the Dividend Policy providing for:

- an increase in the total amount of dividends for any reporting year to an amount equivalent to an annual dividend yield of at least 6% or RUB 1.19 per one share of the Corporation;
- payment of interim dividends for 9 months of the reporting year.

The revised approach to distribution of dividends allows the Corporation to increase the amount of dividends paid, thus increasing the shareholder returns on the Corporation's securities and enhancing the investment appeal of the Corporation.

## **6.2. Board of Directors**

The Board of Directors is a collective governance body in charge of oversight and strategic management. Under Sistema's Charter the Board's responsibilities include:

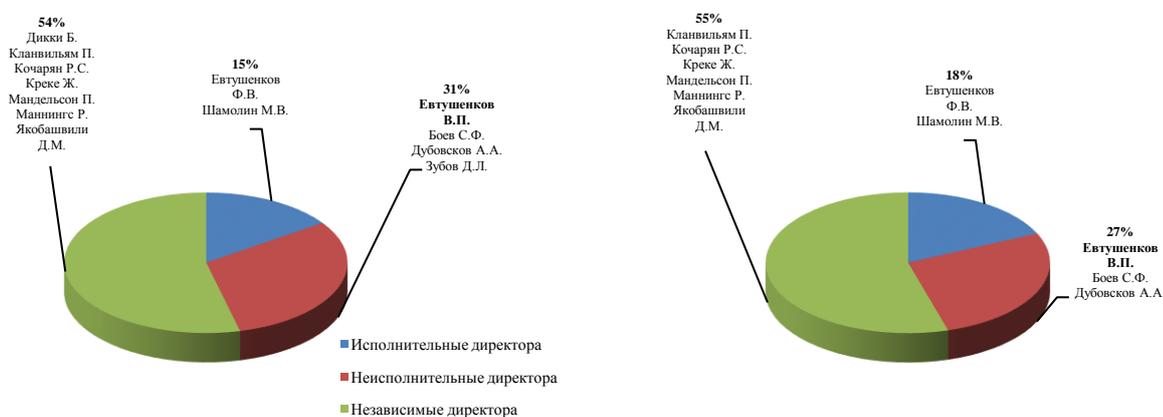
- supervising the operations of the Corporation in general;

- formulating strategic and financial development plans;
- determining investment principles and criteria;
- assessing the performance of the management team;
- setting the principles of corporate governance;
- approving transactions in accordance with applicable legislation and the Corporation’s internal regulations.

### Composition of the Board of Directors

The Board of Directors effective as of 31 December 2016 was elected at the Company’s AGM on 25 June 2016. Independent members of the Board of Directors form a majority (55%).

	<i>composition of the Board of Directors from 1 January to 25 June 2016, (elected on 27 June 2015)</i>	<i>composition of the Board of Directors from 25 June to 31 December 2016, (elected on 25 June 2016)</i>
1	Vladimir Evtushenkov (Chairman) Sergey Boev (Deputy Chairman) Brian Dickie <sup>1</sup> Andrey Dubovskov Felix Evtushenkov Dmitry Zubov Patrick Clanwilliam <sup>3</sup> Robert Kocharyan <sup>2</sup> Jeannot Krecké <sup>2</sup> Peter Mandelson <sup>2</sup> Roger Munnings <sup>2</sup> Mikhail Shamolin David Iakobachvili <sup>2</sup>	Vladimir Evtushenkov (Chairman) Sergey Boev (Deputy Chairman) Andrey Dubovskov Felix Evtushenkov Patrick Clanwilliam <sup>2</sup> Robert Kocharyan <sup>2,2</sup> Jeannot Krecké <sup>2</sup> Peter Mandelson <sup>2</sup> Roger Munnings <sup>2</sup> Mikhail Shamolin David Iakobachvili <sup>2</sup>



In 2015, the general meeting of shareholders approved a reduction in the number of Board members from 13 to 11. The main change from the 2015-2016 corporate year is that Brian Dickie and Dmitry Zubov left the Board.

### Meetings of the Board of Directors

Board meetings are held regularly in compliance with the adopted annual Board work plan, which developed based on Sistema’s strategic planning and reporting cycle.

<sup>1</sup> Independent directors meeting the independence criteria of Moscow Exchange’s Listing Rules.

<sup>2</sup> In accordance with Moscow Exchange’s Listing Rules the Corporation recognised Robert Kocharyan as independent. Information on this decision was disclosed on Sistema’s website.

<sup>3</sup> Patrick Clanwilliam was nominated to the Board of Directors by a group of minority shareholders.

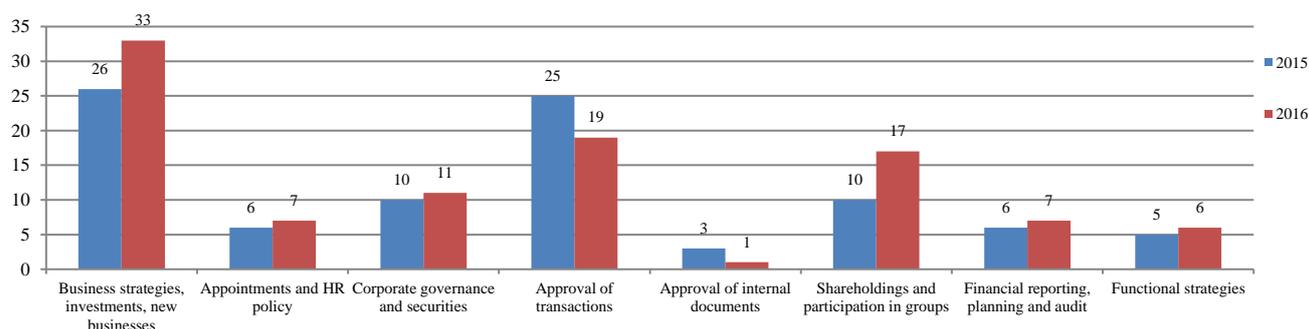
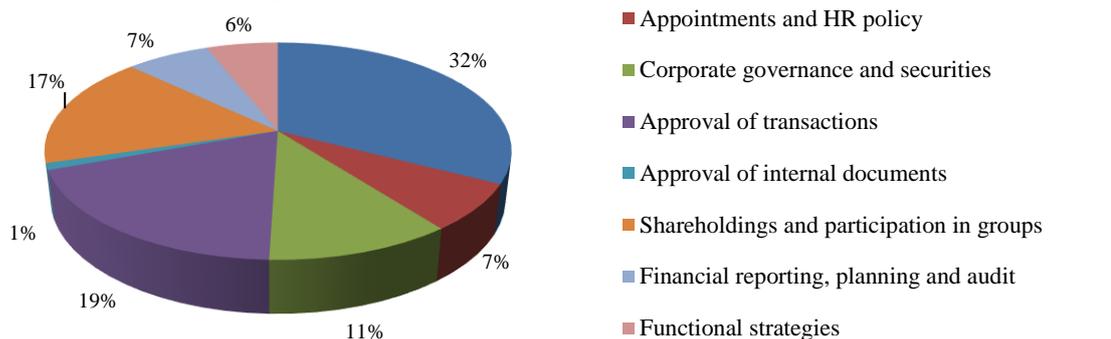
In 2016, the Board of Directors of Sistema PJSFC held 13 meetings: 8 scheduled in-person meetings and 5 unscheduled meetings in the form of a letter ballot (an absentee vote). In 2016, the Company's Board of Directors considered 101 agenda items, an 11% increase from the previous year:

	<b>2016</b>	2015
Number of in-person meetings	<b>8</b>	8
Number of absentee votes	<b>5</b>	3
Number of items in accordance with the Board's work plan	<b>43</b>	40
Actual number of items reviewed by the Board	<b>101</b>	91

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

- 1) Sistema's development strategy.
- 2) Sistema's asset portfolio structure.
- 3) Sistema Group's strategic planning cycle.
- 4) Sistema's investment policy and priority investment areas in 2016-2017.
- 5) Development strategy, value creation and monetisation strategy of key portfolio assets in the following sectors:
  - telecom;
  - consumer (retail) including e-commerce;
  - agricultural;
  - forest products;
  - banking;
  - high-tech;
  - real estate and development;
  - healthcare;
  - pharmaceuticals;
  - power grids;
  - hotels.
- 6) Sistema's results and performance against budget.
- 7) Budget planning, approval of Sistema's consolidated budget management KPIs for 2017.
- 8) Functional strategies (for financial management and financial planning, investor relations etc).
- 9) Placement of securities (registration-exempt bonds).
- 10) Risk and opportunity management.
- 11) Report of the Internal Control and Audit Department.
- 12) HR issues, HR management and personnel motivation.
- 13) Assessment of corporate governance including the self-assessment results of the Board and its committees.
- 14) Sistema's corporate social responsibility.
- 15) Mandatory corporate procedures, including convening the AGM and developing the Board's work plan.
- 16) Composition of Board Committees and determining the status of Board members.
- 17) Approval of internal regulations.
- 18) Approval of transactions, including acquisition of equity stakes.

*Matters considered by the Board of Directors in 2016*



Most agenda items at Board meetings in 2016 related to strategies of the Corporation and its portfolio companies, approval of transactions (including equity holdings in Sistema Group companies) and corporate governance. The Board of Directors focuses on considering new investment projects and building a portfolio strategy, including asset monetisation. In 2016 the number of items related to business strategies and investments increased by 25% from 2015.

*Preparation for Board meetings and attendance rates*

Procedures for Board meetings aim to use the time and experience of Board members efficiently, to enable them to take important decisions affecting the Corporation’s strategic development. Agenda materials are made available via the Board’s electronic portal at least 10 days before each meeting, to give members enough time to form an informed opinion on all agenda items. Most agenda items (including approval of transactions) undergo a mandatory preliminary review at meetings of the Board’s Committees.

Board members meet with speakers on the agenda items and the Corporation’s management at a business dinner the evening before each meeting, where they can get clarifications on all agenda matters.

Board meetings usually have a high attendance rate. The average attendance in 2016 was 96%.

*Participation of Board members in meetings of the Board of Directors and its Committees in 2016*

	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	12/13 <sup>1</sup>	12/12	-	-	-	-

<sup>1</sup> The first number denotes the number of meetings attended by the Board member, the second number stands for the total number of meetings the member could have participated in.

S. Boev	13/13	6/12	6/7	3/3	6/7	-
B. Dickie <sup>1</sup>	6/6	-	-	3/3	3/4	-
A. Dubovskov	13/13	10/12	-	-	-	-
F. Evtushenkov	12/13	2/12	-	-	3/7	-
D. Zubov <sup>2</sup>	6/6	-	-	2/3	-	-
P. Clanwilliam	13/13	-	6/6	-	-	7/7
R. Kocharyan	13/13	6/12	-	6/6	7/7	-
J. Krecké	13/13	-	12/13	-	-	7/7
P. Mandelson	11/13	-	4/7	2/3	1/3	-
R. Munnings	13/13	-	13/13	6/6	7/7	7/7
M. Shamolin	13/13	12/12	-	-	-	0/7
D. Iakobachvili	12/13	5/12	12/13	5/6	-	7/7

### ***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 preparation and adoption of decisions in specific functional areas, as well as to ensure in-depth review of matters before they are brought forward for consideration by the Board of Directors. Meetings of the Committees (except the Strategy Committee) usually take place on the day preceding a full Board meeting.

The Committees of the Board of Directors have broad procedural powers, and have the right (within their remit) to engage independent external experts and to obtain all necessary information from the executive management of the Corporation, to use other resources of the Corporation, and to set tasks for the management of the Corporation.

### *Functions of the Board Committees*

<b>Name of the Committee</b>	<b>Functions of the Committee</b>
Strategy Committee	<ul style="list-style-type: none"> <li>- analysis of strategic issues related to Sistema Group management ;</li> <li>- review of strategic planning methodology;</li> <li>- consideration of M&amp;A transactions and large investment projects.</li> </ul>
Audit, Finance and Risk Committee	<ul style="list-style-type: none"> <li>- preparation and audit of the Corporation's financial statements;</li> <li>- interaction with the Corporation's external auditors;</li> <li>- assessment of the risk management system and compliance with the applicable legal requirements for financial reporting, audit and planning;</li> <li>- preliminary appraisal of transactions submitted to the Board of Directors.</li> </ul>
Nomination, Remuneration and Corporate Governance Committee	<ul style="list-style-type: none"> <li>- preliminary review of candidates: <ul style="list-style-type: none"> <li>➤ for the Board of Directors of Sistema PJSFC;</li> <li>➤ for the Boards of Directors of portfolio companies;</li> <li>➤ for top management positions at the Corporation and its portfolio companies;</li> <li>➤ for the position of the Corporation's Corporate Secretary;</li> </ul> </li> <li>- development of the Corporation's incentive and remuneration policies;</li> <li>- improving the corporate governance systems of the Corporation</li> </ul>

<sup>1</sup> Member of Sistema's Board of Directors until 25 June 2016

	and its portfolio companies, safeguarding shareholders' interests and rights.
Ethics and Control Committee	<ul style="list-style-type: none"> <li>– corporate security;</li> <li>– monitoring compliance with the requirements of the Corporation's Code of Ethics;</li> <li>– corruption prevention system at the companies that make up Sistema PJSFC.</li> </ul>
Investor Relations and Dividend Policy Committee	<ul style="list-style-type: none"> <li>– maintaining effective relations with the financial community and government agencies, strengthening Sistema's investment case;</li> <li>– developing Sistema's dividend policy, including the development of recommendations for the Corporation's Board of Directors with respect to the amount of dividends to be paid;</li> <li>– protection of the rights and interests of Sistema's shareholders.</li> </ul>

### Strategy Committee

The Strategy Committee is an advisory body of the Board of Directors and is responsible for the mandatory preliminary review of: all Sistema Group merger and acquisition projects with a value exceeding \$100m; all Sistema Group projects related to entering new regions or industries, all Sistema Group projects with significant government participation.

The status, appointment procedures, powers and decision-making processes of the Strategy Committee are regulated by the Terms of Reference of the Strategy Committee.

Доля независимых членов СД в составе Комитета



### Membership of the Strategy Committee

Name of Board Member	Position held
V. Evtushenkov (Committee Chairman)	Chairman of the Board of Directors of Sistema PJSFC
S. Boev	Deputy Chairman of the Board of Directors of Sistema PJSFC
A. Dubovskov	Management Board member of MTS, member of Sistema's Board of Directors
F. Evtushenkov	First Vice President of Sistema PJSFC, member of the Board of Directors of Sistema PJSFC
A. Zassoursky	Head of the Strategy Function of Sistema PJSFC
R. Kocharyan	Member of the Board of Directors of Sistema PJSFC
V. Latsanich	Vice President for Strategy at MTS
O. Mubarakshin	Management Board member, Head of the Legal Function of Sistema PJSFC
V. Chirakhov	CEO of Detsky Mir
M. Shamolin	President, member of the Board of Directors of Sistema PJSFC
D. Iakobachvili	Member of the Board of Directors of Sistema PJSFC

In 2016, the Committee held 12 meetings and reviewed matters related to the development of Sistema's portfolio companies and considered one item concerning the Corporation's strategy.

At its meetings, the Strategy Committee also considered matters related to the development of Sistema assets that were undergoing strategic reviews. The Committee also reviewed Sistema's possible participation in investment funds.

*Audit, Finance and Risk Committee*

The Audit, Finance and Risk Committee of Sistema's Board of Directors conducts an appraisal of the quality of audit services based on the audit of Sistema's financial statements and gives preliminary recommendations with respect to selecting RAS and IFRS auditors for the company. Based on the opinion formed by the Committee, the Board of Directors gives recommendations to the general meeting of shareholders on appointment of the Corporation's external auditor.

The procedures for nominating members, the responsibilities and decision-making processes of the Audit, Finance and Risk Committee are regulated by the Committee's Terms of Reference adopted by the Board of Directors on 13 December 2014.

*Composition of the Audit, Finance and Risk Committee*

<b>Name of Board Member</b>	<b>Position held</b>
R. Munnings (Committee Chairman)	Member of the Board of Directors of Sistema PJSFC, independent director
P. Clanwilliam	Member of the Board of Directors of Sistema PJSFC, independent director
J. Krecké	Member of the Board of Directors of Sistema PJSFC, independent director
D. Iakobachvili	Member of the Board of Directors of Sistema PJSFC, independent director

In 2016, the Audit, Finance and Risk Committee held 13 meetings, at which the committee members

- conducted an appraisal of the auditor's services and issued recommendations for the Board of Directors on appointing an external auditor;
- reviewed and approved Sistema's quarterly and annual financial reports, the annual report, the annual budget and the report on performance against the Corporation's budget.

In 2016, an internal assessment of the Committee's performance was conducted for the first time. Based on the assessment results, potential areas for improvement were identified: the risk management system and tax administration. The Committee members also highly approved of the effectiveness of the internal and external audit systems of the Corporation. The total score of the Committee's performance on a three-point scale was 2.27.

*Nomination, Remuneration and Corporate Governance Committee*

The purpose of the Committee is to facilitate the preparation and implementation of the Corporation's HR policy and support and develop an efficient corporate governance system that meets international standards and help improve the quality of decision-making by the Corporation. The Committee conducts regular monitoring of Sistema Group's potential HR needs and succession pool.

The Committee operates in accordance with the Terms of Reference of the Nomination, Remuneration and Corporate Governance Committee adopted by the Board of Directors on 13 December 2014 and amended on 29 October 2016.

*Nomination, Remuneration and Corporate Governance Committee*

<b>Name of Board Member</b>	<b>Position held</b>
R. Kocharyan (Committee Chairman)	Member of the Board of Directors of Sistema PJSFC, independent director
S. Boev	Member of the Board of Directors of Sistema PJSFC
P. Mandelson	Member of the Board of Directors of Sistema PJSFC, independent director

R. Munnings	Member of the Board of Directors of Sistema PJSFC, independent director
D. Iakobachvili	Member of the Board of Directors of Sistema PJSFC, independent director

Доля независимых членов СД в составе Комитета



The President of Sistema PJSFC M. Shamolin attends the Committee meetings in the capacity of a permanent invitee and does not vote on matters submitted to the Committee for consideration.

In 2016, the Nomination, Remuneration and Corporate Governance Committee held six meetings (including one joint meeting with the Ethics and Control Committee) and reviewed the following items:

- development of corporate governance across Sistema Group;
- incentive schemes, performance assessments and remuneration systems;
- HR processes and preliminary review of candidates for senior management positions at Sistema PJSFC and nominees for the boards of directors and CEO positions at key portfolio companies;

The Nomination, Remuneration and Corporate Governance Committee of Sistema PJSFC also organises the self-assessment procedure of the Board of Directors. The assessment looks at ten key criteria in order to identify those areas in the work of the Board of Directors that are in need of improvement. The Committee uses the results of self-assessment to make an annual plan aimed at developing Sistema's corporate governance systems, which is then submitted to the Board of Directors for approval.

#### *Ethics and Control Committee*

The Ethics and Internal Control Committee serves the purpose of forming an efficient system of economic security, internal control and prevention of fraud and other potentially illegal misconduct. The Committee abides by the Terms of Reference of the Ethics and Control Committee approved by the Corporation's Board of Directors.

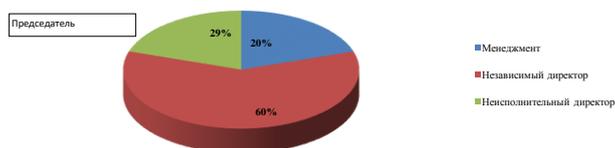
#### *Composition of the Ethics and Control Committee*

Name of Committee Member	Position held
S. Boev (Committee Chairman)	Deputy Chairman of the Board of Directors of Sistema PJSFC
F. Evtushenkov	First Vice President of Sistema PJSFC, member of the Board of Directors of Sistema PJSFC
R. Kocharyan	Member of the Board of Directors of Sistema PJSFC, independent director
P. Mandelson	Member of the Board of Directors of Sistema PJSFC, independent director
R. Munnings	Member of the Board of Directors of Sistema PJSFC, independent director

In 2016, the Ethics and Control Committee met seven times and reviewed, inter alia, the following matters:

- performance of the Internal Control and Audit Department in 2015 and work plan for 2017;
- a report on risk management at Sistema;
- results of an ethics assessment at the Corporation;
- methods of preventing and curbing fraud and corruption at Sistema.

Доля независимых членов СД в составе Комитета



### Investor Relations and Dividend Policy Committee

The Investor Relations and Dividend Policy Committee aims to strengthen the Corporation's investment case; it develops and maintains a transparent and stable dividend policy; it supports effective relations with the financial community and government agencies.

The Committee abides by the Terms of Reference of the Investor Relations and Dividend Policy Committee approved by the Board of Directors.

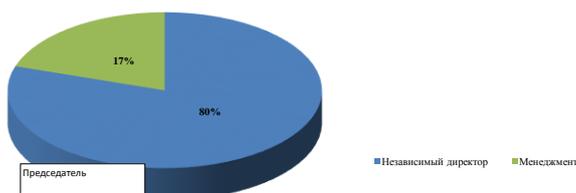
#### Composition of the Investor Relations and Dividend Policy Committee

Name of Committee Member	Position held
D. Iakobachvili (Committee Chairman)	Member of the Board of Directors of Sistema PJSFC, independent director
P. Clanwilliam	Member of the Board of Directors of Sistema PJSFC, independent director
J. Krecké	Member of the Board of Directors of Sistema PJSFC, independent director
R. Munnings	Member of the Board of Directors of Sistema PJSFC, independent director
M. Shamolin	President, member of the Board of Directors of Sistema PJSFC

In 2016, seven meetings of the Investor Relations and Dividend Policy Committee were held, at which, inter alia, the following matters were considered:

- amendments to the Corporation's dividend policy;
- corporate social responsibility and the operations of the Sistema Charitable Foundation;
- items related to market analysis and monitoring, the perception of Sistema PJSFC by the investment community and implementation of measures to increase market capitalisation.

Доля независимых членов СД в составе Комитета



### 6.3. President

The President of Sistema PJSFC is a permanent chief executive officer whose main tasks include managing the current operations of the Corporation and dealing with matters outside the remit of the General Meeting of Shareholders, the Board of Directors, and the 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 the General Meeting of Shareholders of Sistema PJSFC.

Mikhail Shamolin has been Sistema's President since 10 March 2011. On 10 March 2017, the Board of Directors re-appointed Mikhail Shamolin as President of Sistema PJSFC for a three-year term.

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<b>Mikhail Shamolin</b>	Was born in Moscow in 1970.
President of Sistema PJSFC, Chairman of the Management Board.	Graduated from the Moscow Automobile and Road Technical Institute in 1992, and from the Russian Presidential Academy of Public Administration in 1993.  In 1996-1997, completed a finance and management course for senior executives at the Wharton School of Business.  In 1998-2004, worked for McKinsey&Co, an international consultancy firm.  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.  On 10 March 2011, appointed President of Sistema PJSFC. Sistema's Board of Directors reappointed Mr Shamolin as President and Management Board Chairman for a new three-year term twice: on 15 March 2014 and on 10 March 2017.  Member of the Board of Trustees of Sistema Charitable Foundation.

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#### **6.4. Management Board**

Sistema's Management Board determines methods and means for implementation of the Corporation's development strategy, formulates development plans, determines and monitors investment processes, conducts assessment of personnel performance, and reviews most of the matters that are subsequently submitted to the Corporation's Board of Directors.

In 2016, the Management Board conducted 30 meetings and reviewed 82 agenda items in the following key areas:

- 1) Preliminary review of the matters to be submitted to the Board of Directors, including:
  - Sistema's development strategy;
  - Sistema's asset portfolio structure;
  - Sistema Group's strategic planning cycle;
  - development and value creation strategies for Sistema's key assets;
  - Sistema's functional strategies;
  - performance against budgets and budget planning;
  - Sistema's corporate social responsibility;
  - approval of specific deals.
- 2) Debt and liquidity management.
- 3) Risk management and preparation of risk maps.
- 4) Participation in investment projects.
- 5) Review of deals requiring no approval from the Board of Directors or the General Meeting of Shareholders.

In September 2015, upon expiry of the term of the previous Management Board, Sistema's Board of Directors formed a new Management Board for another three-year term. Sistema's current Management Board comprises 14 members.

*Members of the Management Board of Sistema PJSFC as of 31 December 2016*

- |   |                        |
|---|------------------------|
| <ol style="list-style-type: none"> <li>1. Mikhail Shamolin</li> <li>2. Elena Vitchak</li> <li>3. Alexander Gorbunov</li> <li>4. Felix Evtushenkov</li> <li>5. Artyom Zassoursky</li> <li>6. Valentin Korchunov<sup>1</sup></li> <li>7. Leonid Monosov</li> <li>8. Oleg Mubarakshin</li> <li>9. Vsevolod Rozanov</li> <li>10. Ali Uzdenov</li> <li>11. Mikhail Cherny</li> <li>12. Evgeny Chuikov</li> <li>13. Sergey Shishkin</li> <li>14. Vladimir Shukshin</li> </ol> | <p><i>Chairman</i></p> |
|---|------------------------|

*Changes to Sistema's Management Board in 2016*

In 2016, the Management Board went through a number of changes:

<i>N. Vasilkov</i>	12 March 2016	Membership terminated.
<i>A. Zassoursky</i>	21 May 2016	Elected to the Management Board, appointed Vice President, Head of the Strategy Function of Sistema PJFSC.

After the reporting period, in 2017 the following new members were elected to the Management Board: A. Guryev (Vice President, Head of HR Department) and A. Sirazutdinov (Vice President, Investment Portfolio Manager).

**6.5. The 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;
- Internal Control Committee;
- Disciplinary 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 in decision-making.

*Finance and Investment Committee*

The responsibilities of the Finance and Investment Committee include:

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<sup>1</sup> Upon completion of the reporting period in 2017 Elena Vitchak and Valentin Korchunov left the Management Board.

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

The Committee consists of 10 members. The Chairman of the Committee is the Corporation's President Mikhail Shamolin, and the Deputy Chairman is Senior Vice President, Head of the Finance and Investment Function Vsevolod Rozanov.

In 2016, the Committee met 60 times.

An Expert Council operates under the Finance and Investment Committee and considers all new investment ideas of the Corporation for acquiring new assets operating in new or multiple industries, as well as in sectors where Sistema already has a presence.

The Expert Council consists of 11 members: the Expert Council is chaired by Vice President, Head of the Strategy Function of Sistema PJSFC, A. Zassoursky.

In 2016, the Expert Council met 15 times.

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

The Risk Subcommittee consists of nine members. As of 31 December 2016, the Subcommittee was chaired by Sistema's Managing Director for Risks and Procurement N. Nosova.

In 2016, the Risk Subcommittee met 10 times.

#### *Tender Committee*

The responsibilities of the Tender Committee include:

- organising tenders for goods, works, and services;
- ensuring acquisition of goods, works, and services on the best possible terms;
- ensuring the transparency of purchasing procedures;
- facilitating prevention of corruption and other wrongdoing in the area of purchasing.

The Committee consists of 11 members. The Chairman of the Committee is Senior Vice President, Head of Sistema's Finance and Investment Function V. Rozanov. The Deputy Chairman is Executive Vice President for Finance and Economic Affairs A. Kamensky.

In 2016, the Tender Committee met 36 times.

#### *HR Committee*

The responsibilities of the HR Committee include:

- reviewing and making proposals with regards 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. The Chairman of the Committee is the President of Sistema PJSFC M. Shamolin.

In 2016, the Committee met 15 times.

#### *Security Committee*

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

The Committee consists of 32 members. The Chairman of the Committee is Vice President, Head of the Security and IT Department of Sistema PJSFC V. Shukshin.

In 2016, the Committee met four times.

#### *Disciplinary Committee*

The Disciplinary 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 six members. The Chairman of the Committee is the President of Sistema PJSFC M. Shamolin.

In 2016, the Committee met six times.

## ***6.6. Specific characteristics of risk management, internal control and internal audit systems***

### *Risk management*

The Sistema PJSFC risk management system uses a two-level approach where risks identified in Sistema and its portfolio companies are consolidated to assess their impact on Sistema Group as a whole.

The integrated risk management system (ERM) used in the Corporation addresses the following tasks:

- identification of risks at all levels of management (from top to line management), which includes identifying risk owners and creating risk passports;
- primary assessment of the materiality of identified risks and their analysis (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 their effectiveness;
- risk monitoring, quarterly reports on risks facing the Corporation.

The risk management procedures of Sistema PJSFC 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 of Sistema PJSFC.

### *Internal control system*

In February 2015, the Board of Directors approved the Policy on the Internal Control System setting out the key principles of internal control and defining it as a continuous integrated process involving all of the Corporation's subdivisions and governance bodies.

The key objectives of the internal control system are:

- creating control mechanisms that will ensure the efficiency of business processes and the implementation of investment projects of the Corporation;
- ensuring safety of the Corporation's assets and 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 is legally required to be publicly disclosed;
- ensuring the Corporation's compliance with applicable laws and regulatory requirements.

In accordance with the "three lines of defence" principle the efficiency of the Corporation's internal control system is ensured at three levels (in addition to the Board of Directors and the top management of the Corporation):

- Level 1: Heads of subdivisions and employees of the Corporation 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 of the Corporation. For example:
  - the risk management function and the risk committee are responsible for developing and monitoring the implementation of an effective risk management practice;
  - the Finance and Investment Committee of the Corporation approves and monitors the implementation of investment projects;
  - the Discipline Committee reviews matters related to breaches of the Ethics Code and disciplinary offences;
  - the Security and IT Department is responsible, among other things, for economic security, corruption prevention and information security.
- Level 3: The Internal Control and Audit Department conducts an independent assessments of the efficiency of the internal control system, the risk management procedures, and the corporate governance system.

All of the Corporation's employees in charge of various control procedures bear responsibility for the efficiency of such controls and risk management activities as prescribed in their job descriptions and internal regulations.

### *Internal audit*

The body in charge of internal control at the Corporation and the companies of Sistema Group is the Internal Control and Audit Department that 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 the resolutions passed by the Corporation's 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 the management improve the internal control system by performing regular audits of efficiency of the Corporation's internal control, risk management, and corporate governance systems;

- facilitating the attainment of the Corporation's strategic goals;
- supplying the Corporation's management and shareholders with objective information on the existing internal risks and their probability;
- enhancing the awareness of the Corporation's management about the performance of Sistema Group companies;
- monitoring 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 the following functions:

- performing independent audits of individual operations, processes, and units;
- assessing the efficiency of the internal control system;
- assessing the efficiency of the risk management system;
- assessing the efficiency of the corporate governance system, preventing violations of the law and the Corporation's regulations, ensuring observance of professional and ethical standards, and preparing recommendations for improvement thereof;
- developing recommendations to remedy deficiencies identified and monitoring remediation thereof;
- examining and evaluating documents provided with regards to specific investment projects for compliance with current regulations; performing scheduled and unscheduled monitoring of performance against project targets;
- ensuring uninterrupted functioning of the whistleblowing hotline;
- administering investigations, including internal ones;
- monitoring compliance with the Corporation's internal regulations;
- monitoring and investigating instances potentially qualifying as disciplinary offence and/or violation of discipline and/or conflict of interest in the Corporation or Sistema Group companies.

The Internal Control and Audit Department interacts closely with the independent auditors, coordinates audits and offers consultations in the course of preparation of the Department's annual audit plans with regard to assessment of the efficiency of internal controls applied to financial statements, as well as during discussions and assessment of identified risks.

In 2016, the Internal Control and Audit Department conducted 44 scheduled and unscheduled audits to assess the efficiency of internal control, risk management and corporate governance systems. The audits performed by the Internal Control and Audit Department did not uncover any weaknesses or risks that could affect the sustainability of the Corporation's business.

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

#### *Resolution of conflicts of interest*

In December 2015, the Board of Directors of Sistema PJSFC approved a revised Code of Ethics that provides for an ethics assessment procedure: the top managers of the Corporation and Sistema Group's subsidiaries are now required to complete ethics and conflict-of-interest declarations.

Before launching an ethics assessment procedure Sistema conducted a training course aimed at familiarising employees with the revised Code of Ethics and the procedure of completing ethics declarations.

The results of ethics assessment were reviewed by the President and the Ethics and Control Committee of Sistema's Board of Directors. 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 practice in corporate governance.

Ethics assessments 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 the financial statements of Sistema PJSFC. 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 the auditor's impartiality and objectivity.

### **6.7. Development of the corporate governance system in 2016**

#### *Independent directors on the Corporation's Board*

In 2016, 11 members were elected to the Corporation's Board of Directors, six of which qualify as independent directors or are recognised as independent according to the rules of the Moscow Exchange and the Russian Corporate Governance Code.

The current Board includes the following independent directors:

- Patrick Clanwilliam;
- Robert Kocharyan;
- Jeannot Krecké;
- Peter Mandelson;
- Roger Munnings;
- David Iakobachvili.

All of the Corporation's independent directors have vast experience in managing large organisations and possess strong professional reputations. Independent directors make up a majority on the Board, which ensures the objectivity of their judgements and freedom from influence by the Corporation's management and shareholders when making important decisions.

#### *Dividend policy*

In 2016, Sistema's Board of Directors approved a revised dividend policy. In line with the new policy, total dividends recommended for each reporting year will be, at a minimum, the higher of either an amount equivalent to a dividend yield of at least 4%, or RUB 0.67 per ordinary share. The Corporation also set itself the goal of paying dividends twice a year: for the first half of a reporting year and for a full reporting year. This approach enables Sistema to pay predictable dividends, ensuring transparency of the procedure for determining the amount of dividend payouts and strengthening the Corporation's investment case.

#### *Top management co-investment programme*

In May 2016, the Board of Directors approved a programme allowing Sistema's senior managers to co-invest in subsidiaries and /or Sistema PJSFC (hereinafter –"Co-investment Programme"). The Co-investment Programme aims to increase top management's motivation to boost the Corporation's capitalisation and provides for additional incentives linked to achievement of strong financial results through originating and implementing projects and efficiently managing the Corporation's assets, including asset acquisition, sale, restructuring, capitalisation growth and increasing dividend flows. More detailed information on the Co-investment Programme is available in Section 8 of this Annual Report.

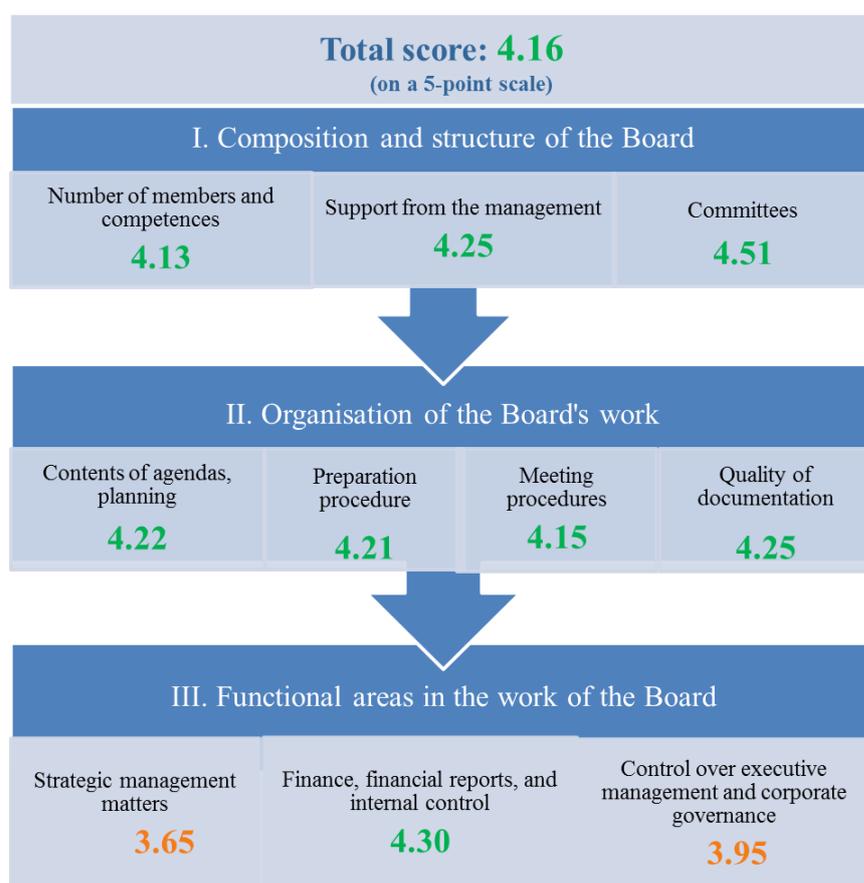
### Assessment of the work of the Board of Directors

The most recent assessment of the Board of Director’s work was performed in May 2016. As a result of the analysis of the Board’s performance the total score on a 5-point scale was 4.16 (in 2015 the score was 4.02).

The Board of Directors’ performance was assessed on the basis of judgements made by the Board members themselves.

As part of the assessment the Board members completed questionnaires containing the following sections: (1) membership and structure of the Board of Directors; (2) procedures and organization of the Board of Directors’ work; (3) organisation of the work of the Board’s Committees; (4) decisions of the Board of Directors in the area of strategic planning; (5) decisions of the Board of Directors in the area of finance, financial reporting and risk management; (6) decisions of the Board of Directors in the area of oversight over executive management and corporate governance.

Moreover, each Board member was requested to specify general strengths and weaknesses of the Board of Directors and indicate the projects and functional areas to which this Board member is capable of contributing. The self-assessment results reflect the high effectiveness of the Board of Directors and its Committees.



In accordance with the assessment results the action plan on improving the corporate governance system for 2017 envisages increased involvement of professional independent directors in the analysis of investment projects reviewed by the Board of Directors.

To this end, in the autumn of 2016, the Corporation introduced a procedure for challenging reports on the items included in the Board’s agenda. In accordance with the procedure the Chairman of the Board of Directors appoints one or several independent directors as opponents to ensure thorough consideration of the presented materials. The work of such a group of opponents makes it possible to ensure an in-depth and constructive discussion of each matter reviewed at the Board of Directors’ meeting.

### Corporate governance ratings

In 2016, the Russian Institute of Directors (RID) conducted a repeated assessment of the corporate governance practices of Sistema PJSFC in accordance with the updated methodology of the National

Corporate Governance Rating (NCGR). Sistema scored 8 on the NCGR scale, denoting “Advanced corporate governance practice.”

RID assessed Sistema’s corporate governance by four criteria, identifying both strengths and areas in need of further improvement:

- shareholders’ rights,
- activities of the governance and control bodies,
- disclosure of information,
- corporate social responsibility and sustainable development.

Institutional Shareholder Services (ISS) agency, which specialises in giving recommendations to shareholders on voting at the general meetings of issuers, assigned Sistema a governance quality score of 1, implying the lowest possible risk for investors.

The ISS assessment is based on four components:

- composition of the Board of Directors
- top management remuneration,
- shareholders’ rights,
- audit system.

## 7. SOCIAL RESPONSIBILITY

Sistema's investments in a number of critical and structurally important sectors of the Russian economy, as well as the activities of its portfolio companies, have a significant economic, technological, social and environmental impact on local communities.

The Corporation's responsible approach to investment and business is based on universally recognised international and national principles for CSR and sustainable development, as stipulated in the United Nations Global Compact, ISO 26000 (*Guidance on social responsibility*), the Russian Union of Industrialists and Entrepreneurs' Social Charter of Russian Business and internal corporate documents.<sup>1</sup> Key principles of the Corporation's approach include:

- Strict compliance with legislation and the norms of business ethics;
- Zero tolerance for and prevention of corruption in all its forms;
- Long-term contribution to regional development and support for local communities;
- Investment in human capital and stimulation of innovation;
- Creation of favourable working conditions and equal opportunities;
- Observance of human rights and non-discrimination;
- Minimisation of environmental impact;
- Balance of stakeholder interests, openness and transparency.

For Sistema, all ten principles of the UN Global Compact covering human rights, labour, the environment and anti-corruption are equally important. The Corporation shares the UN-backed Principles for Responsible Investment (PRI), developed by an international group of major institutional investors in collaboration with experts from the investment industry, intergovernmental organisations and civil society. It is committed to implementing them in its investment practice by incorporating the risks and opportunities associated with environmental, social and corporate governance (ESG) issues into both investment analysis (portfolio strategy and preparation of deals) and development of operating strategies and investment programmes for assets.

Sistema is interested in the sustainable development of its subsidiaries. The socioeconomic and environmental performance of these subsidiaries underpins not only the successful creation of shareholder value for the Corporation, but also the welfare of the state and society, including employees, consumers, partners, suppliers and local communities.

Compliance with these requirements by Sistema's new and existing assets is ensured by implementing high standards of corporate governance and business ethics, as well as unified approaches to HR, risks and procurement management, anti-corruption, CSR and charitable activities. Subsidiaries are directly responsible for environmental and occupational safety, health and well-being of employees and customers, product quality and reliability of services. Decisions are made with the involvement of Sistema's representatives in the boards of directors of portfolio companies, and effective implementation is achieved by recruiting highly qualified management teams, including from the Corporation's internal talent pool. In 2016, CSR issues considered by Sistema's Board of Directors were included in the regular agendas of the collective corporate governance bodies of all of the Group's key companies.

Sustainable development activities are regularly monitored in preparation for annual public non-financial reporting, which details significant aspects of the Corporation's sustainable development. Sistema encourages its companies to be integrated into CSR projects, and supports independent disclosure of sustainable development information by key assets in accordance with Global Reporting Initiative (GRI) guidelines.

### *Contribution to sustainable development*

With innovative, infrastructural and systemically important companies in a number of strategic sectors and an intensive social policy in its regions of operation, Sistema makes a significant contribution towards achieving priority goals in Russia's economic, social and environmental development, and also

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<sup>1</sup> Code of Ethics, Corporate Governance Code, HR Management Code, Corporate Social Responsibility Policy and Charity Policy .

towards achieving most of the global Sustainable Development Goals (SDGs) of the UN's 2030 Agenda for Sustainable Development. Many of the Corporation's projects operate at the intersection of various SDGs, while simultaneously addressing urgent domestic objectives including growth of labour productivity; technological development; import substitution; food security; educational, healthcare, social and environmental improvements, and raising overall living standards.

#### *Social investments and partnerships*

The Corporation makes significant investments in important social projects every year. Total spending on social and charitable activities in 2016 amounted to almost RUB 1.5bn, of which about one third was allocated to programmes run by Sistema Charitable Foundation. This foundation, which is financed by the Group's companies, is Sistema's main vehicle for social investment and manages a portfolio of strategic programmes in three key areas to generate long-term positive effect and meet the interests of all stakeholders:

Improvement of engineering education;

Social projects and volunteering;

Use of advanced technologies to promote culture and the arts.

The Corporation aims to unlock synergies between the fund and relevant objectives of its subsidiaries' CSR strategies, and to involve as many portfolio companies as possible in corporate-wide and joint projects aimed at creating shared value for Sistema and stakeholders.

#### *Supporting talent and innovation*

Sistema Charitable Foundation's flagship educational programme, Lift to the Future, has been run jointly with Group companies since 2011, and aims to build an effective system for training highly qualified engineering personnel capable of solving complex practical issues in knowledge-intensive sectors of the Russian economy. More than 3,200 children from across Russia have taken part in Lift to the Future qualifying competitions since its inception, and about half of them have visited temporary engineering and design schools over the years.

In 2016, three camp-based schools were organised, including the first ever regional engineering and design school in Altay. As of the end of the year, Lift to the Future had partnership agreements with 22 Russian universities. In addition, a number of new projects were launched covering the entire spectrum of technical education, including grants.

#### *Social projects and volunteering*

Sistema's social projects aim to increase quality of life of underprivileged groups by spreading cutting-edge social technologies and developing volunteering. Since 2015, SCF and Medsi Group have successfully run the Taking Care of Veterans programme under an agreement signed between Sistema, the Moscow City Government and the Moscow City Council of Veterans. About 700 programme participants, including war veterans, have been treated at Medsi clinics in Moscow, while aggregate investment in the programme has exceeded RUB 70m.

A special role in supporting war veterans, children and other target groups of CSR programmes is played by the corporate volunteer movement, whose activities are coordinated by Sistema Charitable Foundation's Volunteer Centre. In 2016, the Foundation recruited employees of the Group's main donor companies and external social partners as volunteers for its projects. The number of businesses regularly participating in joint volunteer campaigns grew by 62% to 21, including new assets (Concept Group, Sistema Venture Capital), while the share of the Group's volunteers participating in joint corporate programmes amounted to 6.5%. The Volunteer Centre implemented 64 projects in eight regions (Moscow, Moscow region, St Petersburg, Tula region, Kirov region, Karelia, Altay and Bashkortostan) for over 15,000 beneficiaries, and secured support from 16 external social partners.

Employees and senior managers of Sistema and its subsidiaries began providing regular support to specific social projects in 2016. The New Year's charitable auction (organised for the first time) and several fundraisers as part of the annual Wishing Tree campaign raised over RUB 11m

from Sistema employees that went to recipients including the Volgograd regional hospice and the Pavlovsky assisted-living facility in St Petersburg.

A vivid example of a company's contribution to solving pressing social problems in a region of operation is Detsky Mir's long-term project to support underprivileged children. During the traditional charity campaign Participate! in 2016, Detsky Mir customers in 160 cities of Russia and Kazakhstan collected over three million gifts worth RUB 112m for 550 beneficiaries. The company also opened 79 playrooms in 30 hospitals and rehabilitation centres in 18 Russian cities. The total number of playrooms opened by Detsky Mir in numerous cities in the last three years reached 174.

#### *New technologies for promotion of culture and education*

Last year was pivotal for the key recipient of Sistema's donations in the sphere of culture and art, the State Russian Museum. Sistema signed a 20-year agreement to support the museum in 2003, with annual financing envisaged at up to RUB 30m. With support from MTS for the development of multimedia museum technologies, the museum was able to launch an international educational project. More than 200 information and education centres dubbed "virtual branches" of the Russian Museum have opened at various museums, schools and universities, cultural and scientific centres. In March 2016, the Museum presented its new website, developed with support from Sistema Charitable Foundation. This marked another step towards making information more accessible for a broad audience about the museum's activities, exhibitions, permanent collection, funds and Russian art in general. On 1 December 2016, on the sidelines of the St. Petersburg International Cultural Forum, the Russian Museum officially launched its new platform – a multimedia information centre in the Western pavilion of the Mikhailovsky Castle. The multimedia centre was almost fully equipped by sponsors, and primarily Sistema. A multimedia cinema opened here first in 2011 and then became a platform for online lectures in 2013.

Sistema has an in-house centre to develop cutting-edge museum solutions. Kronshtadt Group participated in the large-scale reconstruction of the Aurora cruiser, where a new multimedia exposition opened in 2016.

MTS has been running *Generation M*, Russia's biggest charitable project to promote creativity, for several years. Using digital tools, the project brings together ideas to develop young talents from across Russia and support seriously ill children. Since its launch, the project has raised over RUB 15m.

An important place in Sistema Group's social and educational efforts belongs to projects aimed at making web and mobile technologies safer and more accessible for all users, from children to the elderly. MTS has teamed up with employees of Moscow State University's Psychology Department to develop the *Children and the Internet* programme, which includes lessons in online safety for younger schoolchildren, and an interactive exhibition, workshops and webinars for teachers and parents. Over 340,000 people in 30 regions completed the programme in the last five years. In 2016, exhibitions and lessons on safe and productive web surfing were organised in libraries, museums and children's art centres in eight cities: Krasnoyarsk, Saratov, Kemerovo, Omsk, Orenburg, Orsk, Kurgan and Izhevsk.

#### *Environmental responsibility*

Given the scale of its business and the environmental impact of its portfolio companies, Sistema considers reduction of its overall environmental footprint, including greenhouse gas emissions and resource consumption, as a priority, and is striving to achieve positive change by introducing environmentally friendly technologies and promoting green lifestyles. The Corporation's key environmental initiatives focus on responsible use, preservation and restoration of forests.

Segezha Group, the biggest forest user in the European part of Russia, promotes sustainable forest use, which envisages sustainability of resources, forest protection, reforestation, and prevention of forest fires and illegal felling to ensure that the forest brings maximum value to

people as well as to the economy. Segezha Group works actively with the government on projects to implement new models of intensive and responsible forest management aimed at facilitating sustainable forest development. Its experience was used to develop the required legal framework, first of all, for the pilot project of intensive forest use and reforestation in Karelia.

Segezha Group is actively engaged in forest management on leased forest areas in four regions of Russia. In 2016 alone, it restored about 22,000 ha of forests. Segezha Group's Russian companies invested some RUB 85m in environmental projects in 2016, while its foreign subsidiaries contributed EUR 150,000. The holding has an environmental management system based on ISO 14000, performs internal audits of the environmental activities of all of its subsidiaries, and undergoes voluntary Forest Stewardship Council (FSC) certification of its forest resources and supply chains. In 2015, the Group's largest enterprise, Segezha Pulp & Paper Mill, confirmed the compliance of its supply chain and controlled timber with FSC standards until December 2021.

Sistema encourages the introduction of high environmental standards in the timber industry. In June 2016, Segezha Group and WWF Russia teamed up for a joint initiative to develop an environmental responsibility ranking for Russian timber companies, which received support from other major players.

Paper packaging manufactured by Segezha Group's companies is broadly used by leading retail chains as an eco-friendly alternative to plastic bags. Detsky Mir was the first children's goods retailer in Russia to offer its customers eco-friendly bags produced by Segezha Group. The bags appeared at Detsky Mir stores in Moscow and the Moscow region in December 2015, and six months later the project was rolled out to the entire chain, with the number of paper bags sold surging five-fold to 30,600. MTS has also been gradually introducing eco-friendly packaging for SIM cards since 2015. In 2016, 8.5m SIM cards were packaged into envelopes made of kraft cardboard, which does not contain any synthetic agents and dissolves easily and naturally.

MGTS, which is part of MTS Group, launched a programme with WWF Russia to preserve Russia's forest resources, encouraging Moscow residents to reduce paper consumption by switching to electronic billing and inviting subscribers to make donations to WWF Russia for reforestation. The number of MGTS customers who switched to e-bills doubled over the year, which helped the company to reduce its spending on paper bills by 6.5%. About 1,000 customers made donations for forest preservation, and MGTS contributed RUB 7 for each rouble donated by subscribers. The funds raised went to protect about 3 million trees in particularly valuable forests in Arkhangelsk.

Sistema companies (RTI, MTS, MTS Bank, MGTS and Segezha) participated in an environmental campaign organised by FSC Russia to mark International Day of Forests and collected about 2.4 tons of waste paper for recycling, which saved more than 40 trees, 17,000 litres of water, 9,600 kWh of energy and prevented the emission of more than 4 tonnes of CO<sub>2</sub>.

#### *Information about fuel and energy consumption*

Type of resources	Unit of measurement	Actual resource consumption in 2016	
		in physical terms	in monetary terms, thousand RUB
Heat power	Gcal	1,626	2,612
Electric power	kWh	2,311	8,488
Petrol	litres	235,141	8,440

#### *A team of professionals*

As one of Russia's biggest employers, Sistema creates jobs with competitive salaries and additional social guarantees, and offers employees unique opportunities for career growth and to develop new skills. In

2016, the Group employed about 158,000 people in all regions of Russia.<sup>1</sup> The Group's companies strictly adhere to generally accepted norms and principles of labour relations, including those set out in World Labour Organisation guidelines and Russian legislation to prevent discrimination, protect employees' personal data and observe human rights.<sup>2</sup>

Sistema sees its main HR task as building strong and highly motivated management teams for its investment portfolios and assets, and organising efficient transfer of best practices, knowledge and professionals within the Group.

In May 2016, Sistema took a new important step towards transforming long-term incentive system for senior executives with the introduction of a co-investment programme for senior management. The programme is designed primarily to align the interests of investment portfolio managers with those of shareholders, in line with best global practices in the investment sector.

Sistema's management system is based on regular assessment of executives' efficiency, achievement of business targets and meeting corporate culture requirements (values, competences, cross-sector and social skills). In 2016, Sistema conducted assessment using state-of-the-art tools and with active support of the Corporate Centre's senior management. At the initial stage, assessment was conducted for 56 executives of Sistema, including members of the Management Board, and 128 CFOs of the Corporate Centre and subsidiaries.

In 2015, Sistema launched the Sistema Academy, a corporate educational project bringing together the best coaches and educational programmes from its subsidiaries. About 20 Group companies are currently involved in the project. In 2016, the Sistema Academy introduced new professional clubs that offer members opportunities for professional development, informal communication and networking.

The Corporation's employees may receive professional training, including free courses, at the Moscow State University's Higher School of Management and Innovation, a joint department between the University and Sistema that celebrated its 10<sup>th</sup> anniversary last year. Over these years, the school has awarded more than 300 master's degrees, with holders taking up executive positions at leading Russian and foreign companies. Last year, over 100 holders of master's degrees, including over 50 employees of Sistema and its subsidiaries, attended various advanced training courses at the department.

The Corporation not only creates a favourable environment for professional growth and its employees' development, but also shapes a common corporate culture aimed at teamwork and high achievement. Sistema also takes its employees' health very seriously. The biggest annual event bringing together employees of all Sistema Group companies and their families in support of healthy lifestyles is the Summer Games, which in 2016 gathered 19 teams and about 4,000 participants and supporters at the Yantar stadium in Moscow.

The Corporation's HR efforts result in a high level of personnel engagement and make Group companies attractive employers. The Corporation conducts an engagement survey once every two years. In 2016, the survey covered 16 companies (56% of Group staff). The average engagement level grew by 4% since the last survey (in 2014) to 64%.

In 2016, MTS improved its position in the ranking of Russia's best employers compiled by HeadHunter and RBC, moving up one notch to fourth among more than 230 companies and also being named best employer among telecoms companies. Detsky Mir was named among the most attractive Russian employers in the *AON Best Employers Russia 2016* survey, the results of which were announced at Vedomosti's HR Forum. MTS also made it to the top 14 employers of 2016.

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<sup>1</sup> Including Targin.

<sup>2</sup> The Corporation is n Rights.



## 8. REMUNERATION POLICY APPLIED TO BOARD MEMBERS AND SENIOR MANAGEMENT

### *Remuneration policy for Sistema Board members*

Remuneration for members 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 PJSC<sup>1</sup>.

#### **Basic remuneration of Board members**

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

#### **Supplementary remuneration of Board members**

Board members are awarded supplementary remuneration in the form of ordinary shares of Sistema, subject to investment targets for the reporting year being achieved: (i) the arithmetic mean of total shareholder return (TSR) and internal total shareholder return (iTSR) exceeds or equals cost of equity (CoE)<sup>2</sup>; or (ii) TSR exceeds or equals the change of the MSCI index ( $\Delta$ MSCI), provided that iTSR exceeds or equals CoE. The number of ordinary shares awarded to Board members 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 Board members, the amount of remuneration in monetary terms is equal to the amount of basic remuneration less applicable taxes, and 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 AGM.

#### **Remuneration for performance of additional duties**

Board members performing additional duties such as Chairman and Deputy Chairman of the Board of Directors, and chairmen of Board Committees, receive remuneration quarterly in the amount stipulated by the Policy on Remuneration and Compensation.

Board members are reimbursed for expenses accrued in connection with 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 for senior management*

#### **Short-term incentive system**

In 2016, the short-term (up to one year) incentive scheme for senior managers consisted of:

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

<sup>1</sup> Approved by the General Meeting of Shareholders on 27 June 2015.

<sup>2</sup> This investment target was achieved in 2016, since the arithmetic mean of TSR and iTSR was 41.2% and CoE was 14.6%. CoE represents the minimum level of return that a company must provide to its shareholders for the expectation of profit and risk. CoE 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.

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

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

#### **Long-term incentive system**

In 2016, the long-term (more than one year) incentive scheme for senior managers formed part of a three-year incentive programme (2015-2017) designed to increase Sistema's shareholder value and create additional incentives for maintaining long-term employment and corporate relations between the Corporation and its management. Programme participants are assigned a certain number of shares that are transferred to them in instalments in the form of Sistema's ordinary registered shares when targets set by Sistema's shareholders are achieved. Share transfers take place annually over the course of five years from the launch of the programme. The number of shares allocated to a programme participant is calculated using the following formula:

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

#### **Co-investment programme**

In May 2016, the Board of Directors approved a programme allowing Sistema's senior managers to co-invest in subsidiaries and/or shares of Sistema. The Co-investment Programme aims to increase senior management's motivation to boost the Corporation's market capitalisation, and includes additional incentives linked to achievement of strong financial results through project origination and implementation and efficient management of the Corporation's assets, including asset acquisitions, sales, restructurings, growth of market capitalisation and increasing dividend flows.

The programme participants are the President and heads of Investment Portfolios, Functions and Departments. Co-investment Programme participants use their own funds to acquire:

- shares/stakes in Sistema's subsidiaries; and/or
- ordinary shares of Sistema PJSFC.

The amount of co-investment is limited by the participant's average annual income.

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 is directly linked to the gain in the value of the shares of the subsidiary and/or ordinary shares of Sistema.

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.

#### *Remuneration paid to Board members and senior management in 2016<sup>1</sup>*

Members of Sistema's Board of Directors received the following remuneration in 2016:

Cash remuneration	RUB 498,400,342	Remuneration for work in the Board of Directors and additional duties, as well as salaries and
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<sup>1</sup> All figures in this section are given before the applicable income tax.

		bonuses for 2016 paid to Board members who were also employees of the Corporation in 2016. <sup>1</sup>
Remuneration in the form of ordinary shares of Sistema	RUB 422,928,991	Shares paid to Board members for corporate year 2015-2016 <sup>2</sup> and remuneration under the long-term incentive programme.
Reimbursement of expenses incurred by Board members in connection with their duties	RUB 3,713,752	

Members of Sistema's Management Board<sup>3</sup> received the following remuneration in 2016:

Cash remuneration	RUB 3,148,937,048	Including fixed salaries and bonuses. <sup>4</sup>
Remuneration in the form of ordinary shares of Sistema	RUB 1,155,134,028	Shares paid under the long-term incentive programme.

<sup>1</sup> Excluding members of Sistema's Board of Directors who were members of its Management Board.

<sup>2</sup> The rouble equivalent of fixed amounts in US dollars, calculated at the Russian Central Bank's exchange rate on the date of payment (see above in this section).

<sup>3</sup> Including the President of Sistema PJSC.

<sup>4</sup> Bonuses for 2016 were paid to Sistema's employees in January 2017.

## ANNEX

### ***Annex 1. Brief biographies of Sistema's Board members, President, Management Board members, and Corporate Secretary. Their shareholding in Sistema PJSFC. <sup>1</sup>***

#### *Members of the Board of Directors*

<i>Name, position</i>	<i>Brief biography</i>
<b>Vladimir Evtushenkov</b>  Chairman of the Board of Directors  Non-executive director	<p>Born in 1948 in the Smolensk region.</p> <p>In 1973, graduated from the Moscow Mendeleev Institute of Chemical Technology, and in 1980, from the Economics Department of the Moscow Lomonosov State University. Holds a PhD degree in Economics.</p> <p>1975 - 1982 - Shop manager; deputy director; chief engineer, the Karacharovo Plastics Factory.</p> <p>1982 - 1987 - Chief engineer, first deputy CEO, the Polymerbyt Research and Manufacturing Association.</p> <p>1987 - 1988 - Head of the Technical Department, then head of the Main Department of Science and Technology, the Moscow City Executive Committee.</p> <p>1990 - Chairman of the Moscow Municipal Committee for Science and Technology.</p> <p>1993 - Founded Sistema Joint-Stock Financial Corporation together with a group of associates.</p> <p>Principal shareholder, Chairman of the Board of Directors and Chairman of the Strategy Committee of the Board of Directors of Sistema PJSFC.</p> <p>Member of a number of government commissions, actively involved in decision-making for improvement of competitiveness of the Russian industry, development of high technologies and innovations, science and culture; chairman of the Russian-Arab Business Council, member of the management boards of the main associations of entrepreneurs in Russia - the Russian Union of Industrialists and Entrepreneurs and the Russian Chamber of Commerce and Industry.</p> <p>Chairman of the Council of Trustees of the Fund for Development of the State Russian Museum "Friends of the Russian Museum". Member of the Board of Trustees of Sistema Charitable Foundation.</p> <p>Share in the authorised capital of Sistema PJSFC – 64.1939%.</p>
<b>Sergey Boev</b>  Deputy Chairman of the Board of Directors  Non-executive director	<p>Born in 1953 in Moscow.</p> <p>In 1978, graduated from the All-Union Correspondence Law Institute, in 1984, from the Moscow Ordzhonikidze Institute of Management. Holds PhD degrees in Economics and Engineering. Professor.</p> <p>Winner of the State Prize of the Russian Federation in science and technologies. Awarded the Order of Honour. Awarded the titles of the honoured economist of Russia and the honoured radio engineer of Russia.</p>

<sup>1</sup> As of 31 December 2016.

Member of the Russian President's Council for Economic Modernisation and Innovative Development of Russia, the Working Group for Technological Development of the Russian President's Economic Council, the Federation Council's council on legislative support for the defence industry and military technical cooperation, the Science and Technology Council of the Military and Industrial Commission of the Russian Government, and the Academic Board of the Russian Security Council; co-chairman of the working group for innovations of the EU-Russia Industrialists' Round Table; full member of the Academy of Military Science; head of the Intelligent Information and Radiophysical Systems Department of the Moscow Institute of Physics and Technology; professor of the Radio Engineering Department of the National Research Mordovian State Ogarev University.

1971-1999 - Worked at the Mintz Radio Technology Institute where he made a career from fitter's apprentice to CEO.

2000 - 2008 - CEO, OJSC RTI Concern.

2008 - 2011 - Vice President, Head of the High Technology and Industry Business Unit, Sistema PJSFC.

2011-2016 - CEO, OJSC RTI.

Since 2016 - Chief Designer, OJSC RTI.

2012 - Appointed Chief Designer of the National Missile Warning System.

Chairman of the Board of Directors of OJSC RTI, OJSC Mintz Radio Technology Institute, OJSC Research Institute of Long-Range Radio Communications, member of the Board of Directors of Almaz-Antey Concern and a number of other companies.

Member of the Boards of Trustees of Sistema Charitable Foundation, the Russian Admirals' Club and the Suvorov Military School in Tver.

Member of the Board of Directors of Sistema PJSFC since 2013. Deputy Chairman of the Board of Directors, Chairman of the Ethics and Control Committee, member of the Strategy Committee and the Nomination, Remuneration and Corporate Governance Committee of the Board.

Share in the authorised capital of Sistema PJSFC – 0.0225%.

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**Andrey Dubovskov**

Born in 1966.

Non-executive director

In 1993, graduated from the Gerasimov State Institute of Cinematography with a degree in Film Direction.

Has an extensive experience in the telecom sector: Since 1993, he has held managerial positions at Millicom International Cellular, LLC Regional Cellular Telecommunications, CJSC 800 and other companies in Moscow, Almaty, Nizhny Novgorod and other cities. 2002 - 2004 - CEO, Tele2 (Nizhny Novgorod).

2004 - 2006 - Director, the Nizhny Novgorod branch, OJSC MTS. 2006 - 2007 - Director, the Ural Macro Region, OJSC MTS. In 2007, he became first deputy CEO of CJSC UMS (MTS Ukraine) and in 2008 was appointed CEO of MTS Ukraine.

Appointed president, chairman of the management board of PJSC MTS in

April 2011.

Member of the Supervisory Board of MTS Ukraine. Chairman of the board of directors of PJSC MGTS, JSC RTC, LLC Mobile TeleSystems (MTS Belarus).

Member of the Board of Directors of Sistema PJSFC since 2015. Member of the Strategy Committee of the Board.

Share in the authorised capital of Sistema PJSFC – 0.0049%.

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<b>Felix Evtushenkov</b>	Born in 1978 in Moscow.
Executive Director Management Board member	In 2000, graduated from the Griboyedov Institute of International Law and Economics with a degree in law.  1999 - 2000 - Assistant to President of CJSC Sistema Invest, Executive Director of Industry Department at Sistema PJSFC.  2000 - 2006 - Deputy CEO, CEO at CJSC Sistema Hals.  2006 - 2008 - President at OJSC Sistema Hals.  2008 - 2011 - Vice President, Head of Consumer Assets Business Unit at Sistema PJSFC.  2011 - 2011 - First Vice President, Head of Core Assets Business Unit at Sistema PJSFC.  From 2012 - First Vice President, Sistema PJSFC.  Chairman of the Board of Directors of OJSC BPGC and some other companies.  Member of the Board of Directors of Sistema PJSFC since 2015. Member of the Strategy Committee and the Ethics and Control Committee of the Board.  Share in the authorised capital of Sistema PJSFC – 0.0978%.

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<b>Patrick Clanwilliam</b>	Born in 1960 in London.
Independent Director	Educated at Eton College and Royal Military Academy Sandhurst.  1990 - 1998 - Councillor in the Royal Borough of Kensington and Chelsea (two successive terms).  1993 - now - Founding Partner at Meade Hall & Associates, a political, strategic, financial and legal communication consultancy.  2002 - 2005 - Chairman of the Transport Committee, the London Chamber of Commerce and Industry. Also served as chairman of the board of Cleveland Bridge UK Ltd., a leading global engineering company.  2006 - 2014 - Non-executive member of the board of directors, OJSC Polyus Gold, Russia's biggest gold producer (by market share).  Since 2007 - Chairman of the board, LLC Eurasia Drilling, Eurasia's biggest provider of drilling and well workover services.  Since 2012 - Non-executive director, NMC Healthcare PLC (UAE), a

healthcare company.

Since 2013 - Non-executive director, SOMA Oil & Gas (UK), a private company pursuing oil and gas exploration on continental shelf.

Member of the Board of Directors of Sistema PJSFC since 2015. Member of the Investor Relations and Dividend Policy Committee of the Board.

Share in the authorised capital of Sistema PJSFC – 0.0051%.

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**Robert Kocharyan**

Independent Director

Born in 1954 in Stepanakert, Nagorno-Karabakh Autonomous Region.

In 1982, graduated from the Yerevan Polytechnic Institute. 1991 - 1994 - Deputy of the first Supreme Council of the Nagorno-Karabakh Republic (NKR), Chairman of the State Defence Committee of the NKR and Prime Minister of the NKR.

1994 - 1997 - President of the NKR.

1997 - 1998 - Prime Minister of the Republic of Armenia.

1998 - 2008 - President of the Republic of Armenia.

Member of the Board of Directors of Sistema PJSFC since 2009. Chairman of the Nomination, Remuneration and Corporate Governance Committee, member of the Strategy Committee and the Ethics and Control Committee of the Board.

Share in the authorised capital of Sistema PJSFC – 0.0133%.

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**Jeannot Krecké**

Independent Director

Born in 1950 in Luxembourg.

Graduated from the Free University of Brussels. Further education in economics, accounting and taxation. Co-author of the annual manual on taxation in Luxembourg and of books on tax control and tax fraud monitoring.

2004 - Minister of Sport, Luxembourg.

2004 - 2011 - Minister of Economics and Foreign Trade, Luxembourg, representative of the Luxembourg Government in the Council of Ministers of the European Union.

1987 - 1997 - Co-founder and President of the Alzheimer Association Luxembourg. Since 1997 - President of the Alzheimer Foundation.

1970 - 1977 - Played for the Luxembourg national football team; participated in transatlantic and polar expeditions (Greenland, Svalbard).

Member of the Board of Directors of Sistema PJSFC since 2012. Member of the Audit, Finance and Risks Committee and the Investor Relations and Dividend Policy Committee of the Board.

Share in the authorised capital of Sistema PJSFC – 0.0106%.

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**Peter Mandelson**

Independent Director

Born in 1953 in the United Kingdom.

Graduated from the Oxford University, where he majored in political science, philosophy and economics.

1985 - 1990 - Director of Campaigns and Communications for the Labour

Party of the UK.

1992 - 2004 - Member of the UK Parliament.

July 1998 - December 1998 - British Secretary of State for Trade and Industry.

1999 - 2001 - Secretary of State for Northern Ireland. 2004 - 2008 - European Commissioner for Trade. 2008 - 2010 - Secretary of State for Business, Innovation and Skills; First Secretary of State.

Life peer in the House of Lords since 2008.

2010 - Became chairman of Global Counsel, a consultancy firm, and senior advisor to Lazard Ltd.

President of the Policy Network think tank.

Member of the Board of Directors of Sistema PJSFC since 2013. Member of the Nomination, Remuneration and Corporate Governance Committee and the Ethics and Control Committee of the Board.

Share in the authorised capital of Sistema PJSFC – 0.0089%.

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**Roger Munnings**

Independent Director

Born in 1950 in the United Kingdom.

Graduated from the Oxford University with a degree of Master of Arts in Politics, Philosophy, Economics.

Member of the UK Government's working group on trade and investments between Great Britain and Russia, Chairman of the Institute of Audit Committees of Russia.

Roger has had a long and successful career with the international auditor KPMG (1974-2008), including during his time as the President and Managing Partner of KPMG in Russia and the CIS (1996-2008), as well as Chairman of the world energy and natural resources committee of KPMG (1993-2008). Member of the Institute of Certified Accountants of England and Wales.

Member of the Board of Directors of Sistema PJSFC since 2010. Chairman of the Audit, Finance and Risks Committee, member of the Investor Relations and Dividend Policy Committee, the Nomination, Remuneration and Corporate Governance Committee and the Ethics and Control Committee of the Board.

Share in the authorised capital of Sistema PJSFC – 0.0123%.

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**Mikhail Shamolin**

Executive Director

President

Chairman of the Management Board

Born in Moscow in 1970.

In 1992, graduated from the Moscow Automobile and Road Construction 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 the Wharton School of Business.

In 1998-2004, worked for McKinsey&Co, an international consultancy firm.

2004 - 2005 - Managing Director for the Ferroalloys Division, Interpipe Corp

(Ukraine).

2005 - 2011 - Vice President for Sales and Customer Service, then Vice President, Head of Business Unit, President of OJSC MTS Russia.

On 10 March 2011, appointed President of Sistema PJSFC. On 15 March 2014, the Board of Directors reappointed Mr Shamolin President and Chairman of the Management Board of Sistema for a new three-year term.

Chairman of the Management Board of Sistema PJSFC. Member of the Strategy Committee and the Investor Relations and Dividend Policy Committee of the Board. Member of the Board of Trustees of Sistema Charitable Foundation.

Share in the authorised capital of Sistema PJSFC – 0.2354%.

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**David Iakobachvili**

Born in 1957 in Georgia.

Independent Director

Graduated from the Civil and Industrial Engineering Department of the Georgian Technical University in Tbilisi.

1986 - 2000 - Private entrepreneur involved in various projects: official dealership of General Motors cars, tourism and hotel business, timber processing, retail, communications and banking.

1992 - One of the founders of a well-known dairy products company, Wimm-Bill-Dann.

1992 - 2011 - Member and later Chairman of the Board of Directors, Wimm-Bill-Dann.

President of LLC Orion Naslediye. Member of the boards of directors of a number of companies.

Member of managing bodies of various Russian and international organisations: Vice President and member of the Management Bureau of the Russian Union of Industrialists and Entrepreneurs (RSPP), head of the RSPP Committee for Corporate Social Responsibility and Demographic Policy, chairman of the RSPP United Ethics Committee, chairman of the board of RusBrand, president of the Russian-American Business Council, member of the board of the Russian Chamber of Commerce and Industry, the General Council of LLC Business Russia, the World Economic Forum in Davos, of the President's Global Council at New York University, the Public Council of the Russian Culture Ministry, the Coordination Council for Intellectual Property Protection.

Member of the Board of Directors of Sistema PJSFC since 2011. Chairman of the Investor Relations and Dividend Policy Committee, member of the Strategy Committee, the Nomination, Remuneration and Corporate Governance Committee, and the Audit, Finance and Risk Committee of the Board.

Share in the authorised capital of Sistema PJSFC – 0.0171%.

*President and Board members*

*Name, position*

*Brief biography*

**Mikhail Shamolin** Born in Moscow in 1970.

President of Sistema PJSFC  
Chairman of the Management Board of Sistema PJSFC

In 1992, graduated from the Moscow Automobile and Road Construction 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 the Wharton School of Business.

In 1998-2004, worked for McKinsey&Co, an international consultancy firm.

2004 - 2005 - Managing Director for the Ferroalloys Division, Interpipe Corp (Ukraine).

2005 - 2011 - Vice President for Sales and Customer Service, then Vice President, Head of Business Unit, President of OJSC MTS Russia.

On 10 March 2011, appointed President of Sistema PJSFC. On 15 March 2014 the Board of Directors reappointed Mr Shamolin President and Chairman of the Management Board of Sistema for a new three-year term.

Chairman of the Management Board of Sistema PJSFC. Member of the Strategy Committee and the Investor Relations and Dividend Policy Committee of the Board. Member of the Board of Trustees of Sistema Charitable Foundation.

Share in the authorised capital of Sistema PJSFC – 0.2354%.

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**Elena Vitchak<sup>1</sup>** Born in 1971 in Moscow.

Vice President, Head of HR Department of Sistema PJSFC

In 1992, graduated from the Philology Department of the Rostov State University, in 2005, from the State Academy of Investment Specialists with a degree in HR management.

Member of the Expert Council of the National Union of HR Specialists of Russia.

Member of the HR Committee of the Association of Russian Banks.

2002 - 2008 - Head of the HR Department, Capital Insurance Group.

2008 - 2010 - Director of the HR Department, Member of the Management Board, OJSC Sistema Hals.

2010 - 2012 - Senior Vice President, Director of the HR Department, OJSC MTS Bank.

2012 - 2013 - Executive Vice President, Head of the HR Department, Sistema PJSFC.

From December 2013 - Vice President, Head of the HR Department, Sistema PJSFC.

Share in the authorised capital of Sistema PJSFC – 0.0256%.

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**Alexander Gorbunov** Born in 1967 in Moscow.

<sup>1</sup> Ms Vitchak was relieved of the responsibilities of a Management Board member after the end of the reporting year.

Vice President, Manager of  
Sistema's Telecom Assets

In 1992, graduated from the Moscow Engineering and Physics Institute with a degree in experimental nuclear and plasma physics. In 1999, received an MBA degree from Harvard University.

2002 - 2003 - Deputy CEO, Intellect Telecom.

2003 - 2005 - Head of Strategic Analysis Department, Director for Strategy at the Strategic Analysis Department, OJSC MTS.

2005 - 2006 - Head of the Corporate Development Department, Acting First Vice President, Head of the Strategy and Development Function, Sistema PJSFC.

2006 - 2010 - Vice President for Strategy and Development, OJSC Comstar United TeleSystems.

September - December 2010 - Advisor to the president of OJSC Sitronics.

2010 - 2012 - Executive Vice President of the Telecom Assets Business Unit, Executive Vice President for Telecom Assets Development at the Core Assets Business Unit, Sistema PJSFC.

2012 - 2015 - Executive Vice President of an Investment Portfolio of Sistema PJSFC.

From December 2015 - Vice President, Sistema PJSFC.

Share in the authorised capital of Sistema PJSFC – 0%.

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**Felix Evtushenkov**

Born in Moscow in 1978.

First Vice President,  
Investment Portfolio  
Manager of Sistema PJSFC

In 2000, graduated from the Griboyedov Institute of International Law and Economics with a degree in law.

1999 - 2000 - Assistant to President of CJSC Sistema Invest, Executive Director of Industry Department at Sistema PJSFC.

2000 - 2006 - Deputy CEO, CEO at CJSC Sistema Hals.

2006 - 2008 - President at OJSC Sistema Hals.

2008 - 2011 - Vice President, Head of Consumer Assets Business Unit at Sistema PJSFC.

2011 - 2011 - First Vice President, Head of Core Assets Business Unit at Sistema PJSFC.

From 2012 - First Vice President, Sistema PJSFC.

Chairman of the Board of Directors of OJSC BPGC and some other companies.

Share in the authorised capital of Sistema PJSFC – 0.0978%.

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**Valentin Korchunov<sup>1</sup>**

Born in Moscow in 1982.

Vice President, Investment

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<sup>1</sup> Mr Korchunov was relieved of the responsibilities of a Management Board member after the end of the reporting year.

Portfolio Manager of Sistema PJSFC

In 2005, graduated from the St Petersburg Polytechnic University with a degree in computer science; in 2015, obtained an MBA degree from the Chicago School of Business.

2006 - 2009 - Analyst, the Corporate Finance Department, Alfa Bank.

2009 - 2012 - Head of Investment Analysis and Transactions, VTB Capital

2012 - 2015 - Investment Director at an Investment Portfolio of Sistema PJSFC.

From December 2015 - Vice President, Sistema PJSFC.

Share in the authorised capital of Sistema PJSFC – 0.0605%.

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**Leonid Monosov**

Born in 1958 in Mozyr, Belarus.

Vice President, Investment Portfolio Manager of Sistema PJSFC

In 1980, graduated from the Moscow Institute of Railway Engineers with a degree in industrial and civil construction.

Recipient of various awards and the title of Honoured Builder of the Russian Federation.

1999 - 2007 - CEO of OJSC Moskapstroy.

2007 - 2010 - Head of the Moscow City Contract Repairs Department.

2010 - 2012 - Vice President, the state-owned corporation Olympstroy.

2012 - 2013 - Executive Vice President of the Developing Assets Business Unit, Executive Vice President, Sistema PJSFC.

From December 2013 - Vice President, Sistema PJSFC.

Share in the authorised capital of Sistema PJSFC – 0.0550%.

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**Oleg Mubarakshin**

Born in 1968 in the Saratov region.

Senior Vice-President, Head of the Legal Function, Sistema PJSFC.

In 2000, graduated from the Moscow State Academy of Law with a degree in law; in 2002, from the Finance Academy of the Government of the Russian Federation with a degree in finance.

In 1991, graduated from the Defence Ministry's Military Institute.

1996 - 1998 - Deputy CEO for legal matters, the oil and gas company Belye Nochi (Russia).

1998 - 2007 - Vice President for Corporate and Legal Affairs for Central and Eastern Europe, InBev FMCG Group (Russia).

2008 - 2009 - Vice President for Legal Affairs for Western Europe, InBev FMCG Group (Belgium).

2009 - 2013 - Member of the Management Board, Head of Legal, EastOne Investment and Consulting Group (Ukraine, Great Britain).

2013 - 2015 - Vice President, Head of the Legal Function, Sistema PJSFC.

From December 2015 - Senior Vice President, Head of the Legal Function, Sistema PJSFC.

Share in the authorised capital of Sistema PJSFC – 0.1685%.

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<b>Vsevolod Rozanov</b>	Born in Moscow in 1971.
Senior Vice President, Head of the Finance and Investment Function of Sistema PJSFC	Graduated from the Economics Department of the Moscow Lomonosov State University with a degree in economics. 1993 - 2001 - Held various positions at the consultancy Bain & Company Inc. in Moscow, London and Stockholm. 2002 - 2004 - Deputy CEO for Economics and Finance, CJSC MTU-Inform. 2004 - 2006 - Vice President for Economics and Finance, OJSC Comstar United Telesystems. 2006 - 2008 - Vice President for Finance and Investment, member of the Management Board, OJSC MTS. 2008 - 2013 - CEO of Sistema Shyam TeleServices Limited. Board member of SSTL and OJSC MTS. From June 2013 - Senior Vice President, Head of the Finance and Investment Function of Sistema PJSFC.
	Share in the authorised capital of Sistema PJSFC – 0.0852%.

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<b>Ali Uzdеноv</b>	Born in 1962 in Kislovodsk, the Stavropol territory.
Senior Vice President, Investment Portfolio Manager of Sistema PJSFC.	In 1985, graduated from the Rostov Institute of Railway Engineers. In 1990, continued his education at the International Survival School (Italy). 1994 - 1997 - Head of the Rostov Commodity Exchange. 1997 - 1998 - CEO of LLC Ayaks. 1998 - 2001 - CEO of the Rostov branch, OJSC Bashneft. 2001 - 2007 - Chairman of the Board of Directors, OJSC Kormmash. 2007 - 2009 - CEO of LLC Rostovregiongaz. 2009 - 2012 - First Vice President for Refining and Sales, OJSC Bashneft. 2012 -2013 - Vice President, Sistema PJSFC. From December 2013 - Senior Vice President, Sistema PJSFC.
	Share in the authorised capital of Sistema PJSFC – 0.0729%.

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<b>Mikhail Cherny</b>	Born in 1971 in Saratov.
Vice President, Investment Portfolio Manager of Sistema PJSFC	In 1994, graduated from the Moscow State University of International Relations of Russia's Ministry of Foreign Affairs (MGIMO) with a degree in international economics. In 2004, obtained an MBA degree from Washington University. 2006 - 2009 - Vice President, head of the division for work with energy companies, LLC Morgan Stanley Bank. 2009 - 2011 - Deputy CEO for Strategy and Energy Markets, OJSC

Bashkirenergo.

2011 - 2015 - Executive Vice President of an Investment Portfolio of Sistema PJSFC.

From December 2015 - Vice President, Sistema PJSFC.

Share in the authorised capital of Sistema PJSFC – 0.0122%.

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**Evgeny Chuikov**

Born in 1984 in Kiev.

Vice President, Head of the Corporate Communications Function of Sistema PJSFC

In 2005, received a BA degree from Courtauld Institute of Art.

2008 - 2009 - anti-crisis manager at Imperial Energy (an independent oil company) and Ferrexpo (one of the leading producers of iron ore in the world).

2009 - 2010 - Co-Director of Pelham Bell Pottinger, a financial PR Agency in the UK.

2010 - 2015 - Managing Director for Investor Relations, Corporate Communications Function, Sistema PJSFC.

From September 2015 - Vice President, Head of the Corporate Communications Function, Sistema PJSFC.

Share in the authorised capital of Sistema PJSFC – 0.0242%.

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**Sergey Shishkin**

Born in Moscow in 1970.

Vice President, Head of the Corporate Governance Function of Sistema PJSFC

In 1992, graduated with honours from the Moscow Lomonosov State University with a degree in law. In 1996, received a PhD in Law.

1998 - 2000 - Director at the Foundation of International Institute for Development of Legal Economy.

2001 - 2003 - Member of the bar association of Moscow.

2005 - 2011 - Head of the Property Department, Director of the Department of Property Projects, Sistema PJSFC.

2011 - 2015 - Executive Vice President for Corporate Projects, Sistema PJSFC.

October 2014 - December 2015 - Acting Senior Vice President, Head of the Corporate Governance Function, Sistema PJSFC.

From December 2015 - Vice President, Head of the Corporate Governance Function of Sistema PJSFC.

Share in the authorised capital of Sistema PJSFC – 0.0204%.

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**Vladimir Shukshin**

Born in 1959 in the Kovytkinsky district of Mordovia, Russia.

Vice President, Head of Security and IT Department of Sistema PJSFC

In 1991, graduated from the State Institute of Physical Training, in 1999, from the Academy of the Federal Security Service with a degree in law, in 2003, from the Russian Presidential Academy of National Economy and Public Administration with a degree in state and municipal administration. PhD degree in Political Science.

1998 - 2005 - Advisor to the Mayor of Moscow.

2005 - 2010 - Deputy head of staff of the Moscow city administration.

2010 - 2011 - Deputy Mayor of Moscow for coordination with law-enforcement agencies.

January 2012 - June 2012 - Deputy CEO for Security, IDGC Holding.

2012 - 2013 - Deputy Chairman of the Management Board, Federal Grid Company of United Energy System (part-time).

2013 - 2014 - Deputy CEO for Security, OJSC Russian Grids.

2014 - 2015 - Executive Vice President, Head of the Security and IT Department, Sistema PJSFC.

From March 2015 - Vice President, Head of the Security and IT Department, Sistema PJSFC.

Share in the authorised capital of Sistema PJSFC – 0.0152%.

### *Corporate Secretary*

<i>Name, position</i>	<i>Brief biography</i>
<b>Igor Petrov</b>	Born in 1978 in Leningrad.
Corporate Secretary of Sistema PJSFC	In 1999, graduated from the St Petersburg State University with a degree in Oriental and African studies. In 2000, obtained a degree in philology from the same university. In 2004, graduated from the Utrecht University (the Netherlands) with a degree in international law. In 2009, obtained a degree in corporate finance and financial analysis from the Russian Academy of National Economy, Moscow. 2005 - Lawyer, Freshfields Bruckhaus Deringer, Amsterdam. 2005 - 2006 - Lawyer, LLC ICICI Bank Eurasia. Corporate Secretary of Sistema PJSFC since 2006. Share in the authorised capital of Sistema PJSFC – 0.0045%.

***Annex 2. Transactions with Sistema shares carried out by Sistema's Board members, President, and Management Board members during 01 January - 31 December 2016.<sup>1</sup>***

*Sistema shares received by members of Sistema's Board of Directors on 11 July 2016 as remuneration for serving on Sistema's Board*

<i>Name</i>	<i>Number of Sistema shares</i>
Sergey Boev	473,728
Andrey Dubovskov	473,728
Felix Evtushenkov	473,728
Vladimir Evtushenkov	473,728
Patrick Clanwilliam	495,230
Robert Kocharyan	495 230
Jeannot Krecké	495 230
Peter Mandelson	495 230
Roger Munnings	495 230
Mikhail Shamolin	473,728
David Iakobachvili	495 230

*Divestment of Sistema shares by members of the Board of Directors, President and members of the Management Board of Sistema PJSFC*

<i>Name</i>	<i>Number of Sistema shares</i>	<i>Dates of transactions</i>
Alexander Gorbunov	469,835	11 January 2016
Valentin Korchunov	724,270	14 January 2016
Sergey Shishkin	238,900	05 January 2016
Elena Vitchak	600,000	17 October 2016

*Acquisition of Sistema shares by members of the Board of Directors, President and members of the Management Board of Sistema PJSFC*

<i>Name</i>	<i>Number of Sistema shares</i>	<i>Dates of transactions</i>
Oleg Mubarakshin	4,675,885	20 April 2016
Mikhail Shamolin	3,464,100	29 June 2016

<sup>1</sup> Information provided herein coincides with the information included in the notices of transactions with the Corporation's securities submitted to Sistema PJSFC by the Board members, President and Management Board members.

Elena Vitchak	338,000	30 June 2016
Evgeny Chuikov	1,293,300	30 June – 01 July 2016
Artem Zassoursky	231,000	05 July 2016 г.
Sergey Shishkin	471,200	11 July 2016 г.
Vladimir Shukshin	673,306	22-27 July 2016 г.
Oleg Mubarakshin	4,699,800	28-29 July 2016 г.
Vsevolod Rozanov	749,000	29 July – 01 August 2016 г.
Valentin Korchunov	5,838,200	09-15 September 2016 г.

***Annex 3. List of transactions carried out by Sistema PJSFC in the reporting year that are recognised as major transactions according to the Federal Law On Joint-Stock Companies, and other transactions subject to the major transactions approval procedure pursuant to the Company's Charter.***

During 2016 Sistema PJSFC did not carry out any transactions are recognised as major transactions according to the Federal Law On Joint-Stock Companies or other transactions subject to the major transactions approval procedure pursuant to the Company's Charter.

**Annex 4. List of transactions carried out by Sistema PJSFC in the reporting year that are recognised as related party transactions under the Federal Law On Joint-Stock Companies**

All the transactions closed by Sistema PJSFC in 2016 that are recognised as related party transactions under the Federal Law On Joint-Stock Companies were approved by the Board of Directors of the Corporation.

1	2	3	4	5	6
No	No of the BoD/AGM minutes and decision date	Subject of the transaction	Counterparties	Transaction value	Related parties
1	07-14 13/09/2014	Sistema's shareholding in TCF Project PTE LTD by purchasing additionally issued shares of TCF Project PTE LTD	TCF Project PTE LTD	RUB 1,113,749,000.00	JSC Sistema Finance
2	07-15 27/08/2015	Acquisition of ordinary registered book-entry shares in PJSC MTS Bank from PJSC MTS Bank.	PJSC MTS Bank	RUB 3,700,000,000.00	JSC Sistema Finance V. Evtushenkov, F. Evtushenkov, V. Rozanov
3	01-16 06/02/2016	Signing a Guarantee Agreement between Sistema JSFC and the Central Bank of India to secure the liabilities of SSTL under the Guarantee Facility Agreement	Central Bank of India, SSTL	INR 3,910,000,000.00	JSC Sistema Finance V. Rozanov
4	01-16 06/02/2016	Signing Amendment Agreement to Documentary Letter of Credit Agreement by Sistema and ING Bank (Eurasia) to secure the liabilities of SSTL	ING Bank (Eurasia) JSC, SSTL	INR 2,500,000,000.00	JSC Sistema Finance, V. Rozanov
5	01-16 06/02/2016	Amendment of Loan Agreement between Sistema JSFC as the Lender and JSC Kronstadt Group as the Borrower	JSC Kronstadt Group	RUB 316,000,000.00	JSC Sistema Finance, S. Boev, M. Shamolin, M. Cherny
6	01-16 06/02/2016	Sistema making an additional contribution to the authorised capital of LLC The Davydovs' Estate.	LLC Davydovs' Estate	RUB 274,000,000.00	JSC Sistema Finance
7	07-15 27/08/2015	Acquisition of securities from Sitronics IT B.V.	Sitronics IT B.V.	RUB 5,874,725,408.00	JSC Sistema Finance
8	07-15 27/08/2015	Pledge of property to the Bank of Moscow	OJSC Bank of Moscow	RUB 5,874,725,408.00	OJSC Sistema Finance, S. Boev, F. Evtushenkov, V. Rozanov
9	01-16 06/02/2016	Provision of free-of-charge financial aid to CJSC Cottagestroy-17.	CJSC Cottagestroy-17	RUB 309,000,000.00	JSC Sistema Finance
10	02-16 12/03/2016	Acquisition from JSC Steppe Agro Holding of ordinary registered shares additionally issued by JSC Steppe Agro Holding	JSC Steppe Agro Holding	RUB 6,063,880,000.00	JSC Sistema Finance, A. Uzdеноv, S. Shishkin
11	03-16 06/04/2016	Provision of an interest-bearing loan to JSC Steppe Agro Holding	JSC Steppe Agro Holding	RUB 2,652,706,984.00	JSC Sistema Finance, A. Uzdеноv, S. Shishkin
12	04-16 15/04/2016	Provision of an interest-bearing loan to LLC Kronstadt Group	LLC Kronstadt Group	RUB 1,129,000,000.00	JSC Sistema Finance, S. Boev, M. Cherny,

					M. Shamolin, S. Shishkin
13	04-16 15/04/2016	Making an additional contribution to the authorised capital of LLC Kronstadt Group	LLC Kronstadt Group	RUB 4,251,928,407.53	JSC Sistema Finance, S. Boev, M. Cherny, M. Shamolin, S. Shishkin
14	04-16 15/04/2016	Contributing ECU GEST HOLDING S.A. shares and Sistema Capital S.A. shares to the authorised capital of Sistema Finance S.A. in exchange for Sistema Finance S.A. shares	Sistema Finance S.A.	RUB 8,001,000,000.00	JSC Sistema Finance, F. Evtushenkov, V. Rozanov, M. Shamolin
15	06-16 21/05/2016	Amendment of the terms of the interest-bearing loan issued to JSC Business Nedvizhimost (maturity date, loan amount, interest rate)	JSC Business Nedvizhimost	RUB 3,709,815,832.00	JSC Sistema Finance, L. Monosov, S. Shishkin, V. Shukshin
16	06-16 21/05/2016	Amendment of the terms of the interest-bearing loan issued to JSC Leader Invest (loan amount, interest rate)	JSC Leader Invest	RUB 300,000,000.00	JSC Sistema Finance, V. Evtushenkov, F. Evtushenkov, V. Rozanov, S. Shishkin
17	06-16 21/05/2016	Acquisition of ordinary registered book-entry shares of OJSC RTI from S. Boev	S. Boev	RUB 286,200,000.00	JSC Sistema Finance, S. Boev
18	06-16 21/05/2016	Transfer of ordinary registered book-entry shares of OJSC RTI to S. Boev	S. Boev	RUB 286,200,000.00	JSC Sistema Finance S. Boev
19	08-16 05/08/2016	Transfer of 355,456 shares in OZON HOLDINGS LIMITED (10.8%) to Sistema Finance S.A.	Sistema Finance S.A.	RUB 2,707,147,500.00	Sistema Finance
20	02-16 12/03/2016	Acquisition of additionally issued ordinary registered shares in Sistema Finance S.A. from Sistema Finance S.A.	Sistema Finance S.A.	RUB 3,510,474,734.00	JSC Sistema Finance, F. Evtushenkov, V. Rozanov, M. Shamolin
23	08-16 05/08/2016	Provision of an interest-bearing loan to JSC Sistema Venture Capital	JSC Sistema Venture Capital	RUB 2,083,006,357.91	JSC Sistema Finance, M. Cherny
24	10-16 10/09/2016	Acquisition of additionally issued registered book-entry shares of PJSC MTS Bank	PJSC MTS Bank	RUB 7,750,000.00	JSC Sistema Finance, V. Evtushenkov, F. Evtushenkov, V. Rozanov.
25	10-16 10/09/2016	Signing of a shareholder agreement between Sistema and K. Averin	Konstantin Averin	RUB 587,000,000.00	JSC Sistema Finance
26	10-16 10/09/2016	Acquisition of additionally issued shares of JSC Business Nedvizhimost	JSC Business Nedvizhimost	RUB 3,349,994,822.44	JSC Sistema Finance, L. Monosov, S. Shishkin, V. Shukshin
27	10-16 10/09/2016	Contribution of cash funds to the authorised capital of LLC Segezha Group	LLC Segezha Group	RUB 7,600,000,000.00	JSC Sistema Finance
28	10-16 10/09/2016	Concluding an agreement on early redemption of interest-bearing promissory notes issued by LLC Segezha Group to Sistema PJSFC	LLC Segezha Group	RUB 7,600,000,000.00	JSC Sistema Finance
29	11-16 06/10/2016	Granting a loan to JSC Steppe Agro Holding	JSC Steppe Agro Holding	RUB 4,858,842,700.00	JSC Sistema Finance, A. Zasursky, A. Uzdenov, S. Shishkin
30	12-16 29/10/2016	Granting an interest-bearing loan to LLC Sistema Hotel Management	LLC Sistema Hotel Management	RUB 2,900,000,000.00	JSC Sistema Finance, L. Monosov

31	12-16 29/10/2016	Sale of Detsky Mir shares to Sistema's Management Board member Valentin Korchunov	V. Korchunov	RUB 27,531,138.00	JSC Sistema Finance, V. Korchunov
32	12-16 29/10/2016	Selling MTS shares to LLC Stream Digital	LLC Stream Digital	RUB 356,000,000.00	JSC Sistema Finance, V. Evtushenkov, A. Dubovskov, F. Evtushenkov, M. Shamolin, A. Gorbunov, V. Rozanov.
33	13-16 09/12/2016	JSC Steppe Agro Holding granting an interest-bearing loan to PJSFC Sistema	JSC Steppe Agro Holding	RUB 1,000,000,000.00	JSC Sistema Finance, A. Zasursky, A. Uzdenov, S. Shishkin
34	13-16 09/12/2016	Acquiring an equity stake in LLC Kronstadt Group from OJSC RTI	OJSC RTI	RUB 657,000,000.00	JSC Sistema Finance, V. Evtushenkov, S. Boev, F. Evtushenkov, S. Shishkin.
35	13-16 09/12/2016	Granting an interest-bearing loan to LLC Sistema Telecom Assets	LLC Sistema Telecom Assets	RUB 6,000,000,000.00	JSC Sistema Finance, S. Shishkin
36	13-16 09/12/2016	Transfer to LLC Sistema Telecom Assets of a promissory note issued by OJSC NPK NIIDAR	LLC Sistema Telecom Assets	RUB 1,421,972,360.30	JSC Sistema Finance, S. Shishkin
37	13-16 09/12/2016	Acquisition of promissory notes from CJSC RTI Microelectronics	CJSC RTI Microelectronics	RUB 3,360,291,000.00	JSC Sistema Finance
38	13-16 09/12/2016	Pledge of promissory notes issued by CJSC RTI Microelectronics to PJSC VTB Bank	PJSC VTB Bank	RUB 7,100,000,000.00	JSC Sistema Finance, V. Evtushenkov, S. Boev, F. Evtushenkov, S. Shishkin.

## ***Annex 5. Report on compliance with the Corporate Governance Code recommended by the Bank of Russia***

In the opinion of Sistema's Board of Directors, the Corporation complies with the principles and the guidelines of the Corporate Governance Code recommended by the Bank of Russia (hereinafter, the "Code") with the reservations mentioned herein below.

When assessing compliance of Sistema's corporate governance practices with the Code's recommendations, the Board assessed both formal and actual adherence to the principles and recommendations of the Code by the Corporation and its officers, including achievement of the general level of corporate governance standards stipulated by the Code, even through alternative mechanisms.

<i>No.</i>	<i>Corporate governance principle</i>	<i>Criteria for assessment</i>	<i>Compliance</i>	<i>Notes</i>
<b>I. Shareholder rights and equality for exercise of their rights</b>				
1.1.	The company should ensure equal and fair treatment of all shareholders for exercise of their rights to participate in the company's governance.			
1.1.1.	The company should create the most favourable conditions for participation in the general meeting, for developing a substantiated position on the general meeting's agenda items, coordinating their actions, and expressing their opinions on the items under consideration.	1. An internal document of the company approved by the general meeting of shareholders and regulating procedures of the general meeting is publicly disclosed. 2. The company offers an available means of communication with the company, such as a hotline, e-mail or a web forum, that allows shareholders to express their opinions and submit queries about the agenda during preparations for the general meeting. These actions were taken by the company ahead of each general meeting held in the reporting period.	Observed	The procedure for convening, preparing and conducting the General Meeting of the Shareholders of the Corporation is regulated by the Terms of Reference of the General Meeting of Shareholders that was approved by the General Meeting of Shareholders of Sistema PJSC (Minutes No. 2-15 dd. 01 July 2015) and is freely available on the Corporation's website.  When holding each general meeting of shareholders, the Corporation communicates to its shareholders an e-mail address to which they may send their opinions or questions with regard to the general meeting, including its agenda.
1.1.2.	The procedure for notification of the general meeting and provision of materials for the general meeting should enable the shareholders to prepare for the meeting as appropriate.	1. A notice of the conduct of the general meeting of shareholders is published on the website at least 30 days before the date of the meeting. 2. The notice specifies the venue and documents needed for admission to the meeting. 3. The shareholders are provided access to information about persons that proposed agenda items and nominated candidates to the board of directors and the auditing commission of the company.	Observed	In accordance with Sistema's Charter, a notice of the general meeting of shareholders, including the date, time and venue of the meeting and documents needed for admission, is published in both Russian and English on the Company's website ( <a href="http://www.sistema.ru/www.sistema.com">www.sistema.ru/www.sistema.com</a> ) at least 30 days before the meeting. The information about who proposed each item to the agenda of the general meeting and about each candidate nominated for election to the Corporation's governance bodies and who nominated them shall be provided in explanatory notes or other relevant materials.
1.1.3.	During preparation and conducting of the general meeting, the shareholders should be able to receive information about the meeting and the relevant materials in a timely manner and without any hindrance, put questions to	1. In the reporting period, the shareholders had an opportunity to ask members of the Company's governance bodies and board of directors questions ahead of the general meeting or during the meeting.	Observed	During preparations for a general meeting, the shareholders are entitled to receive answers to their questions sent to a special email address ( <a href="mailto:osa@sistema.ru">osa@sistema.ru</a> ), which is included in the notice of the general meeting. Shareholders participating in the general meeting may put questions to members of the

	executive bodies and members of the company's board of directors and to communicate with each other.	2. The stance of the board of directors (including dissenting opinions included in the minutes) on each agenda item of the general meetings held in the reporting period was included in materials for the general meetings. 3. The company provided to eligible shareholders access to the list of persons that have the right to participate in the general meeting from the date it was obtained by the company, in all instances of holding general meetings in the reporting period.		governance bodies, of the board of directors and the management board and the President who are also present at the meeting. The stance of the Board of Directors on the agenda items of the general meeting is included in the explanatory note for each agenda item. In accordance with the Terms of Reference of the General Meeting of Shareholders, its shareholders are entitled to see the list of persons that have a right to participate in the general meeting by contacting Sistema's corporate secretary.
1.1.4.	Exercise of a shareholder's right to request convention of the general meeting, nominate candidates to the company's governance bodies and to make proposals for the general meeting's agenda should not be fraught with needless complexities.	1. In the reporting period, shareholders had the opportunity within at least 60 days after the end of the respective calendar year to propose items for the agenda of the annual general meeting. 2. In the reporting period, the company did not refuse to accept items proposed for the agenda or nominees to the company's governance bodies for reasons of typos or other insignificant deficiencies in a shareholder's proposal.	Observed	The Charter of Sistema PJSFC sets a deadline for submission of shareholders' proposals for the general meeting's agenda to 100 days after the end of the financial year. Should a shareholder's proposals contain material deficiencies, the Corporation informs the shareholder accordingly in advance, so that such deficiencies could be eliminated before the Board of Directors has approved the general meeting's agenda and the list of candidates for election to the governance and control bodies.
1.1.5.	Each shareholder should be able to exercise their voting right in the easiest and most convenient way for the shareholder, without any hindrances.	1. The company's internal regulations (internal policy) include provisions that entitle each participant of the general meeting to request a copy of his/her filled-in voting ballot certified by the teller committee before the end of the general meeting.	Observed	The provision that a person filling in the voting ballot is entitled to have a copy of his/her filled-in voting ballot certified by the teller committee before the end of the general meeting is included in the Terms of Reference of the Annual General Meeting of Shareholders.
1.1.6.	The procedure of general meetings adopted by the company should ensure equal opportunities for all the persons present at the meeting to express their opinions and to ask their questions.	1. General meetings of shareholders held in the format of a meeting (joint presence of shareholders) in the reporting period allocated sufficient time for reports on agenda items and discussions. 2. Candidates to the company's governance and control bodies were available for answering shareholders' questions at the meeting at which their nominations were to be voted on. 3. When making decisions related to preparation and conduct of general meetings of shareholders, the board of directors considered use of telecom technologies to give shareholders remote access	Observed	In the reporting year, the General Meeting of shareholders held in the format of joint presence allocated up to 20 minutes for a report on each agenda item and time for discussion of such items. The candidates nominated to the Board of Directors and the Auditing Commission are present at the respective general meeting. Participants of the General Meeting have the possibility to consult with each other on the agenda items. In the reporting year, the Corporation was not using telecom technologies to provide its shareholders with remote access to the General Meeting of shareholders, but during the preparations for the General Meeting the Corporation considered the option of e-voting. The Corporation provides a sufficiently big room that

		to general meetings in the reporting period.		accommodates all the persons willing to participate in the General Meeting.
1.2.	The shareholders should be given equal and fair opportunities to share in the company's net income via dividends.			
1.2.1.	The company should develop and implement a transparent and clear mechanism for determining the amount or dividends and their distribution.	1. The company has developed a dividend policy, which has been approved by the board of directors and publicly disclosed. 2. If the company's dividend policy uses the indicators in the company's financial statements to determine the dividend amount, the relevant provisions of the dividend policy are based on consolidated financial statements.	Observed	The Corporation's Board of Directors has approved the Dividend Policy (Minutes of the Board of Directors of Sistema PJSFC No.04-17 dd 03 April 2017). The Corporation seeks to distribute dividends twice a year. In accordance with the revised Dividend Policy, the recommended amount of dividend distributions for a reporting year is based on a target dividend yield of at least 6%, or RUB 1.19 per ordinary share, whichever is greater. The Dividend Policy of Sistema PJSFC is published on its corporate website.
1.2.2.	It is not recommended for companies to take a decision to distribute dividends if such decision, while formally being within the restrictions imposed by the government, is economically unreasonable and can lead to misrepresentation of the company's business.	1. The company's dividend policy clearly specifies financial/economic circumstances under which it should not pay dividends.	Partially observed.	In accordance with the Dividend Policy, the Corporation is entitled to deviate from the criteria for determining the amount of dividends set out in the Dividend Policy, and in this case the Corporation shall disclose information about the reasons of such a deviation. The Corporation does not declare dividends if net income or cash flow are insufficient (liquidity shortage) or if it is economically unreasonable.
1.2.3.	Companies should not allow the dividend entitlements of existing shareholders to be downgraded.	1. The company did not take actions that would downgrade the dividend entitlements of existing shareholders in the reporting period.	Observed	The Corporation has issued only one type of ordinary shares. Holders of global depository receipts are entitled to dividends on a par with holders of ordinary shares. In the reporting period, the Corporation did not take actions that would downgrade dividend entitlements of holders of ordinary shares and/or global depository receipts.
1.2.4.	Companies should strive to avoid situations where shareholders receive from the company any types of profit (income) other than dividends or disposal value.	1. In order to rule out situations when shareholders receive any types of profit (income) from the company other than dividends or disposal value, the company's internal regulations envisage control mechanisms that ensure timely identification and approval procedures for transactions with persons affiliated with material shareholders (persons entitled to dispose of votes allocated to voting shares) in cases when such transactions are not formally recognised as related party transactions by law.	Observed	The Corporation has the Ethics Code approved by the Board of Directors (Minutes No.08-15 dd 02 November 2015), which stipulates that officers responsible for transactions shall timely report any conflicts of interest related to a transaction to the Board of Directors.
1.3.	Corporate governance system and practices should ensure equal footing for all shareholders that hold shares of the same category (type), including minority and foreign shareholders, and equal treatment of them by the company.			
1.3.1.	Companies should create conditions for fair treatment of each shareholder by the	1. In the reporting period, the procedures for managing major shareholders'	Observed	The Corporation has created all the conditions necessary to prevent shareholder's actions that are

	governance bodies and the controlling persons of the company, including prevention of abuse of power by major shareholders in respect of minority shareholders.	potential conflicts of interest were efficient, and the board of directors paid sufficient attention to conflicts between shareholders, if there were any.		intended to harm other shareholders or the Corporation as well as other abuse of shareholder rights. There were no recorded conflicts between the Corporation's shareholders in the reporting period.
1.3.2.	Companies should not take actions that will or may lead to artificial redistribution of corporate control.	Quasi-treasury shares are absent or do not participate in voting in the reporting period.	Partially observed.	The internal regulations of the Corporation do not contain any prohibition on voting with the shares of the Corporation held by legal entities under the Corporation's control. In the Corporation's shareholder structure, there is a controlling shareholder who is not part of the executive management, which eliminates the possibility of the management using quasi-treasury shares for artificial redistribution of corporate control.
1.4.	Shareholders should be provided with reliable and efficient ways to register rights to the shares, and the ability to dispose of their shares freely and easily.			
1.4.	Shareholders should be provided with reliable and efficient ways to register rights to the shares, and the ability to dispose of their shares freely and easily.	1. The quality and reliability of services provided by the company's registrar to keep the shareholder register meet the needs of the company and its shareholders.	Observed	The Registrar of the Corporation is one of the largest special registrars in Russia, which has proven and reliable technologies that provide the most efficient way to ensure registration of proprietary rights and exercise of shareholder rights. Jointly with the Registrar, the Corporation is undertaking measures aimed at updating information about the shareholders recorded in the shareholder register.
<b>II. Board of Directors</b>				
2.1	The board of directors is in charge of strategic management of the company, determines the main principles and approaches to organising the company's risk control and internal control systems, controls the work of its executive bodies and performs other key functions.			
2.1.1.	The board of directors should bear responsibility for decisions relating to appointment and dismissal of executive bodies, including cases of dismissal due to improper performance of their duties. The board of directors should also control that the company's executive bodies act in compliance with the approved development strategy and the core areas of the company's business.	1. The powers of the board of directors to appoint and dismiss members of executive bodies and determine the terms of their employment agreements are set out in the charter. 2. The board of directors reviewed a report (reports) of the sole executive body and members of the collective executive body on implementation of the company's strategy.	Observed	The Charter of Sistema PJSFC stipulates that the authority of the Board of Directors includes appointment of the President of the Corporation, election of members of the Management Board and early termination of the President's and Management Board members' employment, as well as the terms of agreements with the President and members of the Management Board. The Nomination, Remuneration and Corporate Governance Committee of the Board of Directors approves candidates to the positions of sole executive bodies of subsidiaries and approves nomination of candidates to boards of directors of subsidiaries. The authority of the Board of Directors with regard to nominating candidacies to the executive bodies and Board of Directors of entities under the Corporation's control are not recorded in the Charter. The Board of Directors monitors implementation of the Corporation's strategy and business plans by its

				executive bodies on a regular basis.
2.1.2.	The board of directors should set the key long-term priorities for the company's business, assess and approve key performance indicators and key business goals of the company, evaluation and approve strategies and business plans for the core businesses of the Company.	1. In the reporting period, the board of directors reviewed items on implementation status and update of the strategy, approval of the company's financial plan (budget) and criteria and indicators (including interim ones) of implementation of the company's strategy and business plans.	Observed	The Board of Directors controls and supports each stage of the process of strategy development and execution at the Corporation, evaluates its execution status and feasibility, and make adjustments, if necessary. The strategy and business plans of the Corporation approved by the Board of Directors contain clear criteria, most of which are expressed in quantitative indicators, with interim control indicators. The Board of Directors approves the budget of the Corporation on an annual basis. At least once a year, the Board of Directors reviews the Corporation's strategy and assesses its implementation status and need for updating. Specifically, the Board of Directors reviewed the Corporation's strategy on 29 October 2016.
2.1.3.	The board of directors should determine the principles of and approaches to organising the risk management and internal control systems at the company.	1. The board of directors determined the principles of and approaches to organising the risk management and internal control systems at the company. 2. The board of directors assessed the risk management and internal control systems of the company in the reporting period.	Observed	The Charter of Sistema PJSFC includes approval of risk management principles in the remit of the Board of Directors. The Corporation has the Risk Management Code, the new version of which was approved in 2014. The Board of Directors reviews a risk management report and a report on the work of the internal control system at the Corporation at least once a year and issues its opinion. In the reporting year, this item was reviewed by the Board of Directors on 12 March 2016.
2.1.4.	The board of directors should determine the company's policy with regard to remuneration and (or) reimbursement of expenses to Board members, executive bodies and other key executives of the company.	1. The company developed and introduced a policy (policies), approved by the board of directors, on remuneration and compensation of expenses of members of the board of directors, executive bodies of the company and other senior executives 2. The board of directors reviewed items pertaining to this policy (policies) in the reporting period.	Observed	The General Meeting of shareholders of the Corporation approved the Policy on remuneration and compensations payable to members of the Corporation's Board of Directors (Minutes No. 2-15 dd 01 July 2015). The Board of Directors of the Corporation approved the HR policy and policies on remuneration payable to the employees of Sistema PJSFC. Employees' remuneration includes a fixed part, a bonus for execution of projects and generation of cash income, and long-term incentives. The Board of Directors also approved the rules for reimbursement of expenses to the top executives of the Corporation.
2.1.5.	The board of directors should play a key role in preventing, identifying and settling internal conflicts between the company's governance bodies, shareholders and employees.	1. The board of directors plays a key role in preventing, identifying and settling internal conflicts. 2. The company has created a system for identifying transactions related to conflicts of interest and measures aimed at resolving	Observed	The Board of Directors takes all the measures necessary to prevent and settle internal conflicts. The Corporation regularly collects information about related and affiliated persons of the members of its Board of Directors and executive bodies. In accordance with the Code of Ethics, ethics assessment is

		such conflicts.		performed during which senior managers responsible for the transactions submit ethics and conflict of interest declarations. The Internal Control and Audit Department analyses the information received about the signs of the management responsible for the transactions having conflicts of interest. Resolutions on related party transactions are made by persons that are not involved in the relevant conflict of interest. Employees' compliance with the regulations for resolution of conflicts of interests is secured with disciplinary measures.
2.1.6.	The board of directors should play a key role in securing transparency of the company, timely and full disclosure of the company's information, unhindered access of shareholders to the company's documents.	1. The board of directors adopted a regulation on the information policy. 2. The company has designated persons responsible for implementation of the information policy.	Observed	The Board of Directors of the Corporation approved the Regulation on the Information Policy (Minutes No. 04-10 dd. 17 April 2010). The responsibility to control compliance with the Information Policy lies with the Corporate Secretary reporting to the Board of Directors of the Corporation.
2.1.7.	The board of directors should control the corporate governance practices at the company and play a key role in material corporate events of the company.	1. In the reporting period, the board of directors reviewed an item on corporate governance practices at the company.	Observed	Based on the results of annual appraisal of the Corporation's corporate governance practices, the Nomination, Remuneration and Corporate Governance Committee of the Board of Directors formulates proposals aimed at improving corporate governance practices for review and approval by the Board of Directors.
2.2.	The board of directors should be accountable to the company's shareholders.			
2.2.1.	Information about the work of the board of directors shall be disclosed and provided to shareholders.	1. The company's annual report for the reporting period includes information about directors' attendance of the meetings of the board and board committees. 2. The annual report includes information about the key results of appraisal of the board's work conducted in the reporting period.	Observed	The Annual Report and the Corporation's website ( <a href="http://www.sistema.ru/www.sistema.com">www.sistema.ru/www.sistema.com</a> ) disclose information about the number of meetings of the Board of Directors and its Committees held in the past year, specifying the forms of meetings and Board members' attendance. The main results of the Board's performance assessment and that of its executive bodies are disclosed in the Annual Report of the Corporation.
2.2.2.	Chairman of the board of directors should be available for communication with the company's shareholders.	1. The company has a transparent procedure that gives shareholders a possibility to put questions to the board chairman and to communicate their stance on such matters.	Observed	Shareholders can put questions to the Chairman of the Board of Directors regarding issues within the remit of the Board of Directors, and inform him about their opinions (positions) on such matters via the Corporate Secretary.
2.3.	The board of directors should be an efficient and professional governance body of the company, capable of passing objective independent judgements and taking decisions aligned with the interests of the company and its shareholders.			
2.3.1.	It is recommended to elect to the board of directors persons that have an impeccable business and personal reputation and possess the knowledge, skills and experience	1. The procedure for assessing the board's efficiency adopted by the company includes assessment of the professional skills of the board members.	Observed	The annual assessment of the Board of Directors includes assessment of the Board's competences. The Board's Nomination, Remuneration and Corporate Governance Committee assesses all candidates nominated to the Board

	necessary for making decisions on the matters falling within the remit of the Board of Directors and required for efficient discharge of its functions.	2. In the reporting period, the board of directors (or its nomination committee) assessed candidates to the board in terms of their possessing relevant experience, knowledge, business reputation, absence of a conflict of interest, etc.		of Directors regarding their independence and potential contribution to the work of the Board of Directors. Sufficient professional experience, business reputation and absence of a conflict of interest are important criteria during the assessment of candidates to the Board of Directors.
2.3.2.	Members of the board of directors should be elected in a transparent procedure enabling shareholders to receive information about the candidates that is sufficient to form an opinion of their personal and professional qualities.	1. In all instances in the reporting period when the agenda included items on election of board members, the company provided the shareholders with biographies of all candidates to the board, results of such candidates' assessment by the board (or its nomination committee), information on whether such candidates meet the independence criteria, in accordance with recommendations 102-107 of the Code, and the candidates' written consent to be elected to the board of directors.	Observed	The biographies of candidates to the Board of Directors and recommendations of the Board's Nomination, Remuneration and Corporate Governance Committee with regard to voting on such candidates, as well as information about their meeting the independence criteria are included in materials for General Meetings of shareholders whose agendas include an item on election of the Board of Directors. The status of newly elected members of the Board of Directors and their independence are confirmed at the first meeting of the Board after election.
2.3.3.	The composition of the board of directors should be well balanced, in terms of qualification, experience, expertise and business qualities, and board members should enjoy the confidence of shareholders.	1. As part of the assessment of the board's work in the reporting period, the board of directors analysed its needs in terms of professional and business skills and experience.	Observed	The annual assessment of the Board of Directors includes assessment of the Board's competences and how they match the Corporation's needs.
2.3.4.	The number of members on the company's board of directors should make it possible to organise the work of the board of directors in the most efficient manner, allowing for formation of board committees and giving the opportunity to material minority shareholders of the company to elect candidates they vote for to the board of directors.	1. As part of the assessment of the board of directors conducted in the reporting period, the board of directors considered whether the number of the board members met the company's needs and shareholders' interests.	Observed	The annual assessment of the Board of Directors includes assessment of the number of the Board members.
2.4.	The board of directors should have a sufficient number of independent directors.			
2.4.1.	It is recommended to acknowledge as independent directors the persons that have sufficient expertise, competence, experience, and independence for formulation of their own positions; that are capable of making objective and conscientious judgements; and that are independent from the company's governance bodies, particular groups of shareholders, or other interested parties. It should	1. In the reporting period, all independent board members met all the independence criteria set out in recommendations 102-107 of the Code or were recognised as independent by resolution of the board of directors.	Observed	The criteria of independence of members of the Corporation's board of directors are aligned with the criteria recommended by the Corporate Governance Code and the Listing Rules of Moscow Stock Exchange.

	be noted that a candidate is not normally considered to be independent if he/she is affiliated with the company, its material shareholder, material counterparty or competitor or with the state.			
2.4.2.	It is recommended to assess compliance of candidates to the board of directors with the independence criteria and to analyse compliance of independent directors on the board with the independence criteria on a regular basis. In such assessment, contents should prevail over form.	1. In the reporting period, the board of directors (or its nomination committee) formed an opinion about the independence of each candidate to the board and presented it to shareholders. 2. In the reporting period, the board of directors (or its nomination committee) reviewed the independence of incumbent board members specified as independent in the company's annual report at least once. 3. The company has procedures in place that provide for actions a board member has to take if he/she stops being an independent director, including timely notifying the board.	Observed	The Nomination, Remuneration and Corporate Governance Committee of the Board of Directors (hereinafter, the "Committee") issues an opinion on the independence of candidates to the Board of Directors. At the first meeting of the Board of Directors following the General Meeting of shareholders where such new Board of Directors was elected, the Board of Directors determines the status of independent members of the Board of Directors. The Committee analyses compliance of the independent directors on the Board with the independence criteria on a regular basis. When elected to the Board, Board members undertake in writing to notify the Corporation of any circumstances that may effect their ability to have independent judgement on items reviewed by the Board of Directors.
2.4.3.	It is recommended that independent directors constitute at least one third of elected board of directors.	Independent directors shall constitute at least one third of the board of directors.	Observed	6 of 11 members of the Board of Directors are independent.
4.4.2.	Independent directors should play a key role in preventing internal conflicts in the company and in the performance of significant corporate actions by the company.	Independent directors (not having a conflict of interest) give preliminary assessment to material corporate actions related to a potential conflict of interest, the results of which are submitted to the board.	Observed	Independent directors perform a preliminary assessment of potential actions and draft resolutions of the Corporation that may lead to a conflict as they prepare for meetings of the Board or Board Committees. Notably, the Audit, Finance and Risk Committee pre-approves all related party transactions. Opinions of Board members are incorporated in the meeting materials.
2.5.	Chairman of the board of directors should facilitate the most efficient discharge of functions that fall within the remit of the board of directors.			
2.5.1.	It is recommended to elect an independent director as chairman, or to select a senior independent director among the elected independent directors who would coordinate the work of independent directors and interact with the chairman of the board of directors.	The board chairman is an independent director or a senior independent director is elected among independent directors. The role, rights and duties of the board chairman (and, if applicable, of the senior independent director) are duly set out in the company's internal regulations.	Partially observed.	The role of the Board Chairman is set out in the Terms of Reference of the Board of Directors of Sistema PJSFC approved by the General Meeting of shareholders on 25 June 2016 (Minutes No.1-16 dd 29 June 2016). The Terms of Reference also define the role of the Deputy Chairman of the Board, who, together with the Corporate Secretary, ensures interaction between independent directors and the Board Chairman. Each independent director can communicate his or her position on any agenda item to the Board Chairman.

2.5.2.	The board chairman should ensure a constructive atmosphere of the meetings, free discussions of the matters on the meeting agenda, and control over execution of resolutions passed by the board of directors.	Performance of the board chairman is assessed during assessment of the performance of the board as a whole.	Observed	The annual assessment of the Board of Directors includes assessment of the efficiency of interaction between Board members and the Board Chairman.
2.5.3.	The board chairman should take necessary measures to provide board members with information required for making decisions on the agenda items in a timely manner.	The duty of the board chairman to procure timely provision of materials on agenda items for board members is stipulated by the company's internal regulations.	Observed	In accordance with the Procedure of the Board of Directors, the Board Chairman takes necessary measures to provide Board members with information required for making decisions on the agenda items in a timely manner. The Board Chairman maintains regular contacts with other governance bodies and executives of the Corporation.
2.6.	Members of the board of directors should act in good faith and reasonably, in the best interests of the company and its shareholders proceeding from sufficient amount of information, with due care and diligence.			
2.6.1.	Reasonable and bona fide actions of the board members imply that decisions are made with due consideration of all available information, without conflicts of interest, with equal treatment of the company's shareholders, within usual entrepreneurial risks.	The company's internal regulations stipulate that a board member shall notify the board of directors if he/she is in the situation of a conflict of interest in respect of any item on the agenda of a board or committee meeting before the start of discussion of the respective agenda item. The company's internal regulations stipulate that a board member shall not vote on any agenda item where he/she has a conflict of interest. The company has a procedure in place that allows the board of directors to receive professional advice on matters within its remit at the expense of the company.	Observed	The Terms of Reference of the Board of Directors and the Ethics Code of the Corporation stipulate that Board members shall timely notify the Corporation if a conflict of interest arises and shall not make decisions on any matter where they have a conflict of interest. The Board of Directors is entitled to engage external independent experts for project examination at the Corporation's expense.
2.6.2.	The rights and obligations of board members should be clearly formulated and recorded in the internal regulations of the company.	The company has an internal document in place that clearly defines the rights and obligations of board members.	Observed	Rights and obligations of Board members are recorded in the Charter of Sistema PJSFC, the Terms of Reference of the Board of Directors of Sistema PJSFC, and the Procedure on the Board of Directors.
2.6.3.	Board members should have enough time to perform their duties.	Individual attendance of board and committee meetings and the time spent preparing for the meetings is taken into account during the board's assessment procedure in the reporting period. In accordance with the company's internal regulations, board members are obligated to notify the board of their intention to join governance bodies of	Observed	The annual assessment of the Board of Directors includes assessment of the organisation and attendance of the Board meetings. When elected to the Board, Board members fill in questionnaires envisaged by the Terms of Reference of the Board of Directors, where they must specify companies where they are members of governance bodies or where they intend to be elected.

		other entities (except for the company's subsidiaries and affiliates) and of the fact of such appointment.		
2.6.4.	All members of the board of directors should have equal possibilities to access the company's documents and information. Newly elected members of the board of directors should be provided with sufficient information about the company and the work of the board of directors as soon as possible.	The company's internal documents stipulate the right of board members to get access to documents and make inquiries related to the company and organisations controlled by the company, and the obligation of the company's executive bodies to provide them with such information and documents. The company has a formal induction programme for newly elected board members.	Observed	Sistema's Board members are able to promptly receive answers to their queries and any information they may require from the executive management directly or via the Corporate Secretary. The employees' obligation to provide such information is recorded in the internal regulations of the Corporation. The Corporate Secretary familiarises newly elected Board members with the activities of the Board in accordance with the Terms of Reference of the Board of Directors.
2.7.	Meetings of the board of directors, preparation therefor, and participation of board members therein should provide for efficient work of the board of directors.			
2.7.1.	It is recommended to hold meetings of the board of directors as necessary, taking into account the scale of business and the company's objectives in a certain period of time.	The board of directors held at least six meetings in the reporting year.	Observed	Meetings of the Board of Directors are held at least six times a year in accordance with the approved work plan of the Board of Directors. 13 meetings of the Board of Directors were held in 2016.
2.7.2.	It is recommended to develop and include in the company's internal regulations the procedure for preparing and conducting meetings of the board of directors that would give the board members the possibility to prepare for the meeting.	The company adopted an internal document that regulates the procedure for preparing and holding board meetings, which, among other things, stipulates that the notice of a meeting shall, as a rule, be sent at least 5 days before the meeting.	Observed	The Procedure of the Board of Directors determines the procedure and the time of sending a voting ballot to each member of the Board of Directors and for obtaining the filled-in ballot in case the meeting is held in absentia. Board members have permanent access to the work plan of the Board of Directors. All information for Board meetings is available in Russian and English on the portal of the Board of Directors (to which all Board members are connected) at least 10 days before the Board meeting.
2.7.3.	The form of board meetings should be determined with consideration of the importance of agenda items. The most important items should be discussed at meetings in presentia.	The company's charter or internal regulations stipulate that the most important items (according to the list set out in recommendation 168 of the Code) shall be reviewed at meetings in presentia.	Observed	All scheduled meetings of the Board of Directors are held in presentia. Meetings in absentia are held when some urgent issues arise. The Procedure of the Board of Directors stipulate that the most important items shall be reviewed at meetings in presentia.
2.7.4.	It is recommended that decisions on the most essential aspects of the company's business are made by a qualified majority or a simple majority of votes of all the elected Board members.	The company's charter stipulates that resolutions on the most important items, which are set out in recommendation 170 of the Code, shall be adopted at board meetings by a qualified majority of at least three fourths of votes or by a simple majority of all the elected Board members.	Partially observed.	According to the Charter of Sistema PJSC, decisions on items relating to increase of authorised capital, placement of certain types of securities, approval of material and related party transactions are made in compliance with special voting rules. Decisions on other agenda items are made by simple majority of votes of the Board members. Independent directors constitute a majority on Sistema's Board, and the attendance rate is very high. Given such work organisation, it would be difficult to justify

				introduction of special voting rules for separate agenda items.
2.8.	The board of directors should form committees for preview of the most important matters pertaining to the company's business.			
2.8.1.	For provisional review of matters pertaining to the company's financial activities, it is recommended to form an audit committee consisting of independent directors.	The board of directors set up an audit committee consisting only of independent directors. The company's internal regulations determine the objectives of the audit committee, including objectives set out in recommendation 172 of the Code. At least one member of the audit committee, who is an independent director, has experience and expertise in preparation, analysis, evaluation and audit of statutory (financial) accounts. The audit committee met at least once per quarter in the reporting period.	Observed	The Corporation has formed the Audit, Finance and Risk Committee of the Board of Directors (hereinafter, the "Committee") and approved the Terms of Reference of the Committee. The objectives of the Committee as recorded in the Terms of Reference are aligned with the recommendations of the Corporate Governance Code. Independent director constitute the majority of Committee members (4 out of 5). The Committee is chaired by an independent director, R. Munnings, who has a vast experience and expertise in preparation, analysis, evaluation and audit of statutory (financial) accounts. 13 meetings of the Committee were held in 2016.
2.8.2.	For provisional review of issues relating to development of efficient and transparent practices in the sphere of remuneration, it is recommended to form a remuneration committee consisting of independent directors and chaired by an independent director who is not the chairman of the board of directors.	The board of directors set up a remuneration committee consisting only of independent directors. The remuneration committee is chaired by an independent director who is not board chairman. The company's internal regulations determine the objectives of the remuneration committee, including objectives set out in recommendation 180 of the Code.	Observed	The Corporation has formed the Nomination, Remuneration and Corporate Governance Committee of the Board of Directors (hereinafter, the "Committee") and approved the Terms of Reference of the Committee. The objectives of the Committee as recorded in the Terms of Reference are aligned with the recommendations of the Corporate Governance Code. Independent directors constitute a majority of the Committee members (4 out of 5). The Committee is chaired by an independent director R. Kocharyan who is not the Board Chairman.
2.8.3.	It is recommended to form a nomination (HR) committee to preview issues relating to HR (continuity) planning, professional composition and efficiency of the board of directors. Most of the members of such committee should be independent directors.	The board of directors set up a nomination committee (or its objectives set out in recommendation 186 of the Code are pursued by another committee) consisting mostly of independent directors. The company's internal regulations determine the objectives of the nomination committee (or another committee that carries out its functions), including objectives set out in recommendation 186 of the Code.	Observed	The Corporation has formed the Nomination, Remuneration and Corporate Governance Committee of the Board of Directors (hereinafter, the "Committee") and approved the Terms of Reference of the Committee. The objectives of the Committee as recorded in the Terms of Reference are aligned with the recommendations of the Corporate Governance Code. Independent directors constitute a majority of the Committee members (4 out of 5).
2.8.4.	Depending on the scale of business and the level of risks the company is exposed to, it is recommended to form other committees of the board of directors (strategy committee, corporate governance committee,	In the reporting period, the company's board of directors reviewed an item on whether the composition of the board committees is aligned with the objectives of the board and the company's goals. Additional committees	Observed	The Corporation's Board annually, at the first meeting after its election, forms Board Committees in accordance with the Corporation's goals and objectives.

	ethics committee, risk management committee, budget committee, EH&S committee, etc.)	either were set up or were found not needed.		
2.8.5.	It is recommended to determine the composition of committees so as to allow for a thorough discussion of the items under preliminary consideration, taking into account various opinions.	Board committees are chaired by independent directors. The company's internal regulations (policies) include provisions that stipulate that persons who are not members of the audit committee, the nomination committee and the remuneration committee may attend committee meetings only if invited by the chairman of the respective committee.	Observed	Each Committee of the Board of Directors consists of at least 5 members of the Board of Directors. The Audit, Finance and Risk Committee, the Nomination, Remuneration and Corporate Governance Committee and the Investor Relations and Dividend Policy Committee are chaired by independent directors. Two of the Board Committees are chaired by non-executive directors (the Strategy Committee and the Ethics and Control Committee). The maximum number of committees in which a member of the Corporation's Board of Directors can take part is not determined, however, Board members are usually involved in the work of three committees at the most. Persons who are not members of the Audit, Finance and Risk Committee or the Nomination, Remuneration and Corporate Governance Committee may attend meetings of such Committees only upon invitation from their respective Chairmen.
2.8.6.	Committee chairmen should inform the board of directors and its chairman about the work of their committees on a regular basis.	In the reporting period, committee chairmen regularly reported to the board about the work of their committees.	Observed	Chairmen of the Committees inform the Chairman of the Corporation's Board of Directors about the work of their Committees on a regular basis. The Committees present regular reports on their work to the Board of Directors.
2.9.	The board of directors should ensure performance review of the board of directors, its committees and members of the board of directors.			
2.9.1.	Performance review of the board of directors should be aimed at determining the efficiency of the board of directors, its committees and members of the board of directors, adequacy of their performance for the needs of the company's development, activation of the board's work or identifying areas for improvement.	Self-appraisal or external assessment of the board of directors conducted in the reporting period including assessment of the committees, individual board members and the board as a whole. The results of the self-appraisal or external assessment conducted in the reporting period were reviewed at a board meeting in presentia.	Observed	Performance review of the Board of Directors is provided for in the Terms of Reference of the Board of Directors of Sistema PJSC. The Corporation's assessment procedure for the Board of Directors is based on extensive experience and includes appraisal of the Board's performance, including organisation of its work, and the performance of its Committees. The criteria used to assess the performance of the Board of Directors provide for assessment of the professional and personal qualities of members of the Board of Directors, their independence, teamwork and personal contribution, as well as other factors that have an impact on the performance of the Board of Directors. The assessment results are reviewed at the in-person meeting of the Board of Directors preceding the Annual General Meeting of shareholders. Proceeding from such results, the

				Nomination, Remuneration and Corporate Governance Committee of the Board of Directors formulates suggestions for improvement of the performance of the Board of Directors and its Committees.
2.9.2.	Performance review of the board of directors, its committees and members should be conducted on a regular basis at least once a year. It is recommended to engage a third party (consultant) to perform an independent assessment of the board's performance on a regular basis, not less than once every three years.	The company engaged a third party (consultant) to conduct independent assessment of the work of the board of directors at least once in the last three reporting periods.	Observed	Performance review of the Board of Directors and its Committees is performed annually. The Corporation is planning to engage an independent consultant within three years.
<b>III. Corporate Secretary of the company</b>				
3.1	The corporate secretary should provide efficient day-to-day interactions with the shareholders, coordination of the company's activities aimed at protecting the shareholders' rights and interests, facilitation of the work of the board of directors.			
3.1.1.	The corporate secretary should have the expertise, experience and qualification sufficient for execution of his/her professional duties, an impeccable reputation, and enjoy the confidence of shareholders.	The company adopted and disclosed an internal document, terms of reference of the corporate secretary. The company's website and annual report include the corporate secretary's biography in as much detail as is given for the biographies of the board members and executive management of the company.	Observed	The Corporation's Board of Directors approved the Terms of Reference of the Corporate Secretary of the Corporation (Minutes No. 10-14 dd 17 December 2014). The Policy specifies the requirements to the person who may hold the position of the Corporate Secretary, in line with the guidelines of the Corporate Governance Code. Information about the Corporate Secretary is disclosed in the Annual Report.
3.1.2.	The corporate secretary should have sufficient independence from the company's executive bodies and the authority and resources required to fulfil his/her professional duties.	The board of directors approves appointment, dismissal and additional remuneration of the corporate secretary.	Observed	The Corporate Secretary reports directly to the Board of Directors, and is appointed or dismissed by the Board of Directors. The Corporation's Board of Directors approved the Terms of Reference of the Corporate Secretary of the Corporation setting the requirements to the candidacies to the position of Corporate Secretary, the appointment and dismissal procedures, reporting lines, procedure for the Corporate Secretary's interactions with the governance bodies and the subdivisions, his/her functions, rights and obligations, the terms and procedure of remuneration and the liabilities of the Corporate Secretary.
<b>IV. Remuneration of the Board of Directors' members, executive bodies and key management of the Company.</b>				
4.1.	The level of remuneration paid by the Company should be sufficient for engaging, motivating and retaining employees possessing the competencies and qualifications required by the Company. The remuneration of the Board members, executive bodies and key management shall be paid in accordance with the remuneration policy adopted by the Company.			
4.1.1.	It is recommended that the level of remuneration paid by the Company to the Board members, executive	The company adopted an internal document(s), a policy (policies) on remuneration of members of	Observed	The approaches to remuneration of the Board members are defined in the Policy on Remuneration and Compensations for Members of the

	bodies and other key management, should provide sufficient motivation for their efficient work enabling the Company to engage and retain competent and highly qualified specialists. At the same time, the Company should avoid paying excessive remuneration or having an unjustifiably big gap between the remuneration levels of the persons specified above and other employees.	the board, executive bodies and other key senior executives, which clearly defines approaches to their remuneration.		Board of Directors of the Corporation (approved by Sistema's General Meeting of shareholders on 27 June 2015) The document is available on the Corporation's website. Remuneration of key executives is regulated by the Corporation's internal documents that stipulate principles and approaches to remuneration of all the employees. The level of remuneration paid to the Board members, executive bodies of the Company and other key management correspond to the remuneration levels at peer companies.
4.1.2.	The company's remuneration policy should be developed by the remuneration committee and approved by the company's board of directors. The Board of Directors with the support of the Remuneration Committee should ensure oversight over the implementation of the remuneration policy by the Company and, if necessary, to revise and amend this policy	In the reporting period, the remuneration committee reviewed the remuneration policy (policies) and the practice of its (their) implementation and, if necessary, provided recommendations for the board of directors.	Observed	The Company's remuneration policy is developed by the Nomination, Remuneration and Corporate Governance Committee (hereinafter, the "Committee") of the Company and approved by the Board of Directors. The Board of Directors has approved the internal regulations of the Company in the area of remuneration and long-term incentives of the executive bodies or other key management of the Company. The Committee annually reviews the results of implementation of the Corporation's remuneration policy and, if necessary, makes recommendations for the Board of Directors.
4.3.1.	The Company's remuneration policy should contain transparent mechanisms for determining the amount of remuneration payable to the Board members, executive bodies and other key management of the Company, as well as regulate all types of payments, benefits and compensation granted to the specified persons.	The Company's remuneration policy envisages transparent mechanisms for determining the amount of remuneration payable to the Board members, executive bodies and other key management of the Company, as well as regulates all types of payments, benefits and compensation granted to the specified persons.	Observed	The Company's internal regulations provide detailed guidelines on the procedure for determining the amount of remuneration and for making the respective payments of all remuneration components, as well as any other compensation. Decisions on the amount of remuneration payable to specific employees are taken without the participation of the respective employee and are not discussed with him or her.
4.1.4.	It is recommended that the Company should develop a policy for expenses compensation, specifying the list of costs to be reimbursed and the level of services to which the Board members, executive bodies and other key management of the Company may be entitled. Thus policy should become an integral part of the Company's remuneration policy.	The remuneration policy (policies) or other internal documents of the company stipulate the rules for compensating the board members, executive management and other key executives of the company for their expenses.	Observed	According to the Company's internal regulations compensation is due only for the expenses incurred by the members of corporate governance bodies and other employees of the Company that are directly related to activities performed in the interests of the Company. There are strict regulations on the level of services to which the Board members, the President, the Management Board members and other key employees are entitled. The travel expenses of such persons related to the need to attend the

				Company's meetings and make any other business trips as part of performing their job responsibilities shall be reimbursed.
4.2.	The remuneration system of the Board members should ensure that the financial interests of the directors are closely correlated with the long-term financial interests of the shareholders.			
4.2.1.	Fixed annual remuneration is a preferable form of cash remuneration payable to the Board members. It is inadvisable to pay remuneration for participation in isolated meetings of the Board or its Committees. It is not recommended applying any forms of short-term incentives and additional financial motivation to the Board members.	The fixed annual remuneration was the only form of monetary remuneration of board members for serving on the board of directors in the reporting period.	Observed	In accordance with the Policy on remuneration and compensations payable to members of the Board of Directors of the Corporation, the main form of remuneration of the Board members is fixed remuneration. The Company also pays additional remuneration to the Board members for achievement of the Corporation's investment goals. The amount of such additional remuneration is also fixed.
4.2.2.	A long-term ownership of the Company's shares is the best tool facilitating the proximity of the financial interests of the Board members and the long-term interests of the shareholders. At the same time, it is not recommended that the right to sell shares be linked to the achievement of specific operating targets of the Company, nor is the participation of Board members in stock option schemes recommended.	If the company's internal document(s) – remuneration policy (policies) – envisage payment of the company's shares to board members, the company shall adopt and disclose clear rules for board members' ownership of its shares, aimed at encouraging long-term ownership of such shares.	Partially observed.	A portion of the remuneration of the Board members (additional remuneration) is paid in shares. Long-term ownership of shares by the Board members is encouraged, and in practice most of the Board members hold their shares until they leave the Board. The Board members have no obligation to refrain from using hedging mechanisms.
4.2.3.	It is inadvisable to allow paying any additional remuneration or compensation to the Board members in the event of early termination of their contract due to a change of the controlling shareholder or other circumstances.	The company does not envisage payment of any additional remuneration or compensation to board members in the event of early termination of their contract due to a change of the controlling shareholder or other circumstances.	Observed	There are no provisions on the Board members' entitlement to any additional remuneration or compensation (severance payments) in the event of early termination of their powers due to a change of the controlling shareholder or any other circumstances.
4.3.	The remuneration system of the executive bodies and key management of the Company should ensure correlation of their remuneration and the results of the Company, as well as their personal contribution to the achievement of this result.			
4.3.1.	Remuneration of the executive bodies and other key management of the Company should be determined in such a way as to ensure a reasonable and justifiable ratio of the fixed and variable parts of the remuneration linked to the results of the Company and personal (individual) contribution of the employee in the final result.	In the reporting period, the annual performance indicators approved by the board of directors were used for determining the amount of the variable part of remuneration of members of executive bodies and other key managers of the company. During the latest conducted assessment of the remuneration system of members of executive bodies and other key managers of the company, the board of directors (the remuneration committee) was satisfied that the	Observed	The Corporation has a short-term and long-term incentive system for the members of the executive bodies and other key managers, approved by the Board of Directors. The Board of Directors approves key performance indicators as an element of the incentive system. The Nomination, Remuneration and Corporate Governance Committee is involved in the development of key indicators used as the basis for the short-term and long-term incentive systems and analyses the ratio of the fixed and variable parts of remuneration. According to the provisions of the short-term incentive system the results of the employees are assessed

		<p>company uses an efficacious ratio of the fixed and variable parts of remuneration.</p> <p>The company has a procedure in place that ensures that bonuses wrongly received by members of executive bodies and other key managers of the company are repaid to the company.</p>		<p>at the end of the year.</p> <p>The assessment of the Corporation's year-end performance as part of the short-term and long-term incentive systems takes into account the risks carried by the Corporation.</p> <p>In the event of discovering any instances of manipulation with accounting figures or any other types of wrongdoing committed by employees that jeopardise the interests of the shareholders, the respective employees shall be penalised and shall have to compensate the Corporation for its losses in compliance with the current laws.</p>
4.2.3.	<p>It is recommended that the companies whose shares are traded on a stock exchange, should implement a long-term incentive scheme for the executive bodies of the Company and other key management based on the shares of the Company (stock options or other derivative financial instruments whose underlying asset is the company's shares).</p>	<p>The company adopted a long-term incentive programme for members of executive bodies and other key managers of the company using the company's shares (financial tools based on the company's shares).</p> <p>The long-term incentive programme for members of executive bodies and other key managers of the company stipulates that the right to sell the shares or other financial tools provided under such programme shall not arise until at least three years from the award. This right shall be triggered by the company's achievement of certain performance targets.</p>	Observed	<p>The Corporation has a long-term incentive scheme for the top management and other key employees of the Company based on the shares of the Company.</p> <p>Under the long-term incentive scheme the shares are awarded during a five-year period with annual deferral, depending on the results achieved over the previous two years. There are no further restrictions on the disposal of shares.</p> <p>In view of the fact that under the long-term incentive scheme shares are granted with a deferral, the scheme does not provide for any additional restrictions on the sale of shares in the event of early termination of powers and (or) termination of the employment contract.</p>
4.3.3.	<p>Severance payments (golden parachutes) paid by the Company in the event of early termination of the powers of executive bodies or key management should not exceed the double amount of their fixed annual remuneration, provided that such early termination was prompted by the Company and that the respective employee was not guilty of any wrongdoing.</p>	<p>Severance payments (golden parachutes) paid by the Company in the event of early termination of the powers of executive bodies or key management did not exceed the double amount of their fixed annual remuneration in the reporting period, provided that such early termination was prompted by the Company and that the respective employee was not guilty of any wrongdoing.</p>	Observed	<p>The amount of severance payment made by the Corporation in the event of an early dismissal of members of executive bodies or other key managers prompted by the Corporation does not exceed the mandatory amount set by the law and does not exceed the double amount of fixed annual remuneration.</p>
<b>V. Risk management and internal control system</b>				
5.1.	<p>The Company should have an effective risk management and control system aimed at providing reasonable assurance in the achievement of the goals set for the Company.</p>			
5.1.1.	<p>The Company's Board of Directors should determine the principles of and approaches to organising the risk management and internal control systems at the Company.</p>	<p>The powers of different governance bodies and divisions of the company in risk management and internal control are clearly determined by internal regulations/a respective policy of the company</p>	Observed	<p>The Board of Directors approved the Internal Audit Policy and the Internal Control Policy of the Corporation. The Corporation also adopted the Risk Management Code. All the regulations were developed in accordance with the COSO integrated concept on internal</p>

		approved by the board of directors.		control. The risk management and internal control systems function at operational and organisational levels. The roles and objectives of various governance bodies of the Corporation in this process are set out in the above-mentioned documents.
5.1.2.	The Company's executive bodies should ensure the establishment and maintenance of effective risk management and internal control systems at the Company.	The company's executive bodies ensure distribution of powers with regard to risk management and internal control between heads of divisions and departments that report to them.	Observed	A dedicated risk management subdivision was set up within the Finance and Investment Function. Heads of the Corporation's subdivisions shall, in line with their functional duties, be responsible for developing, documenting, implementing, monitoring and upgrading the risk management and internal control systems in the respective functional areas.
5.1.3.	The risk management and internal control systems of the Company should ensure objective, fair and clear understanding of the current status and prospects of the Company, the integrity and transparency of the Company's financial reporting, the reasonableness and acceptability of the risks assumed by the Company.	The company has adopted an anti-corruption policy. The company provides for a way to inform the board of directors or the board's audit committee about breaches of laws, internal procedures or the company's code of ethics.	Observed	The internal control and risk management system enables the Corporation to timely respond to the newly emerged risks. The Board of Directors approved the Anticorruption Policy of the Corporation. The Corporation has a single whistleblower hotline enabling any employee of the Corporation to report any offences committed by the Corporation and/or its officers. The purpose of the hotline is to counteract potential instances of abuse during implementation of various projects and business activities, including the procurement of products, works and services, and to prevent potential corrupt practices or fraud. The whistleblowers are protected from any types of pressure (including dismissal, persecution and any forms of discrimination).
5.1.4.	It is recommended that the Board of Directors should take all necessary and sufficient measures to make sure that the existing risk management and internal control system of the Company meets the respective principles and approaches approved by the Board of Directors and is functioning efficiently.	In the reporting period, the board of directors or the board's audit committee assessed the efficiency of the company's risk management and internal control system. Information about the key results of such assessment are included in the company's annual report.	Observed	The Board of Directors reviews the matters of organisation, functioning and efficiency of the risk management and internal control systems and, if necessary, gives recommendations for their improvement on a regular basis (at least once a year). Information on the results of the review held by the Board of Directors into the matters of risk management and internal control is provided to the shareholders as part of an Annual Report.
5.2.	To ensure a regular and independent assessment of the reliability and efficiency of its risk management and internal control systems and corporate governance practices the Company should organise internal audits.			
5.2.1.	It is recommended that internal audits should be organised by means of establishing a dedicated subdivision (internal audit unit) or engaging an independent external auditor. In order to ensure the independence of the	For the purposes of internal audits, the company established a separate internal audit unit that functionally reports to the board of directors or the audit committee or engaged an independent external company with similar	Observed	The Corporation has set up the Internal Control and Audit Department operating on the basis of the Terms of References of the Internal Control and Audit Department. The Department functionally reports to the Board of Directors and administratively – to the

	internal audit unit its functional and administrative reporting lines should be divided. It is advisable that the internal audit unit should functionally report to the Board of Directors and administratively – directly to the Company’s sole executive body.	reporting principles.		Corporation’s President. Head of the Department is appointed and dismissed by the President based on the resolution of the Board of Directors.
5.2.2.	It is recommended that the internal audit function should perform an assessment of the efficiency of the internal control and risk management systems, corporate governance, and conform to the generally accepted standards in internal audit.	In the reporting period, an internal audit was conducted that gave assessment to the efficiency of the internal control and risk management system. The company uses generally accepted approaches to internal control and risk management.	Observed	The Corporation’s internal audit procedures comply with the International Internal Audit Standards of the Institute of Internal Auditors. The Corporation’s internal audit procedures include: <ul style="list-style-type: none"> <li>▪ assessing the efficiency of the internal control system,</li> <li>▪ assessing the efficiency of the risk management system,</li> <li>▪ assessing the corporate governance system.</li> </ul>
<b>VI. Disclosing information about the company, information policy of the company</b>				
6.1.	The company and its operations should be transparent for the shareholders, investors and other interested parties.			
6.1.1.	The Company should develop and implement an informational policy ensuring efficient interaction of the Company, shareholders, investors and other interested parties.	1. The company’s board approved an information policy that was developed taking into account the Code’s recommendations. 2. The board (or a board committee) reviewed the company’s compliance with its information policy at least once in the reporting period.	Observed	The Corporation has developed and implemented an Informational policy which was approved by the Board of Directors. The executive bodies of the Corporation and its Corporate Secretary are responsible for the implementation of the Information Policy. The Board of Directors oversees compliance with the Information Policy. Members of the executive bodies hold meetings with analysts on a regular basis to accompany the disclosure (publication) of the Corporation’s financial statements or to comment on the key investment projects and development plans of the Corporation.
6.1.2.	The company should disclose information on the corporate governance system and practices, including detailed information on compliance with the principles and recommendations of this Code.	1. The company discloses information about its corporate governance system and general principles of corporate governance used by the company, including on its website. 2. The company discloses information about the members of its executive bodies and the board of directors, the independence of board members and their membership in board committees (as defined in the Code). 3. If there is an entity controlling the company, the company publishes a memorandum of the	Observed	The Corporation publishes information about its governance bodies and their composition, including the biographies of the members of governance bodies, on the Company’s website ( <a href="http://www.sistema.ru/www.sistema.com">www.sistema.ru/www.sistema.com</a> ). The Corporation has adopted the Corporate Governance Code (hereinafter, the “Code”) setting out the key principles of corporate governance and the obligations assumed by the Board of Directors including representatives of the principal shareholder with respect to the Corporation. The Code has been published on the Corporation’s website. The Corporation’s controlling shareholder is the Board Chairman

		controlling entity disclosing its plans with regard to corporate governance at the company.		and his plans with regard to corporate governance at the Corporation are reflected in publicly disclosed documents approved by the Board of Directors and the General Meeting of shareholders of the Corporation.
6.2.	The Company should timely disclose complete, relevant and reliable information about the Company in order to enable its shareholders and investors to take informed decisions.			
6.2.1.	The Company should disclose information regularly, consistently and promptly and ensure the accessibility, reliability, completeness and comparability of the disclosed data.	The company's information policy determines approaches and criteria for identifying information that may have a material influence on the valuation of the company and the price of its securities and procedures providing for timely disclosure of such information. If the company's securities are traded on foreign organised markets, disclosure of material information in Russia and on such markets is made simultaneously and equally during the reporting year. If foreign shareholders hold a significant amount of the company's shares, disclosure of information in the reporting year was made both in Russian and in one of the most widely spoken foreign languages.	Observed	The Corporation's informational policy makes it possible to coordinate the work of all units and subdivisions of the Corporation dealing with information disclosures. The Corporation discloses information in the shortest possible time. The Corporation's material information is disclosed for Russian and foreign investors simultaneously and in equal volumes in the Russian and English languages. The Corporation promptly responds to any rumours and/or unreliable information about its activities. The Corporation uses its website ( <a href="http://www.sistema.ru/www.sistema.com">www.sistema.ru/www.sistema.com</a> ) and the Interfax news feed for disclosing information. The Corporation is aiming to make sure that the disclosed information is unambiguous, objective and neutral and it does not avoid disclosing negative information.
6.2.2.	It is recommended that the company should avoid adopting a purely technical approach when disclosing information and should disclose all material information about its activities even if the disclosure of such information is not required by the law.	In the reporting period, the company disclosed its annual and semi-annual financial reports prepared in accordance with the IFRS. The company's annual report for the reporting period includes its annual financial statement prepared in accordance with the IFRS, together with the auditors' opinion. The company discloses full information about the structure of the company's capital in accordance with recommendation 290 of the Code in its annual report and on its website.	Observed	The Corporation discloses all material information not only about itself but also about its controlled legal entities. The Corporation discloses the following additional information: <ul style="list-style-type: none"> <li>▪ mission, strategy and objectives of the Corporation,</li> <li>▪ financial operations and financial status of the Corporation,</li> <li>▪ capital structure of the Corporation,</li> <li>▪ social responsibility of the Corporation.</li> </ul>
6.2.3.	The annual report, being one of the most important tools of informational interaction with shareholders and other interested parties, should contain information making it possible to assess the company's annual results.	The company's annual report includes information about the key aspects of the company's operations and its financial performance. The company's annual report includes information about the environmental and social aspects of the company's operations.	Observed	The Corporation discloses all material information in the Annual Report in accordance with the recommendations of the Corporate Governance Code. The Annual Report includes all material data from the annual statutory and financial reports, as well as information about the Corporation's CSR efforts.
6.3.	The Company should ensure that all shareholders have equal and unhindered access to information and documents upon their request.			
6.3.1.	The shareholders should be able to exercise their right	The company's information policy stipulates an easy	Observed	When giving shareholders access to its documents and information, the

	to access documents and information without any unjustifiable difficulties.	procedure for providing shareholders with access to information, including information of the company's controlled legal entities, upon shareholders' request.		Corporation is guided by applicable legislation and seeks to avoid creating unnecessary difficulties. The Corporation's informational policy sets out the procedure for granting such access. The Corporation does not overstate the costs related to making and sending the copies of such documents. The matters of providing information about controlled legal entities are not regulated by the Informational policy, since the companies controlled by the Corporation conduct independent operations and Sistema PJSFC does not take any operational decisions with respect to such companies.
6.3.2.	It is recommended that when providing information to the shareholders the company should ensure a reasonable balance of interests of specific shareholders and the company itself, which is interested in maintaining confidentiality of crucial commercial information that may have a significant impact on its competitiveness.	In the reporting period, the company did not refuse to accommodate shareholders' requests for information or such refusals were justified. In instances stipulated by the company's information policy, shareholders are notified about the confidential nature of information and assume the obligation to maintain its confidentiality.	Observed	A shareholder may be granted access to confidential information about the Corporation only provided that the shareholder is aware of the confidential nature of such information and assumes the obligation to maintain its confidentiality in accordance with applicable laws.

#### VII. Material corporate actions

7.1.	Actions that have or may have a significant impact on the structure of the shareholders' equity or the financial position of the Company and accordingly the position of its shareholders (material corporate actions) should be taken on fair terms providing for the protection of the rights and interests of the shareholders and other interested parties.			
7.1.1.	Material corporate actions include company reorganisation, acquisition of 30 and more percent of company voting shares (a takeover), entering into material transactions, increasing or decreasing the authorised capital of the company, listing and delisting the company's shares, and other actions that may result in a significant change of shareholder rights or have a detrimental effect on their interests. It is recommended that the Company's Charter should determine the list (criteria) of transactions or other actions constituting material corporate actions and vest the board of directors of the company with the exclusive powers to take decisions on such matters.	The company's charter sets out a list of transactions and other actions that constitute material corporate actions and criteria for identifying them. Decisions with regard to material corporate actions are within the remit of the board of directors. If law expressly stipulates that such corporate actions shall be within the remit of the general meeting of shareholders, the board of directors gives shareholders appropriate recommendations. The company's charter stipulates that at least the following actions constitute material corporate actions: the company's reorganisation, acquisition of 30 or more % of the company's voting shares (takeover), material transactions, increase or decrease of the company's authorised capital, listing of	Observed	In accordance with the legislation, decisions on listing and delisting of shares, as well as decisions on reorganisation and approval of major transactions in accordance with applicable laws are within the remit of the General Meeting of shareholders. In accordance with the Charter of Sistema PJSFC, decision-making on all other actions specified in the Corporate Governance Code falls within the remit of the Board of Directors.

		delisting of the company's shares.		
7.1.2.	The Board of Directors should play a key role in taking decisions or developing recommendations on material corporate actions on the basis of the opinions of independent directors of the Company.	The company has a procedure in place that allows independent directors to state their position on material corporate actions before their approval.	Observed	Prior to being considered by the Board of Directors, related party transactions are provisionally reviewed by the Audit, Finance and Risk Committee (hereinafter, the "Committee"), which consists mostly of independent directors. The Committee's opinion is discussed when the transactions are reviewed at a Board meeting. Decisions on approval of related-party transactions are taken by Board members who are not related parties.
7.1.3.	It is recommended that in the course of taking material corporate actions influencing the rights and lawful interests of the shareholders, equal terms should be provided to all the company shareholders, and when the mechanisms provided by the law are insufficient, additional measures should be taken to protect the rights and lawful interests of the Company's shareholders. At the same time, the company should be guided not only by formal requirements of the law, but also by the principles of corporate governance set out in the Code.	The company's charter, taking into account the specifics of its business, sets lower minimum criteria for recognising transactions as material corporate actions than those envisaged by applicable laws. In the reporting period, all material corporate actions passed the approval procedure before they were carried out.	Observed	The Board of Directors reviews all material matters of the Corporation in accordance with procedures envisaged by the Corporation's internal documents. In 2016, all actions that are recognised as material corporate actions in accordance with the Corporate Governance Code were approved by the Board of Directors before they were carried out.
7.2.	The Company should establish such procedures for taking corporate actions that would enable the shareholders to timely receive information on such actions, and provide them with the opportunity to influence such actions and guarantee an adequate level of protection of the shareholder's rights.			
7.2.1.	Disclosures of information on material corporate actions should contain explanations of the reasons, terms and consequences of such actions.	In the reporting period, the company timely and thoroughly disclosed information about its material corporate actions, including the reasons for and the timeframe of such actions.	Observed	Being a public company, the Corporation discloses the maximum possible amount of information on any corporate actions, including those that may influence the dividend and/or any other rights of the shareholders.
7.2.2.	It is recommended that the rules and procedures related to the Company's taking material corporate actions should be set out in the internal regulations of the Company.	The company's internal documents stipulate a procedure for engaging an independent appraiser for determining the value of assets to be disposed or acquired in a major transaction or in a related party transaction. The company's internal documents stipulate a procedure for engaging an independent appraiser for determining the price of acquiring and buying back the company's shares. The company's internal documents set out an extensive list of reasons for recognising board members	Observed	To the extent that the rules and procedures related to the Corporation's taking material corporate actions are not provided for by the applicable laws, such rules and procedures are set forth in the internal regulations of the Corporation. When reviewing material transactions at Board meetings, an independent appraiser or an investment consultant is engaged to determine the price of such transactions. Only Board members that do not have any conflict of interest and are not related parties vote on items on approval of related party transactions.

		and other persons as stipulated by law as related parties in the company's transactions.		
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## ***Annex 6. Report on compliance with key requirements of the UK Corporate Governance Code***

<i>Provisions of the Code</i>	<i>Compliance</i>	<i>Notes</i>
<b>A. LEADERSHIP</b>		
<b>A.1. The Role of the Board</b>		
A.1.1. The board should meet sufficiently regularly to discharge its duties effectively.	Observed	The Board of Directors of Sistema PJSFC meets at least 8 times a year, which allows reviewing and taking decisions on issues within its scope of authority. 13 meetings of the Board of Directors were held in 2016.
There should be a formal schedule of matters specifically reserved for the board's decision.	Observed	The powers and responsibilities of the Board of Directors are set out in the Charter of Sistema PJSFC (cl. 32 of the Charter).
The annual report should include a statement of how the board operates, including a high level statement of which types of decisions are to be taken by the board and which are to be delegated to management.	Observed	The Annual Report of Sistema PJSFC includes information on the procedures of the Board of Directors, including a report on the key items decisions on which were made by the Board of Directors and the Management Board (cl. 6.2, 6.4).
A.1.2. The annual report should identify the chairman, the deputy chairman (where there is one), the chief executive, the senior independent director and the chairmen and members of the board committees.	Observed	Sistema's Annual Report includes information on election of V. Evtushenkov Chairman of the Board of Directors of Sistema PJSFC, and also on elected deputy chairmen of the Board. The Annual Report also includes information on the President and Chairmen and members of the Board Committees. The Corporation's statutory documents do not provide for the position of a senior independent director.
The annual report should also set out the number of meetings of the board and those committees and individual attendance by directors.	Observed	Sistema's Annual Report includes information on the number of meetings of the Board of Directors and Board Committees, as well as their attendance by members (cl. 6.2).
A.1.3. The company should arrange appropriate insurance cover in respect of legal action against its directors.	Observed	In accordance with the Terms of Reference of the Board of Directors, the Corporation insures liability of the Board members from legal actions or claims in relation to business decisions or other actions taken in capacity of a member of the Board of Director of Sistema PJSFC or its affiliates (D&O Policy).
<b>A.2. Division of Responsibilities</b>		
A.2.1. The roles of chairman and chief executive should not be exercised by the same individual. The division of responsibilities between the chairman and chief executive should be clearly established, set out in writing and agreed by the board.	Observed	The Russian legislation and the Charter of Sistema PJSFC stipulate that a person performing the functions of the sole executive body cannot simultaneously hold the position of the Chairman of the Board of Directors of Sistema PJSFC (cl. 31.1 of

the Charter of Sistema PJSFC). The powers of the Board Chairman, Board Members and the President are clearly divided in the Charter of Sistema PJSFC.

### A.3. The Chairman

A.3.1. The chairman should on appointment meet the independence criteria set out in B.1.1 below.	Not observed	The Corporation's main shareholder V. Evtushenkov, who is non-executive member of the Board of Directors, but does not meet the independence criteria, was elected Chairman of the Board of Directors of Sistema PJSFC since his is the Corporation's majority shareholder.
A chief executive should not go on to be chairman of the same company. If, however, the president is nominated board chairman after all, the board should discuss his/her nomination with the corporation's main shareholders in advance, providing sufficient grounds for the election, and should disclose this information in the next annual report.	Observed	The Russian legislation and the Charter of Sistema PJSFC envisage that a person performing the functions of the sole executive body cannot simultaneously hold the position of the Chairman of the Board of Directors of Sistema PJSFC (cl. 31.3 of the Charter of Sistema PJSFC). The powers of the Board Chairman and the President are clearly divided in the Charter of Sistema PJSFC.

### A.4. Non-Executive Directors

A.4.1. The board should appoint one of the non-executive directors meeting the independence criteria to be the senior independent director. The senior independent director should be available to shareholders if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve.	Partially observed	Formal meetings of the Board of Directors of Sistema PJSFC without the executive directors' presence are not held, but there are meetings of the Board Chairman with independent directors. Sistema's internal regulations provide for the position of a Deputy Board Chairman, which is currently held by a non-executive director. The Corporation's regulations do not provide for the position of a senior independent director. Prior to every meeting of the Board of Directors of Sistema PJSFC, independent members of the Board hold a meeting in form of a business dinner, which is also attended by the management of the Corporation, to discuss urgent questions of managing the Company and organising the Board's work.
A.4.2. The chairman should hold meetings with the non-executive directors without the executives present.	Not applicable	Performance of the Board of Directors' Chairman is assessed during the assessment of the performance of the Board of Directors as a whole.
A.4.3. Where directors have concerns which cannot be resolved about the running of the company or a proposed action, they should ensure that their concerns are recorded in the board minutes.	Observed	According to the Procedures of the Board of Directors of the Corporation approved by the Board on 13 December 2014, directors have an opportunity to express (attach to the minutes of a Board meeting) their dissenting opinion within 24 hours after the meeting.

All Board members of Sistema PJSFC are provided with a copy of minutes of every Board meeting.

## B. EFFECTIVENESS

### B.1. The Composition of the Board

<p>B.1.1. The board should identify in the annual report each non-executive director it considers to be independent.</p> <p>The board should determine whether the director is independent in character and judgement and whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgement.</p> <p>The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination.<sup>1</sup></p>	Observed	<p>Information on each non-executive director that meets the independence criteria is included in Sistema's Annual Report.</p> <p>There are 6 directors among members of the Board of Directors that meet the independence criteria: P. Clanwilliam, R. Kocharyan, J. Krecké, P. Mandelson, R. Munnings and D. Iakobachvili.</p>
<p>B.1.2. Except for smaller companies (a smaller company is one that is below the FTSE 350 throughout the year immediately prior to the reporting year), at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent.</p>	Observed	<p>Sistema PJSFC is not included in FTSE 350, however, 7 of its Board Members, or over 50%, meet the independence criteria.</p>

### B.2. Appointments to the Board

<p>B.2.1. There should be a nomination committee which should lead the process for board appointments and make recommendations to the board.</p>	Observed	<p>The Nomination, Remuneration and Corporate Governance Committee of Sistema PJSFC has been set up and is active. Its scope of authority is defined in the Terms of Reference of the Nomination, Remuneration and Corporate Governance Committee of Sistema PJSFC approved on 29 October 2016. One of the Committee's main functions is preliminary consideration of nominees to the Corporation's top management positions to be approved by the Board of Directors of Sistema PJSFC. The Committee also considers candidates to the Board of Directors as part of preparation for the Annual General Meeting of shareholders.</p>
<p>A majority of members of the nomination committee should be independent non-executive directors.</p>	Observed	<p>Independent directors constitute a majority of the Nomination, Remuneration and Corporate Governance Committee (R. Kocharyan (Chairman), P. Mandelson, R. Munnings and D. Iakobachvili).</p>

<sup>1</sup> Including if the director: a) has been an employee of the company or group within the last five years; b) has, or has had within the last three years, a material business relationship with the company either directly, or as a partner, shareholder, director or senior employee of a body that has such a relationship with the company; c) has received or receives additional remuneration from the company apart from a director's fee, participates in the company's share option or a performance-related pay scheme, or is a member of the company's pension scheme; d) has close family ties with any of the company's advisers, directors or senior employees; e) holds cross-directorships or has significant links with other directors through involvement in other companies or bodies; f) represents a significant shareholder; or g) has served on the board for more than nine years from the date of their first election.

<p>The chairman or an independent non-executive director should chair the nomination committee, but the chairman should not chair the nomination committee when it is dealing with the appointment of a successor to the chairmanship.</p>	Observed	<p>The Nomination, Remuneration and Corporate Governance Committee of the Board of Directors of Sistema PJSFC is chaired by the independent non-executive director R. Kocharyan.</p>
<p>B.2.2. The nomination committee should evaluate the balance of skills, experience, independence and knowledge on the board and, in the light of this evaluation, prepare a description of the role and capabilities required for a particular appointment.</p>	Observed	<p>Candidates to the Board of Directors are nominated by shareholders of Sistema PJSFC.</p> <p>Requirements for candidates to the Board are set out in the Terms of Reference of the Board of Directors of Sistema PJSFC. In particular, a candidate should have sufficient professional experience and business reputation, and should be able to devote sufficient time and energy to the performance of duties of a Board member.</p> <p>The Nomination, Remuneration and Corporate Governance Committee (hereinafter, the “Committee”) annually reviews and decides whether the Corporation’s Board of Directors needs additional competences.</p> <p>The Committee also considers candidates nominated for election to the Board of Directors as part of preparation for the Annual General Meeting of shareholders.</p>
<p>B.2.3. Non-executive directors should be appointed for specified terms subject to re-election and to statutory provisions relating to the removal of a director.</p>	Observed	<p>According to the Russian legislation, Board members are elected at the Annual General Meeting of shareholders for 1 year (for the period till the next Annual General Meeting of shareholders) and can be re-elected unlimited number of times.</p>
<p>Any term beyond six years for a non-executive director should be subject to particularly rigorous review, and should take into account the need for progressive refreshing of the board.</p>	Not applicable	<p>According to the Russian legislation, Board members are elected at the Annual General Meeting of shareholders for 1 year (for the period till the next Annual General Meeting of shareholders) and can be re-elected unlimited number of times.</p>
<p>B.2.4. A separate section of the annual report should describe the work of the nomination committee, including the process it has used in relation to board appointments.</p> <p>An explanation should be given if neither an external search consultancy nor open advertising has been used in the appointment of a chairman or a non-executive director.</p> <p>Where an external search consultancy has been used, it should be identified in the annual report and a statement made as to whether it has any other connection with the company.</p>	Observed	<p>Sistema’s Annual Report includes information on the powers and scope of authority of the Nomination, Remuneration and Corporate Governance Committee of the Board of Directors and on key items considered by the Committee, including the rules it used for selecting and assessing candidates to the Company’s Board.</p> <p>In 2016, the Committee did not use the services of an external consultant.</p>
<p>A separate section of the annual report should include a description of the board’s policy on</p>	Observed	<p>The Board of Directors of Sistema PJSFC has a balance of executive (2)<sup>1</sup>,</p>

<sup>1</sup> F. Evtushenkov and M. Shamolin.

diversity, including gender, any measurable objectives that it has set for implementing the policy, and progress on achieving the objectives.		non-executive (3) <sup>1</sup> and independent (6) <sup>2</sup> directors.
A separate section of the annual report should include goals and objectives for the nomination committee, and progress on achieving the objectives.	Observed	The Board Committees section includes a description of the goals and objectives of the Nomination, Remuneration and Corporate Governance Committee and topics considered at its meetings.

### B.3. Commitment

B.3.1. For the appointment of a chairman, the nomination committee should prepare a job specification, including an assessment of the time commitment expected, recognising the need for availability in the event of crises.	Observed	Type of work and tasks of the Board Chairman are set out in the Terms of Reference of the Board of Directors of Sistema PJSFC. The board chairman is elected by all Board members at the first meeting after the Annual General Meeting of shareholders.
A chairman's other significant commitments should be disclosed to the board before appointment and included in the annual report. Changes to such commitments should be reported to the board as they arise, and their impact explained in the next annual report.	Observed	Information on all positions held by the Sistema's Board Chairman is disclosed and included in its Annual Report. Chairman of Sistema's Board of Directors V. Evtushenkov does not hold the position of Chairman at any other significant company except Sistema PJSFC.
B.3.2. The terms and conditions of appointment of non-executive directors should be made available for inspection by any person at the company's registered office during normal business hours and at the AGM.	Observed	Information on the terms and conditions of appointment of the non-executive directors of the Board is available on the corporate website of Sistema PJSFC ( <a href="http://www.sistema.ru">www.sistema.ru</a> / <a href="http://www.sistema.com">www.sistema.com</a> ) and at the office of Sistema PJSFC; the information is also available to the participants of the AGM of Sistema PJSFC in the course of the meeting. According to the Russian legislation all Board members are elected for 1 year and have a right to be re-elected for an unlimited number of times.
The letter of appointment should set out the expected time commitment. Non-executive directors should undertake that they will have sufficient time to meet what is expected of them.	Partially observed	Before nomination, all candidates for election to the Board familiarise themselves with the work plan of the Board of Directors of Sistema PJSFC for the coming year, the rights and obligations of the Board members and their potential inclusion in the Board's committees. During the induction procedure, the Company's Corporate Secretary explains to every new member of the Board its procedures and approximate time commitments for their fulfilment. Before the election, all candidates sign a document confirming their consent to the nomination that includes, <i>inter alia</i> , a consent to follow all the requirements of the internal regulations of the Corporation applicable to

<sup>1</sup> V. Evtushenkov, S. Boev and A. Dubovskov.

<sup>2</sup> P. Clanwilliam, R. Kocharyan, J. Krecké, P. Mandelson, R. Munnings and D. Iakobachvili.

		<p>the Board members.</p> <p>Attendance of meetings and involvement of the Board members in discussion of agenda items is recorded and analysed for subsequently including this information into the report on the quality of corporate governance.</p>
Other significant commitments of non-executive directors should be disclosed to the board before appointment, with a broad indication of the time involved and the board should be informed of subsequent changes.	Observed	<p>The biographies of candidates to the Board of Directors, including information on positions held in other organisations, are included in the materials for the Annual General Meeting of shareholders, and information on the incumbent Board members of Sistema PJSFC is included in the Annual Report.</p> <p>All candidates for election to the Board of Directors complete candidate questionnaires thus providing the Company with necessary information.</p> <p>The obligation to disclose any changes in the information provided by the members of the Board of Directors is set out in the Terms of Reference of the Board of Directors of Sistema PJSFC.</p>
B.3.3. The board should not agree to a full time executive director taking on more than one non-executive directorship in a FTSE 100 company nor the chairmanship of such a company.	Observed	<p>As of 31 December 2016, the Board of Directors of Sistema PJSFC consisted of 11 members, 2 of which held the positions of executive directors (F. Evtushenkov and M. Shamolin).</p> <p>They serve as members on boards of some of Sistema Group's companies that are not included in FTSE 100.</p> <p>Membership in the boards of directors of the subsidiaries of Sistema Group is one of the main duties of executive directors, therefore, this does not create any conflict of interest for work at the Corporation's Board of Directors.</p>
<b>B.4. Development</b>		
B.4.1. The chairman should ensure that new directors receive a full, formal and tailored induction on joining the board. As part of this, directors should avail themselves of opportunities to meet major shareholders.	Observed	<p>Every candidate for election to the Board of Directors of Sistema PJSFC meets the Board Chairman, Board members and the management before the election and receives information on the work of the Board of Directors, his/her role in the Board of Directors and on the Company's business.</p> <p>The Corporate Secretary of Sistema PJSFC provides consultations to new members of the Board on the procedures and organisation of the work of the Board and its committees and provides all the necessary regulatory documents describing the Corporation's strategy, business, markets of presence and financial reports.</p>
B.4.2. The chairman should regularly review and agree with each director their training and	Observed	Sistema's Board members have the right to prepare and implement an individual

development needs.		professional development plan. The main tool, with consent of the Board Chairman, is their participation in international conferences and professional associations on behalf of the Corporation.
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### B.5. Information and Support

B.5.1. The board should ensure that directors, especially non-executive directors, have access to independent professional advice at the company's expense where they judge it necessary to discharge their responsibilities as directors.	Observed	The Terms of Reference of the Board of Directors of the Corporation give Board members the right to engage external independent experts for assessing materials and decisions on any agenda items. Such independent appraisal is organised by the Secretariat of the Board of Directors.
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B.5.2. All directors should have access to the advice and services of the company secretary, who is responsible to the board for ensuring that board procedures are complied with.	Observed	In accordance with the Terms of Reference of the Corporate Secretary of Sistema PJSFC, one of the functions of the Corporate Secretary is to provide support to the work of the Board of Directors, including: providing Board members with requested information and documents regarding the Company's business operations, distributing among Board members the materials for the Board meetings, facilitating the work of the Board Committees.
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### B.6. Evaluation

B.6.1. The board should state in the annual report how performance evaluation of the board, its committees and its individual directors has been conducted.	Observed	The procedure for assessing the work of the Board of Directors of Sistema PJSFC is described in the Company's Annual Report. The Board of Directors' self-appraisal procedure was introduced in 2009. Board members assess the organisation of work of the Board of Directors using the following parameters: membership and structure of the Board, procedures and organisation of the work of the Board, its Committees, the quality of decisions taken by the Board in different functional areas. The Secretariat of the Board of Directors conducts an annual survey of the Board members, analyses the results and submits the final analysis to the Nomination, Remuneration and Corporate Governance Committee, the Board Chairman and the members of the Board of Directors of Sistema PJSFC.
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B.6.2. Evaluation of the board of FTSE 350 companies should be externally facilitated at least every three years. The external facilitator should be identified in the annual report and a statement made as to whether they have any other connection with the company.	Not applicable	Sistema PJSFC is not included in the FTSE 350 list.
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B.6.3. The non-executive directors, led by the senior independent director, should be responsible for performance evaluation of the	Not applicable	The Company's statutory documents do not provide for the position of a senior independent director.
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chairman, taking into account the views of executive directors.		Performance evaluation of the Board Chairman is carried out during assessment of performance of the Board of Directors as a whole.
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**B.7. Re-election**

B.7.1. All directors should be subject to election by shareholders at the first annual general meeting after their appointment, and to re-election thereafter at intervals of no more than three years.	Observed	According to the Russian legislation, Board members are elected at the Annual General Meeting of shareholders for 1 year (for the period till the next Annual General Meeting of shareholders) and can be re-elected unlimited number of times.
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Non-executive directors who have served longer than nine years should be subject to annual re-election.	Observed	According to the Russian legislation, Board members are elected at the Annual General Meeting of shareholders for 1 year (for the period till the next Annual General Meeting of shareholders) and can be re-elected unlimited number of times. The Terms of Reference of the Board of Directors sets out independence criteria for Board members.
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The names of directors submitted for election or re-election should be accompanied by sufficient biographical details and any other relevant information to enable shareholders to take an informed decision on their election.	Observed	Information on the Board candidates including their biographies is provided among other materials for the Annual General Meeting of shareholders, which elects members of the Board of Directors.
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B.7.2. The board should set out to shareholders in the papers accompanying a resolution to elect a non-executive director why they believe an individual should be elected.	Observed	The shareholders are provided with the candidates' biographies and information about their track record and expertise, along with a recommendation of the Nomination, Remuneration and Corporate Governance Committee, based on which shareholders made an independent decision on voting in election of the Board.
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The chairman should confirm to shareholders when proposing re-election that, following formal performance evaluation, the individual's performance continues to be effective and to demonstrate commitment to the role.	Observed	Every year, when the new membership of the Board is determined, information on the work of the Board of Directors in the previous year is disclosed, including attendance of meetings by the Board members and the work of the respective Committees. The shareholders are provided with the candidates' biographies and information about their track record and expertise, along with a recommendation of the Nomination, Remuneration and Corporate Governance Committee, based on which shareholders made an independent decision on voting in election of the Board.
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**C. ACCOUNTABILITY**

**C.1. Financial and Business Reporting**

C.1.1. The directors should state in the annual report that they consider the annual report and accounts, taken as a whole, is fair, balanced	Observed	The Corporation's Annual Report and accounts are pre-approved at meetings of the Board and the Audit, Finance and Risk
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and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.		Committee of Sistema PJSFC.
There should be a statement by the auditor about their reporting responsibilities.	Observed	The respective statement is contained in the auditor's opinion which is an integral part of the annual financial statements.
C.1.2. The directors should include in the annual report an explanation of the basis on which the company generates or preserves value over the longer term (the business model) and the strategy for delivering the objectives of the company.	Observed	Annual report contains the description of the Corporation's development strategy.
C.1.3. In annual and half-yearly financial statements, the directors should state whether they considered it appropriate to adopt the going concern basis of accounting in preparing them, and identify any material uncertainties to the company's ability to continue to do so over a period of at least twelve months from the date of approval of the financial statements.	Observed	The Audit, Finance and Risk Committee analyses this when reviewing the accounts. If necessary, respective reservations are included in the opinion/report of the independent auditor, which are integral parts of the annual and semi-annual financial statements approved by the Audit, Finance and Risk Committee.

## C.2. Risk Management and Internal Control

C.2.1. The directors should confirm in the annual report that they have carried out a robust assessment of the principal risks facing the company, including those that would threaten its business model, future performance, solvency or liquidity. The directors should describe those risks and explain how they are being managed or mitigated.	Observed	The Annual Report has a separate section devoted to description of risks for the Corporation's business and of the risk management system. The Board regularly reviews items on risk management at the Corporation.
C.2.2. Taking account of the company's current position and principal risks, the directors should explain in the annual report how they have assessed the prospects of the company, over what period they have done so and why they consider that period to be appropriate. The directors should state whether they have a reasonable expectation that the company will be able to continue in operation and meet its liabilities as they fall due over the period of their assessment, drawing attention to any qualifications or assumptions as necessary.	Observed	The Annual Report includes a detailed description of the situation and prospects of the Corporation and its portfolio companies, taking into account existing risks.
C.2.3. The board should monitor the company's risk management and internal control systems and, at least annually, carry out a review of their effectiveness, and report on that review in the annual report.	Observed	The Board reviews reports from divisions responsible for risk management and internal control at the Corporation at least once a year. This information is disclosed in the Annual Report.

## C.3. Audit Committee and Auditors

C.3.1. The board should establish an audit	Observed in all	The Audit, Finance and Risk Committee of
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<p>committee of at least three, or in the case of smaller companies two, independent non-executive directors. The board should satisfy itself that at least one member of the audit committee has recent and relevant financial experience.</p>	<p>material aspects</p>	<p>Sistema PJSFC has been established and is active. The Committee consists of four independent Board members: J. Krecké, P. Clanwilliam, R. Munnings and D. Iakobachvili. The Chairman of the Audit, Finance and Risk Committee of the Board of Directors of Sistema PJSFC is R. Munnings, who has extensive experience in the area of financial audit.</p>
<p>C.3.2. The main role and responsibilities of the audit committee should be set out in written terms of reference and should include:</p> <ul style="list-style-type: none"> <li>- to monitor the integrity of the financial statements of the company and any formal announcements relating to the company's financial performance, reviewing significant financial reporting judgements contained in them;</li> <li>- to review the company's internal financial controls and, unless expressly addressed by a separate board risk committee composed of independent directors, or by the board itself, to review the company's internal control and risk management systems;</li> <li>- to monitor and review the effectiveness of the company's internal audit function;</li> <li>- to make recommendations to the board, for it to put to the shareholders for their approval in general meeting, in relation to the appointment, re-appointment and removal of the external auditor and to approve the remuneration and terms of engagement of the external auditor;</li> <li>- to review and monitor the external auditor's independence and objectivity and the effectiveness of the audit process, taking into consideration relevant UK professional and regulatory requirements;</li> <li>- to develop and implement policy on the engagement of the external auditor to supply non-audit services, taking into account relevant ethical guidance regarding the provision of non-audit services by the external audit firm; and to report to the board, identifying any matters in respect of which it considers that action or improvement is needed and making recommendations as to the steps to be taken; and</li> <li>- to report to the board on how it has discharged its responsibilities.</li> </ul>	<p>Observed</p>	<p>The responsibilities of the Audit, Finance and Risk Committee of the Board of Directors of Sistema are set out in the Terms of Reference of the Committee approved by the Corporation's Board of Directors on 13 December 2014. The Terms of Reference of the Audit, Finance and Risk Committee meets the recommendations of section C.3.2 of the UK Corporate Governance Code.</p>
<p>C.3.3. The terms of reference of the audit committee, including its role and the authority delegated to it by the board, should be made available.</p>	<p>Observed</p>	<p>The responsibilities of the Audit, Finance and Risk Committee of the Board of Directors of Sistema are set out in the Terms of Reference of the Committee approved by the Corporation's Board of Directors on 13 December 2014.</p>
<p>C.3.4. Where requested by the board, the audit</p>	<p>Observed</p>	<p>The Audit, Finance and Risk Committee</p>

<p>committee should provide advice on whether the annual report and accounts, taken as a whole, is fair, balanced and understandable and provides the information necessary for shareholders to assess the company's position and performance, business model and strategy.</p>		<p>reviews the Annual Report and the financial statements for their reliability and completeness.</p>
<p>C.3.5. The audit committee should review arrangements by which staff of the company may, in confidence, raise concerns about possible improprieties in matters of financial reporting or other matters. The audit committee's objective should be to ensure that arrangements are in place for the proportionate and independent investigation of such matters and for appropriate follow-up action.</p>	<p>Observed</p>	<p>The Audit, Finance and Risk Committee reviews issues related to the operation of the hot line used by the Corporation's employees and other interested parties for raising concerns about any potential financial malpractice on a confidential basis.</p>
<p>C.3.6. The audit committee should monitor and review the effectiveness of the internal audit activities. Where there is no internal audit function, the audit committee should consider annually whether there is a need for an internal audit function and make a recommendation to the board, and the reasons for the absence of such a function should be explained in the relevant section of the annual report.</p>	<p>Observed</p>	<p>In accordance with the Terms of Reference of the Audit, Finance and Risk Committee of the Board of Directors of the Corporation, one of the main functions of this Committee is to oversee the internal audit system of the Corporation as implemented by the Internal Control and Audit Department. The Audit and Finance Committee, together with the head of the above-mentioned Department and the Company's management, analyses implemented activities aimed at removing deficiencies in internal business processes.</p>
<p>C.3.7. The audit committee should have primary responsibility for making a recommendation on the appointment, reappointment and removal of the external auditors. FTSE 350 companies should put the external audit contract out to tender at least every ten years. If the board does not accept the audit committee's recommendation, it should include in the annual report, and in any papers recommending appointment or re-appointment, a statement from the audit committee explaining the recommendation and should set out reasons why the board has taken a different position.</p>	<p>Observed</p>	<p>According to the Terms of Reference of the Audit, Finance and Risk Committee of the Company's Board of Directors, the Committee analyses the work of external auditors and makes recommendations to the Board of Directors of the Corporation on the appointment and re-appointment of external auditors or rejection of their services. The Committee organises a tender for external auditor's services at least once in five years.</p>
<p>C.3.8. A separate section of the annual report should describe the work of the committee in discharging its responsibilities. The report should include: - the significant issues that the committee considered in relation to the financial statements, and how these issues were addressed; - an explanation of how it has assessed the effectiveness of the external audit process and the approach taken to the appointment or reappointment of the external auditor, and information on the length of tenure of the current audit firm</p>	<p>Observed</p>	<p>Sistema's Annual Report includes information on discharge of its duties by the Audit, Finance and Risk Committee and on the policy for ensuring the impartiality and independence of the Corporation's auditor.</p>

and when a tender was last conducted; and  
- if the external auditor provides non-audit services, an explanation of how auditor objectivity and independence are safeguarded.

## D. REMUNERATION

### D.1. The Level and Components of Remuneration

<p>D.1.1. In designing schemes of performance-related remuneration for executive directors, the remuneration committee should follow the provisions in Schedule A to this Code. Schemes should include provisions that would enable the company to recover sums paid or withhold the payment of any sum, and specify the circumstances in which it would be appropriate to do so.</p>	<p>Observed</p>	<p>The sections of Schedule A of the UK Corporate Governance Code are in general reflected in the remuneration system developed for the Corporation's Board members.</p> <p>All instances when the Corporation may refuse to pay some part of remuneration are stipulated by its internal documents.</p> <p><i>Comments on specific sections of Schedule A are provided below.</i></p>
<p>D.1.2. Where a company releases an executive director to serve as a non-executive director elsewhere, the remuneration report should include a statement as to whether or not the director will retain such earnings and, if so, what the remuneration is.</p>	<p>Partially observed</p>	<p>The managers of the Corporation elected to the boards of directors of subsidiaries do not receive any additional remuneration for serving on such boards. The managers of the Corporation or executive directors elected to the boards of directors of other companies retain their remuneration for serving on the boards of directors of such companies in accordance with the existing internal regulations of such companies.</p> <p>The information on the size of remuneration received by the employees of Sistema PJSFC for serving on the boards of directors of other companies is not disclosed.</p>
<p>D.1.3. Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role. Remuneration for non-executive directors should not include share options or other performance-related elements. If, exceptionally, options are granted, shareholder approval should be sought in advance and any shares acquired by exercise of the options should be held until at least one year after the non-executive director leaves the board.</p> <p>Holding of share options could be relevant to the determination of a non-executive director's independence (as set out in provision B.1.1).</p>	<p>Observed</p>	<p>The Board members of Sistema PJSFC receive additional remuneration for serving as Chairman of the Board of Directors, Deputy Chairman and Chairman of the Board Committee. Special remuneration is also paid for attending the meetings of the Board and its Committees.</p> <p>Stock options are not granted for serving on the Board of Directors.</p>
<p>D.1.4. The remuneration committee should carefully consider what compensation commitments (including pension contributions and all other elements) their directors' terms of appointment would entail in the event of early termination. They should take a robust line on reducing compensation to reflect departing directors' obligations to mitigate loss.</p>	<p>Observed</p>	<p>Pursuant to cl. 1.6. of the Policy on remuneration and compensations for the Board members of the Corporation, in the event of early termination of the powers of a Board member, the amount of remuneration is calculated in proportion to the actual time of service of the specific member on the Board.</p>

D.1.5. Notice or contract periods should be set at one year or less. If it is necessary to offer longer notice or contract periods to new directors recruited from outside, such periods should reduce to one year or less after the initial period.	Observed	In accordance with the Russian laws, the members of the Board of Directors of Sistema PJSFC are elected by the annual general meeting of shareholders for a one-year term (until the next AGM) with the right to be re-elected an unlimited number of times.
<b>D.2. Procedure</b>		
D.2.1. The board should establish a remuneration committee of at least three, or in the case of smaller companies two, independent non-executive directors.	Observed in all material aspects	The Nomination, Remuneration and Corporate Governance Committee of Sistema PJSFC has been set up and is active. The Committee consists of 5 directors, 1 of which (S. Boev) is a non-executive director and 4 (R. Kocharyan, P. Mandelson, R. Munnings and D. Iakobachvili) are independent directors (meet the independence criteria).
The remuneration committee should make available its terms of reference, explaining its role and the authority delegated to it by the board.	Observed	The responsibilities of the Nomination, Remuneration and Corporate Governance Committee of the Board of Directors of Sistema PJSFC are set out in the Terms of Reference of the Committee approved by the Corporation's Board of Directors on 29 October 2016. The Terms of Reference of the above-mentioned Committee are available on the corporate website of the Corporation ( <a href="http://www.sistema.ru">www.sistema.ru</a> / <a href="http://www.sistema.com">www.sistema.com</a> ) and may be provided to shareholders upon request.
When hiring external consultants on the issues of remuneration payable to the Board members, it is necessary to provide information on such consultants and their relation to the Corporation.	Not applicable	In 2016, no external consultants were hired on the issues of remuneration payable to the Board members.
D.2.2. The remuneration committee should have delegated responsibility for setting remuneration for all executive directors and the chairman, including pension rights and any compensation payments.	Observed	The amounts of and the procedures for paying remuneration and compensations to the Corporation's Board members are set out in the Policy on remuneration and compensations for the Board members of the Corporation. If amendments should be made to the above-mentioned Policy, the Nomination, Remuneration and Corporate Governance Committee should develop the required amendments.
The committee should also recommend and monitor the level and structure of remuneration for senior management. The definition of 'senior management' for this purpose should be determined by the board but should normally include the first layer of management below board level.	Observed	In accordance with the Terms of Reference of the Nomination, Remuneration and Corporate Governance Committee of the Board of Directors of Sistema PJSFC, the Committee's functions include: <ul style="list-style-type: none"> <li>▪ preliminary review of employment agreements to be entered into with the President and members of the Management Board of the Corporation, which are submitted for the Board's approval;</li> <li>▪ Assessment of the top managers'</li> </ul>

		performance and determination of their respective bonuses.
D.2.3. The board itself or, where required by the Articles of Association, the shareholders should determine the remuneration of the non-executive directors within the limits set in the Articles of Association. Where permitted by the Articles, the board may however delegate this responsibility to a committee, which might include the chief executive.	Observed	The Policy on remuneration and compensations payable to members of the Board of Directors of the Corporation stipulates a formula for calculating the remuneration and compensations payable to the Corporation's Board members. A special decision of the Nomination, Remuneration and Corporate Governance Committee for such payments is not required.
D.2.4. Shareholders should be invited specifically to approve all new long-term incentive schemes (as defined in the Listing Rules) and significant changes to existing schemes, save in the circumstances permitted by the Listing Rules.	Observed	Long-term incentive systems are approved by the Board of Directors and, when needed, by the Annual General Meeting of shareholders of Sistema PJSFC, and shareholders discuss such matters both at the level of the Board of Directors and the level of the Annual General Meeting of shareholders.

## E. RELATIONS WITH SHAREHOLDERS

### E.1 Dialogue with Shareholders

E.1.1. The chairman should ensure that the views of shareholders are communicated to the board as a whole. The chairman should discuss governance and strategy with major shareholders. Non-executive directors should be offered the opportunity to attend scheduled meetings with major shareholders and should expect to attend meetings if requested by major shareholders.	Observed	Representatives of the main shareholders were elected to the Board of Directors of Sistema PJSFC. The IR Department of the Company works with major institutional investors. The results of its work, including the views of major institutional investors on the Company's strategy and development, are reviewed by the Board of Directors on a regular basis as part of the IR strategy of the Company. It is mandatory for all members of the Board of Directors, including non-executive directors, to attend the Annual General Meeting of shareholders of Sistema PJSFC.
The senior independent director should hold regular meetings with shareholders to discuss the development of the company.	Not applicable	The Company's statutory documents do not provide for the position of a senior independent director. Prior to every Board meeting, independent directors hold a meeting, which is also attended by the Corporation's management. Information on the Board members meeting the independence criteria is available to the shareholders on Sistema's website ( <a href="http://www.sistema.ru">www.sistema.ru</a> / <a href="http://www.sistema.com">www.sistema.com</a> ), so that the shareholders may contact any of them if they have any questions.
E.1.2. The board should state in the annual report the steps they have taken to ensure that the members of the board, and in particular the non-executive directors, develop an understanding of the views of major	Observed	Sistema's Annual Report includes a description of the Corporation's development strategy that reflects the opinion of the Board and the major shareholders.

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shareholders about the company, for example through direct face-to-face contact, analysts' or brokers' briefings and surveys of shareholder opinion.

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## E.2. Constructive Use of General Meetings

E.2.1. At any general meeting, the company should propose a separate resolution on each substantially separate issue, and should in particular propose a resolution at the AGM relating to the report and accounts.	Observed	According to the Russian legislation and the Charter of Sistema PJSFC, every agenda item at the AGM is accompanied by a separate draft resolution with “for”, “against” and “abstained” voting options.
E.2.2. The company should ensure that all valid proxy appointments received for general meetings are properly recorded and counted. The company should ensure that the following information is given at the meeting and made available as soon as reasonably practicable on a website which is maintained by or on behalf of the company: - the number of shares in respect of which proxy appointments have been validly made; - the number of votes for the resolution; - the number of votes against the resolution; and - the number of shares in respect of which the vote was directed to be withheld. When, in the opinion of the board, a significant proportion of votes have been cast against a resolution at any general meeting, the company should explain when announcing the results of voting what actions it intends to take to understand the reasons behind the vote result.	Observed	All votes of the shareholders are registered by the Teller Committee and this information is included in the Minutes of the Annual General Meeting of shareholders. All “for”, “against” and “abstained” votes on every agenda item are recorded separately, voting results for every item are disclosed publicly. In the reporting year, the number of votes cast against resolutions at the General Meeting of shareholders was not significant.
E.2.3. The chairman should arrange for the chairmen of the audit, remuneration and nomination committees to be available to answer questions at the AGM and for all directors to attend.	Observed	In accordance with the Terms of Reference of the Board of Directors of Sistema PJSFC, all members of the Board of Directors are obligated to attend the AGM and answer the questions of the participants. The shareholders attending the Annual General Meeting of shareholders of Sistema PJSFC may put questions to any member of the Board of Directors attending the meeting.
E.2.4. The company should arrange for the Notice of the AGM and related papers to be sent to shareholders at least 20 working days before the meeting.	Observed	According to the Charter of Sistema PJSFC, the Corporation circulates a Notice of the AGM and publishes the related materials no later than 30 days before the meeting.

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