



Consolidated financial statements

For the year ended 31 December 2019

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Independent Auditors' Report

To the Board of Directors and Shareholders of PJSC MegaFon

Opinion

We have audited the consolidated financial statements of PJSC MegaFon (the "Company") and its subsidiaries (the "Group"), which comprise the consolidated statement of financial position as at 31 December 2019, the consolidated income statement, and the statements of other comprehensive income, changes in equity and cash flows for the year then ended, and notes, comprising significant accounting policies and other explanatory information.

In our opinion, the accompanying consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2019, and its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards (IFRS).

Basis for Opinion

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

Key Audit Matters

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

Audited entity: PJSC MegaFon
Registration No. in the Unified State Register of Legal Entities:
1027809169585
Moscow, Russia

Independent auditor: JSC "KPMG", a company incorporated under the Laws of the Russian Federation, a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity.

Registration No. in the Unified State Register of Legal Entities
1027700125628

Member of the Self-regulatory Organization of Auditors Association "Sodruzhestvo" (SRO AAS). The Principal Registration Number of the Entry in the Register of Auditors and Audit Organisations: No.12006020351.



Revenue recognition - technical complexity	
Please refer to the Note 2.1 in the consolidated financial statements.	
The key audit matter	How the matter was addressed in our audit
<p>Revenue is a material amount consisting of a high volume of individually low value transactions. The Group uses billing systems to process revenue related data and relies on the results of these systems.</p> <p>The most significant risks of revenue misstatement arise due to:</p> <ul style="list-style-type: none"> — registration, processing and transfer of data on services parameters between billing systems and the accounting system; and — correct application of tariffs, as these change throughout the year. 	<p>Our audit procedures included an assessment of the Group's policies and controls in place over the IT system environment to determine their effectiveness in preventing and/or detecting revenue-related data distortion or loss.</p> <p>We performed the following key audit procedures:</p> <ul style="list-style-type: none"> — we tested backup and replication frequency, and inspected the server rooms to ensure appropriate physical safeguards were in place; — we tested the incident management procedure for timely resolution; — we tested that only authorised access can be made to the billing systems by inspecting approved access requests for compliance with the internal policy; — we tested that system program changes, including changes to tariff plans, were authorized in accordance with internal rules; — we tested that authority to change tariff plans in billing systems is granted to authorized persons in accordance with internal rules; — we reconciled information on new tariff plans entered into billing systems with approved orders and testing protocols; — we tested processing of data on parameters of provided services at the stage of initial registration of data by the server equipment and subsequent transfer to the billing system, having examined processing of individual entries on connections, and then entries in the accounting system, including by checking significant manual adjustments made during transfer of data from billing systems to the accounting system; — we recalculated the amounts accrued to subscribers on a sample basis, multiplying the parameters of the services provided by the corresponding tariffs. <p>The above procedures were performed with involvement of our IT specialists.</p>

The key audit matter	How the matter was addressed in our audit
	<p>We also performed analytical tests and tests of details:</p> <ul style="list-style-type: none"> — we reconciled the revenue recognized in the accounting system adjusted for the amount of settlements with subscribers at the beginning and end of the reporting period, with the amount of payments in accordance with the accounting system; — we reconciled the subscribers' payments recognized in the accounting system with confirmations from paying agents and banks on a sample basis; — we performed other analytical procedures to ensure that the overall trend and dynamics of revenue by type of service are consistent with our understanding of the Group and the industry in general.

Revaluation of property and equipment

Please refer to the Note 3.1 in the consolidated financial statements.

The key audit matter	How the matter was addressed in our audit
<p>In 2019 the Group decided to transit from the historical cost model of accounting for certain groups of property and equipment to revaluation model.</p> <p>In accordance with IAS 16 Property, Plant and Equipment, the Group recognized certain groups of property and equipment at fair value at the date of revaluation.</p> <p>We considered this matter to be a key matter due to significant part of the Group's total assets that are being revalued and significance of judgments and estimates made by management in determining the approach and key assumptions for calculation of fair value of</p>	<p>Our audit procedures included the following:</p> <p>We assessed professional competence of the qualified independent appraiser, which was engaged by the Group by considering the appraiser's reputation and experience based on publicly available sources.</p> <p>We involved KPMG valuation specialists to assist us in testing the appropriateness of the Group's methodology and key assumptions applied to determine the fair value of items of property and equipment being revalued.</p> <p>We assessed reasonableness of approaches used by independent appraiser for calculation of fair values of items of property and equipment being revalued based on our understanding of generally accepted valuation methods used for similar assets on the market.</p> <p>We evaluated the key assumptions used by the Group in its revaluation as follows:</p> <ul style="list-style-type: none"> — we compared on a sample basis the specific cost of an individual item of property and equipment



The key audit matter	How the matter was addressed in our audit
<p>property and equipment being revalued.</p>	<p>with average market prices, using the Group's tender documents obtained from independent suppliers;</p> <ul style="list-style-type: none"> — we compared useful lives used to calculate physical depreciation with the periods given in the generally accepted in evaluation practices and recommended by specialized reference books for similar assets; — we compared the price change indices used in calculation with those published by the Russian Ministry of Construction, the Russian statistical agency, and the U.S. Bureau of Labor Statistics. <p>We assessed whether the related disclosures in the consolidated financial statements are appropriate.</p>

IFRS 16 Leases (First time adoption)

Please refer to the Note 3.2 in the consolidated financial statements.

The key audit matter	How the matter was addressed in our audit
<p>The Group applied IFRS 16 Leases starting from 1 January 2019.</p> <p>We considered this matter to be a key matter as application of the standard by the Group required significant judgment and estimates to be made by management, including when determining that a contract contains a lease, and estimating a lease term and discount rate that significantly affect the amount of recognized assets and liabilities.</p>	<p>Our audit procedures included the following:</p> <ul style="list-style-type: none"> — we assessed the appropriateness of defining a contract as a lease by analyzing, on a sample basis, the terms and conditions of contracts that could potentially contain lease components; — we assessed the reasonableness of determining the lease term, including management's judgments regarding the lease term, based on our experience, and discount rate by forming our own range of estimates for lease liabilities, including with the involvement of KPMG valuation specialists and comparing the data obtained with the estimates made by management. <p>We assessed whether the related disclosures in the consolidated financial statements are appropriate.</p>



Valuation of investment in AliExpress Russia Holding PTE.LTD ("AER") and net fair value of the investee's identifiable assets and liabilities

Please refer to the Note 3.4 in the consolidated financial statements.

The key audit matter	How the matter was addressed in our audit
<p>In October 2019, the Group completed a transaction to exchange 9.97% of shares in Mail.Ru Group Limited for 24.3% of shares in AER.</p> <p>The Company recognized the investment in AER at fair value.</p> <p>In accordance with the requirements of IAS 28 Investments in Associates and Joint Ventures, the Group determined the net fair value of the investee's identifiable assets and liabilities, including intangible assets representing trademarks mostly.</p> <p>Fair value measurement is a complex process involving a number of judgments and assumptions in relation to input data.</p>	<p>Our audit procedures included the following:</p> <p>We assessed professional competence of the qualified independent appraiser, which was engaged by the Group by considering the appraiser's reputation and experience based on publicly available sources.</p> <p>We involved KPMG valuation specialists to assist us in testing the appropriateness of the Group's methodology and key assumptions applied to determine the fair value of investment in AER and net fair value of the investee's identifiable assets and liabilities.</p> <p>We assessed reasonableness of approaches used by independent appraiser for calculation of fair values based on our understanding of generally accepted valuation methods.</p> <p>We evaluated the key assumptions used by the Group as follows:</p> <p>With regard to measuring the fair value of the investment:</p> <ul style="list-style-type: none"> — we compared the historical information used in the calculations with the financial statements of AER for previous periods; — we compared cross-border and local market shares and the required amount of additional investments in marketing with external market data; — we performed our own sensitivity analysis and assessed the impact of changes in key assumptions which we consider reasonably possible based on our industry knowledge. <p>With regard to measuring the fair value of the trademarks:</p> <ul style="list-style-type: none"> — we reconciled the royalty rate for trademarks, useful lives and market growth rates used in the models with external market data. <p>We assessed whether the related disclosures in the consolidated financial statements are appropriate.</p>

Impairment testing of investment in the associate DTSRetail Limited ("Svyaznoy Group")

Please refer to the Note 3.4 in the consolidated financial statements.

The key audit matter	How the matter was addressed in our audit
<p>During the reporting period indicators of impairment of the investment in DTSRetail Limited were identified, which requires investment impairment testing.</p> <p>Impairment testing is a complex process involving a number of judgments and assumptions in relation to input data. Estimation of a recoverable amount is based on a discounted cash flow model that mainly uses assumptions from internal sources.</p>	<p>Our audit procedures included the following:</p> <p>We assessed professional competence of the qualified independent appraiser, which was engaged by the Group by considering the appraiser's reputation and experience based on publicly available sources.</p> <p>We involved KPMG valuation specialists to assist us in testing the appropriateness of the Group's methodology and key assumptions applied to determine the recoverable amount of investment in DTSRetail Limited.</p> <p>We evaluated the key assumptions used by the Group in the discounted cash flow model as follows:</p> <ul style="list-style-type: none"> — we compared the historical information used in the calculations with the financial statements of Euroset and Svyaznoy Logistica (DTSRetail Limited operating companies until integration in 2019) for the previous reporting periods; — we compared the forecast revenue growth rate with the average annual historical sales level and population growth rate in the forecast period obtained from external sources; — we performed our own sensitivity analysis and assessed the impact of changes in key assumptions which we consider reasonably possible based on our industry knowledge. <p>We assessed whether the related disclosures in the consolidated financial statements are appropriate.</p>

Other Information

Management is responsible for the other information. The other information comprises the information included in the Annual Report but does not include the consolidated financial statements and our auditors' report thereon.

The Annual Report is expected to be made available to us after the date of this auditors' report.

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



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

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

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

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

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

Auditors' Responsibilities for the Audit of the Consolidated Financial Statements

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

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

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.



- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.
- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditors' report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditors' report. However, future events or conditions may cause the Group to cease to continue as a going concern.
- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.
- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

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

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

From the matters communicated with those charged with governance, we determine those matters that were of most significance in the audit of the consolidated financial statements of the current period and are therefore the key audit matters. We describe these matters in our auditors' report unless law or regulation precludes public disclosure about the matter or when, in extremely rare circumstances, we determine that a matter should not be communicated in our report because the adverse consequences of doing so would reasonably be expected to outweigh the public interest benefits of such communication.

The engagement partner on the audit resulting in this independent auditors' report is:



Yerkozha Akylbek
JSC "KPMG"
Moscow, Russia

24 March 2020

MegaFon
Consolidated income statement
(In millions of Rubles)

	Note	Years ended 31 December	
		2019	2018
Continuing operations			
Revenue	2.1	348,961	335,541
Operating expenses			
Cost of revenue		109,158	100,696
Sales and marketing expenses	2.2	20,193	19,574
General and administrative expenses	2.3	67,992	91,114
Depreciation	3.1, 3.2	68,050	49,254
Amortisation	3.3.1	20,340	16,116
Loss on disposal of non-current assets		623	337
Total operating expenses		286,356	277,091
Operating profit		62,605	58,450
Finance costs		(45,195)	(25,927)
Finance income		2,097	1,634
Share of loss of associates and joint ventures and investment impairment loss	3.4	(5,277)	(2,829)
Other non-operating expenses	5.3	(2,087)	(1,677)
(Loss)/gain on financial instruments, net	3.5.4	(1,982)	713
Foreign exchange gain/(loss), net		2,084	(1,271)
Profit before tax from continuing operations		12,245	29,093
Income tax expense	2.4	4,066	7,823
Profit from continuing operations		8,179	21,270
Discontinued operations			
Profit from discontinued operations, net of tax	5.1	—	11,584
Profit for the year		8,179	32,854
Attributable to equity holders of the Company		8,087	35,170
Attributable to non-controlling interest		92	(2,316)
		8,179	32,854

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

MegaFon

Consolidated statement of other comprehensive income

(In millions of Rubles)

	Note	Years ended 31 December	
		2019	2018
Profit for the year		8,179	32,854
Other comprehensive income that may be reclassified to profit or loss in subsequent periods:			
Foreign currency translation difference, net of tax		269	(777)
Net movement on cash flow hedges, net of tax	3.5.4	—	1,567
Net other comprehensive income that may be reclassified to profit or loss in subsequent periods		269	790
Other comprehensive income not to be reclassified to profit or loss in subsequent periods:			
Revaluation of guided media telecom channels, net of tax		57,610	—
Net other comprehensive income not to be reclassified to profit or loss in subsequent periods		57,610	—
Total comprehensive income for the year		66,058	33,644
Total comprehensive income for the year			
Attributable to equity holders of the Company		66,116	36,171
Attributable to non-controlling interest		(58)	(2,527)
		66,058	33,644

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

MegaFon

Consolidated statement of financial position

(In millions of Rubles)

		As of 31 December	
	Note	2019	2018
Assets			
Non-current assets			
Property and equipment	3.1	288,408	224,666
Right-of-use assets	3.2	85,485	—
Intangible assets, other than goodwill	3.3.1	80,845	81,026
Goodwill	3.3.2	30,549	30,549
Investments in associates and joint ventures	3.4.5.1	68,385	73,265
Non-current financial assets	3.5	15,239	3,829
Non-current non-financial assets	3.8	9,092	7,531
Deferred tax assets	2.4	848	2,064
Total non-current assets		578,851	422,930
Current assets			
Inventory	3.7	10,257	9,885
Current non-financial assets	3.8	7,432	7,766
Prepaid income taxes	2.4	3,908	4,275
Trade and other receivables	3.6	37,104	29,137
Other current financial assets	3.5	2,898	7,955
Cash and cash equivalents	3.5.1	52,706	27,214
Assets held for sale	3.9	—	847
Total current assets		114,305	87,079
Total assets		693,156	510,009
Equity and liabilities			
Equity			
Equity attributable to equity holders of the Company	4	104,956	70,667
Non-controlling interests	5.1	(307)	(264)
Total equity		104,649	70,403
Non-current liabilities			
Loans and borrowings	3.5	350,066	288,262
Other non-current financial liabilities	3.5	2,552	509
Non-current non-financial liabilities	3.8	4,000	3,895
Non-current lease liabilities	3.5	77,315	4,204
Provisions	3.10	6,380	5,117
Deferred tax liabilities	2.4	34,601	26,016
Total non-current liabilities		474,914	328,003
Current liabilities			
Trade and other payables	3.5	54,607	53,235
Loans and borrowings	3.5	25,692	39,232
Other current financial liabilities	3.5	251	84
Current non-financial liabilities	3.8	18,264	17,661
Current lease liabilities	3.5	13,584	61
Income taxes payable	2.4	1,195	1,330
Total current liabilities		113,593	111,603
Total equity and liabilities		693,156	510,009

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

MegaFon

Consolidated statement of changes in equity

(In millions of Rubles)

Note	Attributable to equity holders of the Company									
	Ordinary shares		Treasury shares		Capital surplus	Retained earnings	Other capital reserves (Note 4)	Total	Non-controlling interests	Total equity
	Number of shares	Amount	Number of shares	Amount						
As of 1 January 2018	620,000,000	526	24,299,033	(17,387)	12,567	116,596	(1,163)	111,139	55,536	166,675
Profit/(loss) for the year	—	—	—	—	—	35,170	—	35,170	(2,316)	32,854
Other comprehensive income/(loss)	—	—	—	—	—	—	1,001	1,001	(211)	790
Total comprehensive income/(loss)	—	—	—	—	—	35,170	1,001	36,171	(2,527)	33,644
Sale of share in MGL	5.1	—	—	—	—	—	57	57	(55,580)	(55,523)
Purchase of outstanding shares	4	—	—	115,317,504	(76,700)	—	—	(76,700)	—	(76,700)
Dividends to non-controlling interests	—	—	—	—	—	—	—	—	(247)	(247)
Equity-settled share-based compensation	5.2	—	—	—	—	—	—	—	2,239	2,239
Acquisition of subsidiaries	—	—	—	—	—	—	—	—	315	315
As of 31 December 2018	620,000,000	526	139,616,537	(94,087)	12,567	151,766	(105)	70,667	(264)	70,403
Profit for the year	—	—	—	—	—	8,087	—	8,087	92	8,179
Other comprehensive income/(loss)	—	—	—	—	—	—	58,029	58,029	(150)	57,879
Total comprehensive income/(loss)	—	—	—	—	—	8,087	58,029	66,116	(58)	66,058
Purchase of outstanding shares	4	—	—	131,212,843	(86,574)	—	—	(86,574)	—	(86,574)
Sale of own shares	4	—	—	(86,800,000)	58,958	—	(3,232)	55,726	—	55,726
Discount on related party loan	3.5	—	—	—	—	—	(979)	(979)	—	(979)
Acquisition of subsidiaries	—	—	—	—	—	—	—	—	15	15
As of 31 December 2019	620,000,000	526	184,029,380	(121,703)	12,567	155,642	57,924	104,956	(307)	104,649

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

MegaFon

Consolidated statement of cash flows

(In millions of Rubles)

	Note	Years ended 31 December	
		2019	2018
Operating activities			
Profit before tax from continuing operations		12,245	29,093
Profit before tax from discontinued operations	5.1	—	15,768
Profit before tax		12,245	44,861
Adjustments to reconcile profit before tax to net operating cash flows:			
Depreciation	3.1,3.2	68,050	50,553
Amortisation	3.3.1	20,340	20,869
Loss on disposal of non-current assets		623	353
Loss/(gain) on financial instruments, net	3.5.4	1,982	(1,108)
Foreign exchange (gain)/loss, net		(2,084)	965
Share of loss of associates and joint ventures and investment impairment loss	3.4	5,277	2,962
Gain on disposal of discontinued operations	5.1	—	(18,208)
Change in impairment allowance for receivables and other non-financial assets		2,566	3,602
Finance costs		45,195	25,942
Finance income		(2,097)	(1,899)
Equity-settled share-based compensation	5.2	—	2,239
Other non-cash items		—	3
Working capital adjustments:			
(Increase)/decrease in inventory		(372)	63
Increase in trade and other receivables		(10,610)	(13,137)
Increase in current non-financial assets		(1,791)	(3,554)
Increase in trade and other payables		5,438	4,027
(Decrease)/increase in current non-financial liabilities		(603)	4,478
Change in VAT, net		2,702	(4,133)
Income tax paid		(8,281)	(8,850)
Net cash flows received from operating activities		138,580	110,028
Investing activities			
Purchase of property, equipment and intangible assets	3.1,3.3	(71,127)	(79,454)
Proceeds from sale of property and equipment	3.1	253	727
Acquisition of subsidiaries, net of cash acquired	5.1,5.4	27	(8,029)
Proceeds from sale of subsidiaries, net of cash disposed	5.1	—	6,945
Purchase of interest in associates and joint ventures	3.4,5.1	(1,307)	(2,414)
Sale of associates and joint venture	3.4	1,230	—
Net change in short-term deposits		4,141	4,810
Loans granted	3.5	(15,360)	(71)
Repayments of loans granted		3,100	—
Interest received		1,545	1,747
Dividends received from equity-accounted investments		—	19
Net cash flows used in investing activities		(77,498)	(75,720)
Financing activities			
Proceeds from loans and borrowings, net of fees paid		265,524	124,987
Repayment of loans and borrowings		(214,204)	(70,370)
Interest paid		(43,525)	(25,989)
Purchase of outstanding shares	4	(86,574)	(76,700)
Dividends paid to non-controlling interests		—	(247)
Sale of own shares	4	55,726	—
Lease payments		(11,864)	(8)
Net cash flows used in financing activities		(34,917)	(48,327)
Net increase/(decrease) in cash and cash equivalents		26,165	(14,019)
Net foreign exchange difference		(673)	5,086
Cash and cash equivalents at beginning of year		27,214	36,147
Cash and cash equivalents at end of year	3.5.1	52,706	27,214

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

MegaFon

Notes to the consolidated financial statements

1. GENERAL

1.1. About the Company

Public Joint Stock Company MegaFon (“MegaFon”, the “Company” and, together with its consolidated subsidiaries, the “Group”) is a company incorporated under the laws of the Russian Federation and registered in the Unified State Register of Legal Entities under number 1027809169585. Its registered office is at 41 Oruzheyniy lane, Moscow, 127006, Russian Federation.

MegaFon is a leading pan-Russian operator of digital opportunities and offers a broad range of telecommunication and digital services to retail customers, businesses, government clients and telecommunication services providers.

As of 31 December 2019, the majority shareholder of the Company is AF Telecom Holding LLC, a company incorporated in the Russian Federation. The ultimate controlling party is USM Holding Company LLC, a company incorporated in the Russian Federation, which is controlled by a group of individuals, none of whom acting alone has the power to direct the activities of the Group at his own discretion and for his own benefit.

1.2. Basis of preparation

These consolidated financial statements have been prepared in accordance with International Financial Reporting Standards (“IFRS”) as issued by the International Accounting Standards Board (“IASB”).

The consolidated financial statements have been prepared on a historical cost basis, unless disclosed otherwise. The consolidated financial statements are presented in millions of Rubles.

The consolidated financial statements were authorised for issue by the Company’s Chief Executive Officer (“CEO”) and Chief Accountant on 24 March 2020.

Foreign currency translation

The Group’s consolidated financial statements are presented in Rubles, which is also the functional currency of MegaFon and its principal subsidiaries.

The functional currency of CJSC “TT mobile”, the Company’s 75% owned subsidiary in Tajikistan, is the US dollar as a majority of its revenues, costs, property and equipment purchases, debt and trade liabilities is either priced, incurred, payable or otherwise measured in US dollars.

Foreign currency transactions are translated into the functional currency using the exchange rates prevailing at the dates of the transactions or fair value measurement where items are re-measured to their fair value. Foreign exchange gains and losses resulting from the settlement of such transactions and from the translation at year-end exchange rates of monetary assets and liabilities denominated in foreign currencies are recognised in the ‘Foreign exchange gain/(loss), net’ line in profit or loss.

Notes to the consolidated financial statements (continued)

1.2. Basis of preparation (continued)

The assets and liabilities of foreign operations are translated into Rubles at the rate of exchange prevailing on the reporting date and the income and expenses are translated at the exchange rates prevailing on the dates of the transactions. The exchange differences arising on the translation are recognised in other comprehensive income (“OCI”).

1.3. Basis of consolidation

The consolidated financial statements comprise the financial statements of the Company and its subsidiaries as of 31 December 2019.

Subsidiaries are consolidated from the date of acquisition, being the date on which the Group obtains control, and continue to be consolidated until the date when such control ceases. The financial statements of the subsidiaries are prepared for the same reporting period as the parent company, using consistent accounting policies.

Profit or loss and each component of OCI are attributed to the equity holders of the Company and to the non-controlling interests (“NCI”), even if this results in the NCI having a deficit balance.

All intra-group assets and liabilities, equity, income, expenses and cash flows relating to transactions between members of the Group are eliminated in full on consolidation.

1.4. Significant accounting judgments, estimates and assumptions

The preparation of these consolidated financial statements required management to make judgments, estimates and assumptions that affect the amounts reported in the consolidated statement of financial position, the consolidated income statement, the consolidated statement of other comprehensive income and the accompanying disclosures. Subsequent revisions or corrections made to these judgments, estimates and assumptions hereafter could result in outcomes that require a material adjustment to the carrying amount of affected assets or liabilities in future periods.

In the process of applying the Group’s accounting policies, management has made various judgments. Those which management has assessed to have the most significant effect on the amounts recognised in the consolidated financial statements have been discussed in the individual notes for the related financial statement line items: revenue, income taxes, property and equipment, intangible assets, investments in associates and joint ventures, leases, financial assets and liabilities, provisions, and business combinations.

The key assumptions concerning the future and other key estimates made at the reporting date that, if not substantiated, have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are also described in the individual notes for the related financial statement line items below. The Group based its assumptions and estimates on the information available to it when the consolidated financial statements were prepared. Existing circumstances and assumptions about future developments, however, may change due to market changes or circumstances arising that are beyond the control of the Group. Such changes are reflected in the assumptions when they occur.

Notes to the consolidated financial statements (continued)

1.5. Significant accounting policies

The significant accounting policies have been discussed in the individual notes for the related financial statement line items.

Changes in accounting policies and disclosures

On 31 December 2019 the Group changed its accounting policy for measuring the guided media telecom channels and similar assets from cost model to revaluation model (*Note 3.1*).

During 2019 the Group applied the following amendments to accounting standards for the first time (a number of other new standards are effective from 1 January 2019 but they do not have an effect on the Group's consolidated financial statements):

IFRS 16 Leases

In January 2016, the IASB issued IFRS 16, *Leases*, which sets out the principles for the recognition, measurement, presentation and disclosure of leases and replaces previous guidance on leases. The standard requires lessees to present right-of-use assets ("ROU assets") and lease liabilities on the balance sheet for all leases (with limited exceptions).

The Group has applied IFRS 16 using the modified retrospective transition method without restating comparative amounts. The cumulative effect of the initial application of IFRS 16 on the Group's retained earnings at 1 January 2019 is nil. On transition to IFRS 16 the Group recognised 88,651 of ROU assets and lease liabilities at 1 January 2019. New accounting policies and more details on the impact of the adoption of IFRS 16 have been disclosed in *Note 3.2*.

1.6. Standards issued but not yet effective

The standards and interpretations that are issued and applicable to the Group, but not yet effective as of the date of issuance of the Group's consolidated financial statements, are disclosed below. The Group intends to adopt these standards when they become effective.

IFRS 17 «Insurance Contracts»

In May 2017 the IASB issued IFRS 17, *Insurance Contracts*, which establishes principles for the recognition, measurement, presentation and disclosure of insurance contracts issued. The new standard will replace IFRS 4 and is effective for annual periods beginning on or after 1 January 2021. The Group does not expect the standard to have a material impact on the Group's consolidated financial statements.

Conceptual Framework for Financial Reporting

In March 2018 the IASB issued a comprehensive set of concepts for financial reporting replacing the previous version of the Conceptual Framework. The revised Conceptual Framework will be effective from 1 January 2020 – with earlier application permitted – for companies that use it to develop accounting policies when no IFRS Standard applies to a particular transaction. The Group will apply the revised Conceptual Framework from the effective date and does not expect it to have a material impact on the Group's consolidated financial statements.

MegaFon

Notes to the consolidated financial statements (continued)

1.6. Standards issued but not yet effective (continued)

Definition of a Business (Amendments to IFRS 3)

In October 2018 the IASB issued Amendments to IFRS 3, *Business combinations*, clarifying the current definition of a business to enable entities to determine whether a transaction is a business combination or an asset acquisition.

The Amendments are effective for annual periods beginning on or after 1 January 2020. The Group does not expect these amendments to have a material impact on the Group's consolidated financial statements.

Definition of Material (Amendments to IAS 1 and IAS 8)

In October 2018 the IASB issued a clarified definition of "material" in the amendments to IAS 1, *Presentation of Financial Statements*, and IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, and issued practical guidance on applying the concept of materiality. The Amendments will be effective for annual periods beginning on or after 1 January 2020 with earlier implementation permitted. The Group will apply these Amendments from the effective date and does not expect them to have a material impact on the Group's consolidated financial statements.

Notes to the consolidated financial statements (continued)

2. INCOME STATEMENT

2.1. Revenue

Accounting policies

Revenue is measured based on the consideration specified in a contract with a customer and represents amounts receivable for the sale of goods or services in the ordinary course of the Group's activities, net of value added taxes, returns and discounts.

Revenue is recognised when (or as) the Group satisfies a performance obligation by transferring a promised good or service to a customer (which is when the customer obtains control of that good or service). Upfront payments received for connection of new customers and installation of infrastructure connection services are deferred and recognised over the estimated average customer contract life.

Service revenue

Service revenue is generally recognised when the services are rendered.

The revenue from provision of content and other services is presented net of related costs when the Group acts as an agent of the service providers while gross revenues and related costs are recorded when the Group is the primary obligor in the arrangement. The reporting of revenue on a net versus gross basis, depending on an analysis of the Group's involvement as either principal or agent, involves management judgment.

Wireless revenue

The Group earns wireless revenues for usage of its cellular system, which include airtime charges from contract and prepaid subscribers, monthly contract fees, interconnect fees from other wireless and wireline operators, roaming charges, data transfer charges, and charges for value added services ("VAS").

Interconnect revenue includes revenues from wireless and wireline operators that was earned from terminating traffic from other operators. Roaming revenues include revenues from customers who roam outside their selected home coverage area and revenues from other mobile carriers for roaming by their customers using the network of the Group.

VAS include SMS, provision of content and media and commissions for mobile payments.

(a) Loyalty programme

The Group operates a loyalty programme which allows customers to accumulate cashback awards for usage of the Group's cellular network. The awards can then be redeemed by applying the accumulated cashback to payments for services, goods or partner products. The portion of consideration received is allocated to the awards based on their relative standalone selling price which is the cash value and deferred until the award credits are redeemed or expire. The Group estimates the standalone selling price of awards by making assumptions about expected redemption rates and customer preferences.

MegaFon

Notes to the consolidated financial statements (continued)

2.1. Revenue (continued)

(b) Multiple element arrangements

The Group enters into multiple element arrangements in which a customer may purchase a combination of equipment (e.g. handsets) and telecommunication services (e.g. airtime, data, and other services). The Group allocates consideration received from subscribers to the separate performance obligations based on their standalone selling prices. Revenue allocated to the delivered equipment and related costs are recognised in the accompanying consolidated income statement at the time of sale provided that other conditions for revenue recognition are met. Amounts allocated to telecommunication services are deferred and recognised as revenue over the period of rendering the services. Allocation of each separable component of a bundled offer based on the individual components' standalone selling prices involves estimates and management's judgment.

(c) Roaming rebates

The Group enters into roaming discount agreements with a number of wireless operators. According to the agreements the Group is committed to provide and entitled to receive a discount that is generally dependent on the volume of roaming traffic generated by the respective subscribers. The Group uses actual traffic data to estimate the amounts of rebates to be received or granted. Such estimates are adjusted and updated on a regular basis. The Group accounts for discounts received as a reduction of roaming expenses and rebates granted as a reduction of roaming revenue.

The Group takes into account the terms of the various roaming discount agreements in order to determine the appropriate presentation of the amounts receivable from and payable to its roaming partners in its consolidated statement of financial position. Amounts of rebates earned from and given to roaming partners are included in trade and other receivables and payables, respectively, in the accompanying consolidated statement of financial position.

Management has to make estimates relating to revenue recognition, relying to some extent on information from other operators on the values of services delivered. Management also makes estimates of the final outcome in instances where the other parties dispute the amounts charged.

Wireline revenue

The Group earns wireline revenues for usage of its fixed-line network, which include payments from individual, corporate and government subscribers for local and long-distance telecommunications and data transfer services. Charges are based upon usage (e.g., minutes of traffic processed), period of time (e.g., monthly service fees) or other established fee schedules. Wireline revenues also include interconnection charges from wireless and wireline operators for terminating calls on the Group's wireline networks. Revenue from service contracts is recognised when the services are rendered. Billings received in advance of service being rendered are deferred and recognised as revenue as the service is rendered.

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Notes to the consolidated financial statements (continued)

2.1. Revenue (continued)

Construction contracts revenue

The Group has contracts with customers for installation of network equipment for a fixed fee, which cannot exceed the costs incurred plus a certain margin. Revenue under the contracts is recognised over time, for example by reference to the stage of completion as defined in the contract and accepted by the customer, when any of the criteria for transferring control of a good or service over time are met, including the Group's having an enforceable right to payment for performance completed to date. Otherwise, revenue is recognised at a point in time when control of the good or service has been transferred to the customer. An expected loss on a contract is recognised immediately in profit or loss.

Sales of equipment and accessories

Revenue from the sale of equipment and accessories is recognised when the customer obtains control of the goods, usually on their delivery.

Disclosures

As at 31 December 2019, the Group had 19,865 (2018: 20,846) of receivables and nil contract assets from contracts with customers included in trade and other receivables.

As at 31 December 2019, the Group had 12,786 (2018: 13,847) of contract liabilities from contracts with customers included in current non-financial liabilities and 3,915 (2018: 3,777) of contract liabilities included in non-current non-financial liabilities. The contract liabilities decreased since last year mainly as a result of the Group's increasing the share of post-paid products in 2019. The contract liabilities included in non-current financial liabilities as at 31 December 2019 primarily relate to deferred upfront fees for infrastructure services. These are expected to be recognised as revenue over a term of ten years which is the average contract term.

The amount of 13,847 recognised in contract liabilities at the beginning of the year has been recognised as revenue for the year ended 31 December 2019.

The Group used the practical expedient in IFRS 15 and did not disclose the information about its unsatisfied performance obligations for contracts that have an original expected duration of one year or less.

2.2. Sales and marketing expenses

Dealer commissions for connection of new subscribers which represent incremental costs of obtaining a customer contract are deferred and recognised in sales and marketing expenses over the expected contract term. Other dealer commissions are expensed as incurred.

As at 31 December 2019, the Group had 5,848 (2018: 4,617) of deferred customer acquisition costs included in non-current non-financial assets. The amount of costs amortised into sales and marketing expenses for the year ended 31 December 2019 is 6,359 (2018: 5,552).

Advertising costs are expensed as incurred.

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Notes to the consolidated financial statements (continued)

2.3. General and administrative expenses

Included in general and administrative expenses for the years ended 31 December are:

	<u>2019</u>	<u>2018</u>
Employee benefits and related social charges	34,347	34,125

State pension funds

The Group contributes to local state pension funds and social funds on behalf of its employees. The contributions are expensed as incurred. Contributions for the years ended 31 December 2019 and 2018 were 7,059 and 6,559 respectively.

2.4. Income taxes

Accounting policies

Current income tax

The tax expense for the year comprises current and deferred tax. Tax is recognised in profit or loss, except to the extent that it relates to items recognised in OCI or directly in equity. In this case, the tax is recognised in OCI or directly in equity, respectively.

The current income tax is calculated on the basis of the tax laws enacted or substantively enacted at the reporting date in the countries in which the Company and its subsidiaries operate and generate taxable income. Management periodically evaluates positions taken in tax returns with respect to situations in which the applicable tax regulation is subject to interpretation. If the applicable tax regulation is subject to interpretation, the Company establishes a provision where appropriate on the basis of amounts expected to be paid to the tax authorities.

Deferred income tax

Deferred income tax is recognised using the liability method, on temporary differences arising between the tax bases of assets and liabilities and their carrying amounts in the financial statements. However, deferred income tax is not accounted for if it arises from initial recognition of an asset or liability in a transaction other than a business combination that at the time of the transaction affects neither accounting nor taxable profit or loss. Deferred income tax is determined using tax rates and laws that have been enacted or substantively enacted at the reporting date and are expected to apply when the related deferred income tax asset is realised or the deferred income tax liability is settled.

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Notes to the consolidated financial statements (continued)

2.4. Income tax (continued)

Deferred income tax assets are recognised only to the extent that it is probable that future taxable profit will be available against which the temporary differences can be utilised. Deferred income tax is provided on temporary differences arising on investments in subsidiaries and associates, except for deferred income tax liability where the timing of the reversal of the temporary difference is controlled by the Group and it is probable that the temporary difference will not reverse in the foreseeable future.

Significant estimates

The Group assesses the recoverability of deferred tax assets based on estimates of future earnings.

Actual Group income tax receipts and payments could differ from the estimates made by the Group as a result of changes in tax legislation or unforeseen transactions that could affect tax balances. The expected resolution of uncertain tax positions is based upon management's judgment of the likelihood of sustaining a position taken through tax audits, tax courts and/or arbitration, if necessary. Circumstances and interpretations of the amount due or likelihood of a position being sustained may change during the settlement process.

Disclosures

The following presents the significant components of the Group's income tax expense for the years ended 31 December:

	<u>2019</u>	<u>2018</u>
Current income tax:		
Current income tax charge	8,197	5,762
Adjustments recognised for current tax of prior periods	429	631
Deferred tax	(4,560)	1,430
Income tax expense	<u>4,066</u>	<u>7,823</u>

The reconciliation between the average effective income tax rate and tax expense calculated at domestic statutory rates applicable to individual Group entities is as follows:

	<u>2019</u>	<u>2018</u>
Statutory income tax rate	20.0%	20.0%
Non-deductible expenses	12.1%	6.9%
Svyaznoy group impairment	3.7%	—
Effect of intra-group transactions	—	0.5%
Effect of income tax preferences	(0.9%)	(0.3%)
Sale of own shares	(2.1%)	—
Other	0.4%	(0.2%)
Effective income tax rate	<u>33.2%</u>	<u>26.9%</u>

The effect of intragroup transactions, in the table above, represents taxable intra-group income.

MegaFon

Notes to the consolidated financial statements (continued)

2.4. Income tax (continued)

Deferred tax relates to the following:

	Statement of financial position as of 31 December		Income statement for the years	
	2019	2018	2019	2018
Property and equipment	(24,286)	(10,718)	(793)	(5,380)
Intangible assets	(14,867)	(14,892)	(25)	(4,072)
Derivative financial instruments	316	(59)	(375)	829
Investments in associates and subsidiaries	461	(3,067)	(3,528)	5,751
Tax loss carry-forwards	1,368	2,605	1,237	1,404
Revenue recognition	1,772	2,059	287	734
Accrued employee benefits	383	846	463	433
Accrued expenses	1,168	1,181	13	323
Dealers' commissions	(1,181)	(929)	252	588
Leases	1,083	—	(1,083)	—
Other movements and temporary differences	30	(978)	(1,008)	820
Deferred tax (income)/expense			(4,560)	1,430
Net deferred tax liabilities	(33,753)	(23,952)		
Reflected in the consolidated statement of financial position as follows:				
Deferred tax assets	848	2,064		
Deferred tax liabilities	(34,601)	(26,016)		

The Group recognises deferred tax assets in respect of tax loss carry-forwards to the extent that realisation of tax losses against future taxable profit is probable. Deferred tax assets related to tax losses of the Group's subsidiaries are recognised based on the tax planning opportunities that would be implemented, if necessary, to prevent tax losses from not being used.

Deferred tax assets in respect of the tax losses are attributable to the following subsidiaries:

	2019	2018
Scartel	283	1,299
MegaFon Retail	912	1,181
Other	173	125
Balance at end of year	1,368	2,605

In order to utilise tax losses the Group is able to implement appropriate tax planning strategies depending on the results of these subsidiaries in subsequent periods. The tax planning strategies may include, among others, merging of the respective subsidiaries with MegaFon which is expected to have sufficient pretax income to utilise the accumulated tax losses of these subsidiaries.

Unrecognised deferred tax assets in the consolidated statement of financial position amounted to 3,859 as of 31 December 2019 (2018: 3,983). Unrecognised deferred tax assets arose on the acquisition of subsidiaries and associates due to the difference between the accounting and tax bases of the subsidiaries and associates acquired and are not expected to be realised due to lack of appropriate taxable profits.

MegaFon

Notes to the consolidated financial statements (continued)

2.4. Income tax (continued)

Reconciliation of net deferred tax liabilities for the years ended 31 December is as follows:

	2019	2018
Balance at beginning of year	23,952	24,963
Tax (benefit)/expense during the year	(4,560)	1,430
Revaluation (<i>Note 3.1</i>)	14,403	—
Translation adjustment of foreign operations	(42)	48
Discontinued operations	—	(3,222)
Change of accounting policy	—	341
Deferred tax on cash flow hedges in OCI (<i>Note 3.5</i>)	—	392
Balance at end of year	33,753	23,952

Notes to the consolidated financial statements (continued)

3. ASSETS AND LIABILITIES**3.1. Property and equipment***Accounting policies*

Property and equipment is stated at cost, less accumulated depreciation and impairment, if any, except for the guided media telecom channels and similar assets which are stated at revalued amounts starting from 31 December 2019. Cost includes all costs directly attributable to bringing the asset to the location and condition for its intended use. Depreciation is recorded on a straight-line basis over the estimated useful life of the asset.

Depreciation expenses are based on management's estimates of residual value, the depreciation method used and the useful lives of property and equipment. Estimates may change due to technological developments, competition, changes in market conditions and other factors, and may result in changes in estimated useful lives and depreciation charges. The actual economic lives of long-lived assets may be different from the estimated useful lives. A change in estimated useful lives is accounted for prospectively as a change in accounting estimate.

The estimated useful lives are as follows:

Telecommunications network	3 to 20 years
Guided media telecom channels	20 to 33 years
Buildings and structures	7 to 50 years
Vehicles, office and other equipment	3 to 7 years

The assets' residual values, useful lives and depreciation methods are reviewed, and adjusted if appropriate, at each reporting date. The useful lives of certain assets were revised with effect from 1 January 2020, see *Note 5.9*.

Repair and maintenance costs are expensed as incurred. The cost of major renovations and other subsequent expenditure is included in the carrying amount of the asset or recognised as a separate asset, as appropriate, only when it is probable that future economic benefits associated with the item will flow to the Group and the cost of the item can be measured reliably.

The present value of the expected cost for the decommissioning of an asset after its use is included in the cost of the respective asset. Please refer to *Note 3.10* for further information about the provision for decommissioning liabilities.

At the time of retirement or other disposition of property or equipment, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is recorded in consolidated income statement.

The Group plans, develops and uses telecommunication networks, jointly with other operators. These activities are accounted for as joint operations. Accordingly, the Group records its share of the jointly held assets and its share of the jointly incurred expenses.

MegaFon

Notes to the consolidated financial statements (continued)

3.1. Property and equipment (continued)

Starting from 31 December 2019 the Group decided to change its accounting policy so as to measure guided media telecom channels and similar assets at revalued amounts, because they more faithfully depict the value of this group of assets which were found to be significantly undervalued considering the nature of the assets, their resilience to technological changes and their long-term economic lives. The valuation of the assets was carried out as of 31 December 2019 by an independent valuer.

The guided media telecom channels and similar assets are initially measured at cost and subsequently carried at their revalued amount, being the fair value at the date of the revaluation less subsequent accumulated depreciation and impairment losses, if any. Revaluation is to be performed every 3-5 years or more often if necessary to ensure that the carrying amount does not differ significantly from fair value.

The revaluation surplus in the amount of 57,610, net of tax, was recognised in OCI, and a revaluation decrease in the amount of 165 was recognised in the consolidated income statement within 'Depreciation'.

The revaluation surplus included in equity will be transferred directly to retained earnings when the respective asset is disposed of.

As there is no active market for the guided media telecom channels and similar assets, the Group derived the fair value of the assets using a cost approach. The cost approach uses data from internal information sources and the results of analytical reviews of the Russian market for similar assets. Market data was obtained from various published sources, such as catalogues, statistical reports, etc., as well as from suppliers of similar assets in Russia.

The key assumptions used are the useful lives of the assets ranging from 20 to 30 years, cost of one kilometer of fiber-optic lines construction based on the Group's tender offers ranging from 335 to 880 thousand Rubles, construction prices and real estate prices published by Rosstat – the Russian statistical agency, construction prices for fiber optic cables published by the U.S. Bureau of Labor Statistics, and the Ruble/US dollar exchange rate published by the Central Bank of Russia.

Sensitivity to changes in key assumptions

The following reasonably possible changes in the key assumptions made independently, with all other assumptions constant, would result in the following changes in the revalued amount:

Key assumption	Change in key assumption	Change in the revalued amount
Change in useful life by, years	+1/-1	+3,200/(3,500)
Change in fiber optic cable construction cost per 1 km by	+1%/-1%	+0.77%/(0.77%)
Change in construction prices by	+1%/-1%	+0.38%/(0.38%)
Change in real estate prices by	+1%/-1%	+0.26%/(0.26%)
Change in fiber optic cable construction prices by	+1%/-1%	+0.26%/(0.26%)
Change in Ruble/US dollar exchange rate by	+1%/-1%	+0.26%/(0.26%)

Notes to the consolidated financial statements (continued)

3.1. Property and equipment (continued)

Capitalised borrowing costs

Borrowing costs directly attributable to the acquisition, construction or production of a qualifying asset during the construction phase that necessarily takes a substantial period of time are capitalised as part of property and equipment until the asset is ready for use. All other borrowing costs are expensed in the period in which they occur. Borrowing costs consist of interest, related foreign exchange differences, and other costs that the Group incurs in connection with the borrowing of funds.

Impairment

The Group tests long-lived assets, other than goodwill, for impairment when circumstances indicate there may be a potential impairment.

An impairment loss is recognised in the amount by which the asset's carrying amount exceeds its recoverable amount. The recoverable amount is the higher of (1) an asset's fair value less costs to sell and (2) value in use. The recoverable amount is determined for each individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. Impairment losses relating to continuing operations are recognised in profit or loss in the expense categories which are consistent with the function of the impaired asset.

For assets other than goodwill, an assessment is made at each reporting date to determine whether there is an indication that previously recognised impairment losses no longer exist or have decreased. If such indication exists, the Group estimates the asset's recoverable amount. A previously recognised impairment loss is reversed only if there has been a change in the assumptions used to determine the asset's recoverable amount since the last impairment loss was recognised. The reversal is limited so that the carrying amount of the asset does not exceed its recoverable amount, nor exceed the carrying amount that would have been determined, net of depreciation, had no impairment loss been recognised for the asset in prior years. Such reversal is recognised in profit or loss.

Estimating recoverable amounts of assets is based on management's evaluations, including estimates of applicable market rates, if the market approach is used, or future cash flows, discount rates, terminal growth rates, and assumptions about future market conditions, if the income approach is used.

Assets held for sale

Non-current assets are classified as assets held for sale ("AHFS") and stated at the lower of carrying amount and fair value less costs to sell if their carrying amount is to be recovered principally through a sale transaction rather than through continuing use and the sale is considered highly probable.

MegaFon

Notes to the consolidated financial statements (continued)

3.1. Property and equipment (continued)

Disclosures

Property and equipment is as follows:

	Telecom- munications network	Buildings and structures	Vehicles, office and other equipment	Guided media telecom channels	Construction in-progress	Total
Cost as of						
1 January 2018	384,505	68,433	26,614	78,216	19,731	577,499
Additions	—	—	—	—	59,702	59,702
Acquisitions (Note 5.4)	—	—	5	—	694	699
Disposals	(11,981)	(394)	(1,458)	(291)	(14)	(14,138)
Put into use	39,321	2,353	2,667	1,956	(46,297)	—
Discontinued operations (Note 5.1)	(6,145)	(1,400)	(433)	—	(1,140)	(9,118)
Reclassified to AHFS	—	—	(16)	—	—	(16)
Translation	1,656	532	779	—	65	3,032
31 December 2018	407,356	69,524	28,158	79,881	32,741	617,660
Additions	—	—	—	—	46,962	46,962
Disposals	(16,516)	(398)	(1,855)	(234)	(21)	(19,024)
Put into use	47,231	1,495	2,647	2,047	(53,420)	—
Reclassifications	(3)	(3)	(342)	330	18	—
Reclassified to ROUA (Note 3.2)	—	(4,017)	—	—	—	(4,017)
Revaluation	—	—	—	105,608	—	105,608
Revision of estimated provision (Note 3.10)	—	927	—	—	—	927
Translation	(912)	(255)	(345)	—	(104)	(1,616)
31 December 2019	437,156	67,273	28,263	187,632	26,176	746,500
Depreciation as of						
1 January 2018	(268,928)	(35,003)	(23,133)	(29,730)	—	(356,794)
Charge for the year	(39,405)	(4,454)	(2,225)	(4,469)	—	(50,553)
Disposals	11,855	263	1,411	149	—	13,678
Discontinued operations (Note 5.1)	2,601	248	150	—	—	2,999
Reclassified to AHFS	—	—	3	—	—	3
Translation	(1,416)	(312)	(599)	—	—	(2,327)
31 December 2018	(295,293)	(39,258)	(24,393)	(34,050)	—	(392,994)
Charge for the year	(41,149)	(3,762)	(2,543)	(4,217)	—	(51,671)
Disposals	16,112	283	1,808	133	—	18,336
Reclassifications	(21)	1	355	(335)	—	—
Reclassified to ROUA (Note 3.2)	—	855	—	—	—	855
Revaluation	—	—	—	(33,760)	—	(33,760)
Translation	683	157	302	—	—	1,142
31 December 2019	(319,668)	(41,724)	(24,471)	(72,229)	—	(458,092)
Net book value:						
31 December 2018	112,063	30,266	3,765	45,831	32,741	224,666
31 December 2019	117,488	25,549	3,792	115,403	26,176	288,408

Notes to the consolidated financial statements (continued)

3.1. Property and equipment (continued)

Included in construction in-progress are advances to suppliers of network equipment of 978 and 1,607 as at 31 December 2019 and 2018, respectively.

Capitalised borrowing costs

Capitalised borrowing costs were 1,201 and 1,889 for the years ended 31 December 2019 and 2018, respectively. The rate used to determine the amount of borrowing costs eligible for capitalisation was 8.9% and 9.3% for the years ended 31 December 2019 and 2018, respectively.

3.2. Leases

Accounting policies

Previously, the Group recognised operating lease expense on a straight-line basis over the term of the lease, and recognised assets and liabilities only to the extent that there was a timing difference between actual lease payments and the expense recognised.

On transition to IFRS 16, for leases which were previously classified as operating leases and which have now been identified as leases under IFRS 16 (because they convey a right to control the use of an identified asset for a period of time in exchange for consideration), the Group calculated lease liabilities as at 1 January 2019, and then as at the commencement of each new lease, using the present value of the remaining lease payments for the remaining lease term, discounted at the Group's incremental borrowing rate.

The weighted-average discount rate at 1 January 2019 is 10.5%. The discount rates were estimated based on incremental borrowing rates, i.e. the rates of the Group's borrowings with similar terms as the leases.

Simultaneously, the Group recognised the ROU assets in the amount of the lease liabilities increased by any lease prepayments and, in case of new leases which commenced after 1 January 2019, also increased by initial direct costs.

The Group has applied judgment to determine the lease term for the contracts that contain renewal or termination options. The assessment of whether the contract contains such an option and whether the Group is reasonably certain to exercise such an option takes into account various factors, including technology development expectations, costs to terminate the lease, economic factors, and also the Group's historical experience.

The nature of expenses related to those leases has changed because the Group is now recognising a depreciation charge for ROU assets and interest expense on lease liabilities recorded in the 'Depreciation' and 'Finance costs' lines of the consolidated income statement, respectively.

The Group used the following practical expedients when applying IFRS 16 to leases previously classified as operating leases where the Group acts as a lessee:

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Notes to the consolidated financial statements (continued)

3.2. Leases (continued)

- applying a single discount rate to a portfolio of leases with reasonably similar characteristics;
- relying on the assessment of whether leases are onerous by applying IAS 37, *Provisions, contingent liabilities and contingent assets*, immediately before the date of the initial application as an alternative to performing an impairment review;
- excluding initial direct costs from the measurement of the ROU assets at the date of initial application; and
- using hindsight, for example, in determining the lease term if the contract contains options to extend or terminate the lease.

Disclosures

IFRS 16 impacts

The adoption of IFRS 16 did not have a significant impact on the Group's accounting for leases which were previously classified as finance leases, neither did it have a significant impact on those leases where the Group acts as a lessor. As at 1 January 2019 the Group reclassified 3,162 of assets relating to its former finance leases from property and equipment to ROU assets.

The reconciliation between operating lease commitments disclosed at the end of the 2018 financial year and lease liabilities recognised in the statement of financial position at the date of initial application is as follows:

	<u>1 January 2019</u>
Operating lease commitments at 31 December 2018 as reported	29,286
Operating lease commitments discounted at 1 January 2019	23,544
Finance lease liabilities recognised as at 31 December 2018	4,265
Extension options reasonably certain to be exercised	65,107
Lease liabilities recognised at 1 January 2019	<u>92,916</u>

The Group, where it acts as a lessee, has recognised the following assets and their depreciation expense for its leases:

	Lease term, years	ROU assets as of 31 December 2019	ROU depreciation expense for the year ended 31 December 2019
Telecommunication infrastructure	2-14	67,133	10,116
Retail outlets	2-5	8,756	4,342
Administrative premises	2-7	9,596	1,921
Total		<u>85,485</u>	<u>16,379</u>

For the year ended 31 December 2018 finance lease assets depreciation expense amounted to 268. During the year ended 31 December 2019 the Group recognised 9,664 (2018: 477) of interest costs from leases. Total additions to ROU assets and total cash outflow for leases for the year ended 31 December 2019 amounted to 13,405 and 21,506, respectively.

Notes to the consolidated financial statements (continued)

3.3. Intangible assets**3.3.1. Intangible assets, other than goodwill***Accounting policies*

Intangible assets acquired separately are measured on initial recognition at cost. The cost of intangible assets acquired in a business combination is their fair value as of the date of acquisition. Following initial recognition, intangible assets are carried at cost less accumulated amortisation and impairment, if any. Intangible assets consist principally of operating licences, frequencies, customer base and software.

Software development activities involve a plan or design for the production of new or substantially improved products and processes. Development expenditure is capitalised only if development costs can be measured reliably, the product or process is technically and commercially feasible, future economic benefits are probable, and the Group intends to and has sufficient resources to complete development and to use or sell the asset.

The useful lives of intangible assets are assessed as either finite or indefinite. The Group does not have intangible assets with indefinite useful lives, other than goodwill.

All intangible assets are amortised on a straight-line basis over the following estimated useful lives:

Operating licences and frequencies	10 to 20 years
Customer base	3 to 19 years
Trademarks and patents	7 to 20 years
Other software	1 to 5 years
Other intangible assets	1 to 10 years

Amortisation expenses are based on management's judgment as to the amortisation method to be used and its estimates of the useful lives of the intangible assets. Estimates may change due to technological developments, competition, changes in market conditions and other factors, and may result in changes in estimated useful lives and amortisation charges. Critical estimates of useful lives of intangible assets are impacted by estimates of average customer relationship based on churn, remaining licence periods and expected developments in technology and markets. The actual economic lives of the assets may be different from the estimated useful lives. A change in estimated useful lives is accounted for prospectively as a change in accounting estimate.

Impairment

Assets that are subject to amortisation are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. See *Note 3.1* for further description of the accounting policies for impairment testing of non-financial assets.

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Notes to the consolidated financial statements (continued)

3.3. Intangible assets (continued)

Disclosures

Intangible assets, other than goodwill, are as follows:

	Operating licences and frequencies	Customer base	Trademarks and patents	Games	Other software	Other intangible assets	Total
Cost as of							
1 January 2018	80,943	26,489	23,208	13,507	55,299	10,860	210,306
Additions	1,407	118	725	1,413	20,604	74	24,341
Acquisitions (Note 5.4)	—	—	—	—	416	2,073	2,489
Disposals	(535)	(162)	(35)	(36)	(4,334)	(259)	(5,361)
Discontinued operations (Note 5.1)	—	(22,402)	(23,178)	(15,171)	(4,586)	(2,061)	(67,398)
Reclassified to AHFS (Note 3.9)	—	—	—	—	(462)	—	(462)
Translation	75	—	—	287	—	101	463
31 December 2018	81,890	4,043	720	—	66,937	10,788	164,378
Additions	1,222	—	473	—	17,006	1,935	20,636
Disposals	(369)	—	(100)	—	(5,869)	(2,130)	(8,468)
Translation	(32)	—	—	—	—	12	(20)
31 December 2019	82,711	4,043	1,093	—	78,074	10,605	176,526
Amortisation as of							
1 January 2018	(32,674)	(6,467)	(2,843)	(2,321)	(34,013)	(3,848)	(82,166)
Charge for the year	(4,414)	(1,919)	(1,196)	(1,062)	(11,502)	(776)	(20,869)
Disposals	467	162	35	27	4,318	259	5,268
Discontinued operations (Note 5.1)	—	4,971	3,350	3,479	2,130	628	14,558
Reclassified to AHFS (Note 3.9)	—	—	—	—	83	—	83
Translation	(11)	—	—	(123)	—	(92)	(226)
31 December 2018	(36,632)	(3,253)	(654)	—	(38,984)	(3,829)	(83,352)
Charge for the year	(4,339)	(222)	(270)	—	(14,427)	(1,082)	(20,340)
Disposals	244	—	86	—	5,851	1,810	7,991
Translation	32	—	—	—	—	(12)	20
31 December 2019	(40,695)	(3,475)	(838)	—	(47,560)	(3,113)	(95,681)
Net book value:							
31 December 2018	45,258	790	66	—	27,953	6,959	81,026
31 December 2019	42,016	568	255	—	30,514	7,492	80,845
Weighted-average remaining amortisation period, years	10	3	1	—	2	7	4

Operating licences and frequencies provide the Group with the exclusive right to utilise certain radio frequency spectrum to provide wireless communication services.

Notes to the consolidated financial statements (continued)

3.3. Intangible assets (continued)

Operating licences primarily consist of

- several 2G licences,
- a nationwide 3G licence,
- a nationwide 4G licence to use 2.5–2.7 GHz spectrum (10x10 MHz band), and
- a nationwide 4G licence to use 2.5–2.7 GHz spectrum (30x30 MHz band).

These licences are integral to the wireless operations of the Group and any inability to extend existing licences on the same or comparable terms could materially affect the Group's business. While operating licences are issued for a fixed period, renewals of these licences previously had occurred routinely and at nominal cost. The Group believes that there are currently no legal, regulatory, contractual, competitive, economic or other factors that could result in delays in licence renewal, or even an outright refusal to renew.

Nationwide 3G and 4G licences require the Company to meet certain conditions, including capital commitments and coverage requirements (*Note 5.8*).

Neosprint

In April 2019 the Group acquired spectrum in the 3.4GHz-3.6GHz band for St. Petersburg through the purchase of a 100% interest in LLC Neosprint Spb ("Neosprint Spb"). The Group's management concluded that the assets and activities of the acquired company are not capable of being conducted and managed as a business, accordingly the acquisition of Neosprint Spb was accounted for as an acquisition of assets. The purchase price totaled 300, consisting of cash consideration.

In April 2018 the Group acquired spectrum in the 3.4GHz-3.6GHz band for Moscow through the purchase of a 100% interest in LLC Neosprint ("Neosprint"). The Group's management concluded that the assets and activities of the acquired company are not capable of being conducted and managed as a business, accordingly the acquisition of Neosprint was accounted for as an acquisition of assets. The purchase price totaled 720, consisting of cash consideration of 504 and a deferred payment of 216 which was fully settled in June 2018.

3.3.2. Goodwill

Accounting policies

Goodwill represents the excess of the consideration transferred plus the fair value of any NCI in the acquired company at the acquisition date over the fair values of the identifiable net assets acquired. Goodwill is not amortised, but tested for impairment at least annually (*Note 3.3.3*).

After initial recognition, goodwill is measured at cost less any accumulated impairment losses.

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Notes to the consolidated financial statements (continued)

3.3. Intangible assets (continued)

Disclosures

The changes in the carrying value of goodwill, net of accumulated impairment losses of 3,400, for the years ended 31 December 2019 and 2018 are as follows:

	<u>2019</u>	<u>2018</u>
Balance at beginning of year	30,549	73,218
Acquisitions (<i>Note 5.4</i>)	—	7,725
Discontinued operations (<i>Note 5.1</i>)	—	(50,394)
Balance at end of year	<u>30,549</u>	<u>30,549</u>

3.3.3. Goodwill impairment

Accounting policies

Goodwill is not subject to amortisation and is tested annually for impairment as of 1 October or more frequently whenever events or changes in circumstances indicate that the carrying amount may not be recoverable.

For the purpose of impairment testing, goodwill acquired in a business combination is allocated from the acquisition date to each of the cash-generating units (“CGUs”) that are expected to benefit from the synergies of the combination. The Group has allocated goodwill to one CGU: integrated telecommunication services.

An impairment loss of associated goodwill is recognised for the amount by which the CGU’s carrying amount exceeds its recoverable amount. The recoverable amount is the higher of (1) a CGU’s fair value less costs to sell and (2) value in use. The recognised impairment loss is not subsequently reversed.

Estimating recoverable amounts of assets and CGUs is based on management’s evaluations, including determining the appropriate CGUs and estimates of applicable multiples, if the market approach is used, or future cash flows, discount rates, terminal growth rates, and assumptions about future market conditions, if the income approach is used. Allocation of the carrying value of the assets being tested between individual CGUs also requires management’s judgment.

Goodwill impairment test

Goodwill acquired through business combinations has been allocated to related CGUs as follows:

	<u>31 December</u>	
	<u>2019</u>	<u>2018</u>
Integrated telecommunication services	30,549	28,951
GARS	—	1,598
Total goodwill	<u>30,549</u>	<u>30,549</u>

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Notes to the consolidated financial statements (continued)

3.3. Intangible assets (continued)

In assessing whether goodwill has been impaired, the carrying value of the CGU (including goodwill) was compared with its estimated recoverable amount.

As a result of the annual test, no impairment of goodwill was identified in 2019.

Integrated telecommunication services

Over the last few years the business of GARS Holding Limited (“GARS”) blended significantly with the integrated telecommunication services business in terms of mutual management, costs, and inputs and outputs convergence. This process has become particularly evident by 31 December 2019 as the management structure has been revised and integration has risen significantly over the year.

Accordingly, at 31 December 2019 the net assets of the GARS business have been allocated to the integrated telecommunication services CGU. Management has determined that the cash flows of the GARS business should not be considered independent of those from the integrated telecommunication services CGU, because of the extent of their integration with the Company’s other operations.

The recoverable amount of the integrated telecommunication services CGU has been determined based on its value in use (Level 3). The value in use has been determined based on the discounted cash flows (“DCF”).

The calculation of value in use is based on the following key assumptions:

ARPU stable during the forecast period, growth rate	0%
Pre-tax discount rate	11.6%
Terminal growth rate	2.5%
Market share in Russia (in terms of retail customer base)	29.3%-29.4%
EBITDA margin during the forecast period	38.1%-34.5%
CAPEX/Revenue ratio	19.1%-19.9%

Management believes that any change in any of these key assumptions which can currently be reasonably anticipated would not cause the aggregate carrying amount of the integrated telecommunication services CGU to exceed its aggregate recoverable amount.

Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures*Accounting policies*

Investments in associates and joint ventures which are jointly controlled entities are accounted for using the equity method of accounting and are initially recognised at cost or, in case of non-monetary purchases, at fair value of assets received or given, whichever is more appropriate. The Group's share of the profits and losses of these companies is included in the 'Share of loss of associates and joint ventures and investment impairment loss' line in the accompanying consolidated income statement with a corresponding adjustment to the carrying amount of the investment.

Unrealised gains on transactions between the Group and its associates or joint ventures are eliminated only to the extent of the Group's interest in the associates or joint ventures. Unrealised losses are also eliminated to the extent of the Group's interest unless a transaction provides evidence of an impairment of the asset transferred. Accounting policies of associates or joint ventures have been changed where necessary to ensure consistency with the policies adopted by the Group.

Impairment

For associates and joint ventures accounted for using the equity method, at each reporting date the Group determines whether there is objective evidence that the investment in the associate or joint venture is impaired. If there is such evidence, the Group calculates the amount of impairment as the difference between the recoverable amount of the Group's investment in the associate or joint venture and its carrying value, then recognises the loss as 'Share of loss of associates and joint ventures and investment impairment loss' in the consolidated income statement.

Disclosures

Investments in associates and joint ventures are as follows:

Investee	% equity interest	31 December 2019	2018
AER Holding PTE.LTD ("AER"), associate	24.300	35,054	—
JSC Sadovoe Koltso ("Garden Ring"), joint venture	49.999	12,637	12,866
DTSRetail Limited ("Svyaznoy group"), associate	25.000	10,268	15,096
JSC MF Technologies ("MFT group")/ Mail.Ru Group Limited ("MGL"), associate	45.000/ 12.340	8,789	45,295
Other		1,637	8
Total		68,385	73,265

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Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures (continued)

AER

On 5 June 2019 the Company, Alibaba.com Singapore e-commerce private Limited (“Alibaba”), LLC ‘RDIF Investment Management-19’ (“RDIF”), LLC Mail.Ru, and AliExpress Russia Holding PTE. LTD signed an agreement to establish a joint venture on the basis of the existing e-commerce businesses of AER and MGL. On 8 October 2019 MegaFon transferred a 9.97% economic share in MGL to Alibaba in exchange for a 24.3% share in the AER. The purpose of the transaction is to create a unique e-commerce joint venture to provide best-in-class financial services, media, and other consumer offerings to the Russian consumer base.

The fair value of the Group’s holding in AER was estimated in the amount of 35,942.

The provisional fair values of identified assets and liabilities of AER reconciled to the Group’s investment in AER as at the date of acquisition are as follows:

Assets	
Property and equipment	1,037
Intangible assets, other than goodwill	19,534
Inventory	1,073
Trade and other receivables	5,633
Other assets	632
Cash and cash equivalents	19,647
	47,556
Liabilities	
Trade and other payables	(920)
Other liabilities	(358)
	(1,278)
Total identifiable net assets at fair value	46,278
The Group’s share in the investment	24.3%
The Group’s share of identifiable net assets	11,246
Excess of the consideration transferred over the Group’s share in the fair value of identifiable net assets	24,696
Purchase consideration transferred	35,942

Intangible assets mainly consist of trademarks.

The disposal of MGL shares resulted in a 602 loss, presented in the consolidated income statement line “Share of loss of associates and joint ventures and investment impairment loss”.

The fair value of AER as at the date of acquisition has been determined using the cash flow projections for a seven-year period, Gordon growth model and exit multiples for terminal period. The projections are based on AER’s management business plan with profitability adjusted to market levels. AER runs cross-border marketplace business and local business which is currently at the early stage of development. The additional investments (mostly in the form of marketing expenses) can be required for AER to gain its target share of the local e-commerce market with strong competition.

MegaFon

Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures (continued)

The calculation of the fair value of the Group's holding in AER is particularly sensitive to the following assumptions:

Pre-tax discount rate	14.8%
Cross-border market share	25.0%
Local market share	10.0%
EBITDA margin by 2026	13.4%
Life-long additional investments in marketing and other	33,500-77,500

The discount rate represents the current market assessment of the risks specific to AER, taking into consideration the time value of money and individual risks to the underlying assets that have not been incorporated in the cash flow estimates. The discount rate calculation is based on the specific circumstances of AER and is derived from its weighted average cost of capital ("WACC"). The WACC takes into account both debt and equity. The cost of equity is derived from the expected return on investment by AER's investors. The cost of debt is based on the interest-bearing borrowings AER is obliged to service. Investee-specific risk is incorporated by applying individual beta factors. The beta factors are evaluated based on publicly available market data.

Cross-border and local market shares were derived from various sources, including Euromonitor and Russian association of internet trade companies.

EBITDA margin is projected using results of peer e-commerce companies in developed and developing markets.

The amount of the life-long additional investments was calculated based on public companies' benchmarks. Local players in other countries invested about 25–50% of gross merchandise value to achieve 10% of market share, thus AER may need additional investments of 33,500-77,500 to remain competitive locally.

Sensitivity to changes in key assumptions

The following reasonably possible changes in the key assumptions made independently, with all other assumptions constant, would result in the following changes to the fair value of AER:

Key assumption	Change in key assumption	Change in fair value
Change in pre-tax discount rate by	+1 p.p./-1 p.p.	(7.4%)/+8.6%
Change in cross-border market share by	+1 p.p./-1 p.p.	+4.4%/(4.4%)
Change in local market share by	+1 p.p./-1 p.p.	(3.1%)/+3.1%
Change in EBITDA margin by 2026 by	+2 p.p./-2 p.p.	+6.4%/(6.4%)
Change in life-long investments in marketing and other by	+10%/-10%	(3.9%)/+3.9%

MegaFon

Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures (continued)

The reconciliation of summarised financial information of AER to the carrying amount of the Group's interest in AER is presented below:

	31 December 2019
Assets	
Non-current assets	19,919
Cash and cash equivalents	16,206
Other current assets	12,319
	48,444
Liabilities	
Current financial liabilities	(6,784)
Other liabilities	(1,700)
	(8,484)
Total identifiable net assets	39,960
The Group's share in AER	24.3%
The Group's share of identifiable net assets of AER	9,710
Excess of the carrying value of the investment over the Group's share in the fair value of identifiable net assets	25,344
Carrying amount of the Group's interest in AER	35,054

The composition of the Group's share of loss of AER accounted for using the equity method is as follows:

	8 Oct 2019 – 31 Dec 2019
Revenue	6,185
Expenses	(9,239)
Depreciation and amortisation	(699)
Income tax	100
Loss and total comprehensive loss of AER	(3,653)
The Group's share in AER	24.3%
The Group's share of loss and total comprehensive loss of AER	(888)

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Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures (continued)

Garden Ring

Garden Ring, which owns and operates an office building in the center of Moscow, is the Group's joint venture with Sberbank. The Group has a ten-year lease agreement with Garden Ring for a part of the building. This building is the corporate headquarters of the Group, which consolidates the Group's operations in Moscow into the single location. The remaining part of the building is mostly leased by Sberbank.

The Garden Ring joint venture is accounted for using the equity method in the consolidated financial statements.

The reconciliation of the summarised financial information of Garden Ring to the carrying amount of the Group's interest in the joint venture is presented below:

	31 December	
	2019	2018
Assets		
Non-current assets	46,604	47,430
Cash and cash equivalents	329	755
Other current assets	76	45
	47,009	48,230
Liabilities		
Non-current financial liabilities	(22,161)	(22,774)
Other non-current liabilities	(5,570)	(5,685)
Current financial liabilities	(1,859)	(1,897)
Other current liabilities	(8)	(6)
	(29,598)	(30,362)
Total identifiable net assets	17,411	17,868
The Group's share in Garden Ring	49.999%	49.999%
The Group's share of identifiable net assets of Garden Ring	8,705	8,934
Excess of the carrying value of the investment over the Group's share in the fair value of identifiable net assets	3,932	3,932
Carrying amount of the Group's interest in Garden Ring	12,637	12,866

The composition of the Group's share of the loss of the joint venture accounted for using the equity method is as follows:

	Year ended 31 December	
	2019	2018
Loss and total comprehensive loss of Garden Ring	(459)	(909)
The Group's share in the joint venture	49.999%	49.999%
The Group's share of loss and total comprehensive loss of Garden Ring	(229)	(454)

MegaFon

Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures (continued)

Svyaznoy group

In May 2018 the Group acquired an interest in DTSRetail Limited (“Svyaznoy group”), which will amount to 25% of the outstanding shares plus one share after satisfaction of certain conditions, in exchange for contributing to the Svyaznoy group 100% of the shares of Euroset and the Lonestar Enterprises Ltd loan with the ascribed value of 1,730, including accrued interest.

The primary reason for the transaction was to enable MegaFon to acquire an interest in the largest retail chain in the technology sector in the Russian Federation to take part in future development of omnichannel networks.

The financial results of Euroset after the acquisition of the remaining 50% interest from VEON and before the disposal to the Svyaznoy group were presented in the consolidated income statement line “Share of loss of associates and joint ventures” in the amount of 679 (loss).

The fair value of the Group’s holding in the Svyaznoy group was estimated in the amount of 15,440. It approximated the fair value of the consideration transferred by the Group (the shares of Euroset and Lonestar loan receivable).

The fair values of identified assets and liabilities of the Svyaznoy group reconciled to the Group’s investment in the Svyaznoy group as at the date of acquisition are as follows:

Assets	
Property and equipment	1,896
Intangible assets, other than goodwill	48,947
Inventory	25,307
Trade and other receivables	9,612
Other assets	2,132
Cash and cash equivalents	9,210
	97,104
Liabilities	
Loans and borrowings	(19,567)
Deferred tax liabilities	(9,919)
Trade and other payables	(44,099)
Other liabilities	(1,410)
	(74,995)
Total identifiable net assets at fair value	22,109
The Group’s share in the investment	25%
The Group’s share of identifiable net assets	5,527
Excess of the consideration transferred over the Group’s share in the fair value of identifiable net assets	9,913
Purchase consideration transferred	15,440

The disposal of Euroset resulted in a 651 gain, presented in the consolidated income statement line “Share of loss of associates and joint ventures”.

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Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures (continued)

The reconciliation of the summarised financial information of the Svyaznoy group to the carrying amount of the Group's interest in the Svyaznoy group is presented below:

	31 December 2019	31 December 2018
Assets		
Non-current assets	72,541	52,986
Cash and cash equivalents	4,199	9,859
Other current assets	28,436	43,232
	105,176	106,077
Liabilities		
Non-current financial liabilities	(21,730)	(2,442)
Other non-current liabilities	(9,217)	(10,255)
Current financial liabilities	(60,926)	(69,216)
Other current liabilities	(2,840)	(3,434)
	(94,713)	(85,347)
Total identifiable net assets	10,463	20,730
The Group's share in the Svyaznoy group	25%	25%
The Group's share of identifiable net assets of the Svyaznoy group	2,616	5,183
Excess of the carrying value of the investment over the Group's share in the fair value of identifiable net assets	7,652	9,913
Carrying amount of the Group's interest in the Svyaznoy group	10,268	15,096

The composition of the Group's share of the loss of the Svyaznoy group accounted for using the equity method is as follows:

	Year to 31 December 2019	Seven months ended 31 December 2018
Loss and total comprehensive loss of the Svyaznoy group	(10,268)	(1,375)
The Group's share in the Svyaznoy group	25%	25%
The Group's share of loss and total comprehensive loss of the Svyaznoy group	(2,567)	(344)
Investment impairment	(2,261)	—
The Group's share of loss and total comprehensive loss of the Svyaznoy group and investment impairment loss	(4,828)	(344)

Total summarised profit and loss information of Garden Ring and Svyaznoy group is as follows:

	Year ended 31 December 2019	2018
Revenue	118,025	107,056
Depreciation and amortisation	(5,555)	(3,745)
Interest expense	(8,902)	(4,450)
Income tax	1,177	(1,095)

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Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures (continued)

Svyaznoy group investment impairment

At 31 December 2019 the Group determined that the investment in the Svyaznoy group is impaired as a result of the Svyaznoy group's not meeting its original budget for 2019 due to one-off costs associated with the merger of the Euroset and Svyaznoy retail networks, as well as due to the slowdown in the Russian mobile retail market which have impacted the profitability of the Svyaznoy group. The Group has calculated the amount of impairment as the difference between the recoverable amount of the Group's investment and its carrying value and recognised an impairment loss in consolidated income statement in the amount of 2,261.

The estimated recoverable amount of investment is based on its value in use. The value in use was estimated using the cash flow projections for a six-year period. The calculation of the recoverable amount of the investment is particularly sensitive to the following assumptions:

	<u>31 December 2019</u>
Pre-tax discount rate	13.3%
Average annual goods sales revenue growth rate during the forecast period	7.7%
Terminal growth rate	2.4%
EBITDA margin during the forecast period	3.5%

The changes in the carrying value of the investment in Svyaznoy group for the year ended 31 December 2019 are as follows:

At 1 January 2019	15,096
Investment impairment loss	(2,261)
Share of loss of associates and joint ventures	(2,567)
At 31 December 2019 (Level 3)	<u>10,268</u>

MFT group/MGL

MGL is a leading internet services company in Russia. The Group lost control of MGL in June 2018 (*Note 5.1*), but maintained a significant influence over the affairs of MGL as at 31 December 2018 as it held approximately 12% of the total issued shares of MGL, or approximately 31% of the voting rights.

After contributing a 9.97% economic share in MGL to Alibaba in October 2019 (as described above), the Group is now holding its remaining approximately 2% indirect economic interest in MGL (with approximately 26.7% voting rights) via its 45%-owned associate JSC MF Technologies ("MFT group").

The financial results of the direct investment in MGL (ordinary shares) from 1 January 2019 to the date of the shares' disposal in October 2019 are presented in the consolidated income statement line "Share of loss of associates and joint ventures and investment impairment loss" in the amount of 382 (loss).

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Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures (continued)

The reconciliation of the summarised financial information of MFT group to the carrying amount of the Group's interest in MFT group is presented below:

	31 December 2019
Assets	
Non-current assets	111,491
Cash and cash equivalents	9,789
Other current assets	17,713
	138,993
Liabilities	
Non-current financial liabilities	(19,474)
Other non-current liabilities	(10,642)
Current financial liabilities	(30,408)
Other current liabilities	(13,890)
	(74,414)
Total identifiable net assets	64,579
NCI	(62,313)
Total identifiable net assets net of NCI	2,266
The Group's share in MFT group	45%
The Group's share of identifiable net assets of MFT group	1,020
Excess of the carrying value of the investment over the Group's share in the fair value of identifiable net assets	7,769
Carrying amount of the Group's interest in MFT group	8,789

The composition of the Group's share of the profit of MFT group accounted for using the equity method is as follows:

	Year to 31 December 2019
Revenue	96,231
Expenses	(68,066)
Depreciation and amortisation	(16,769)
Interest income	585
Interest expense	(1,459)
Other income and expenses, net	7,738
Income tax expense	(2,635)
Profit	15,625
Profit attributable to NCI	(14,856)
OCI	17
Profit and total comprehensive income of MFT group	786
The Group's share in MFT group	45%
The Group's share of profit and total comprehensive income of MFT group	354

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Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures (continued)

The reconciliation of summarised financial information of MGL to the carrying amount of the Group's interest in the associate is presented below:

	31 December 2018
Assets	
Non-current assets	67,857
Cash and cash equivalents	11,723
Other current assets	13,469
	93,049
Liabilities	
Other non-current liabilities	(20,756)
Current financial liabilities	(13,903)
Other current liabilities	(11,101)
	(45,760)
Total identifiable net assets	47,289
NCI of MGL	(261)
Total identifiable net assets net of NCI	47,028
The Group's share in MGL	12.34%
The Group's share of identifiable net assets of MGL	5,803
Excess of the carrying value of the investment over the Group's share in the fair value of identifiable net assets	39,492
Carrying amount of the Group's interest in MGL	45,295

The composition of the Group's share of loss of MGL accounted for using the equity method is as follows:

	Year ended 31 December 2018
Revenue	35,946
Expenses	(35,290)
Depreciation and amortisation	(6,059)
Interest income	280
Interest expense	(2)
Other income and expenses, net	(758)
Income tax expense	(101)
Loss	(5,984)
OCI	(228)
Loss attributable to NCI	83
Loss and total comprehensive loss of MGL	(6,129)
The Group's share in MGL	12.34%
The Group's share of loss and total comprehensive loss of MGL	(756)

Notes to the consolidated financial statements (continued)

3.4. Investments in associates and joint ventures (continued)

Sale of City-Mobil

In November 2019 the Group sold approximately 5.87% out of approximately 12% interest in LLC City-Mobil (“City-Mobil”), a taxi aggregator, for a cash consideration in the amount of 962.

Then, after subsequent changes in the holdings of the other shareholders following additional contributions by them, MegaFon’s interest in City-Mobil was diluted to approximately 2.63%. The sale resulted in a gain of approximately 1,281 recognised in the consolidated income statement line ‘Share of loss of associates and joint ventures and investment impairment loss’.

3.5. Financial assets and liabilities

Accounting policies

Initial recognition and measurement

Financial assets and financial liabilities are recognised initially at fair value plus transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability, except for a financial asset or financial liability accounted for at fair value through profit or loss, in which case transaction costs are expensed.

Subsequent measurement of financial assets and liabilities

The subsequent measurement of financial assets and liabilities depends on their classification as described below:

- *Fair value through profit or loss.* Derivatives are accounted for at fair value through profit or loss unless they are designated as effective hedging instruments.

Financial assets and liabilities accounted for at fair value through profit or loss are carried in the consolidated statement of financial position at fair value with changes in fair value being recognised in profit or loss, in the ‘Net gain/(loss) on financial instruments’ line.

- *Amortised cost.* Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market such as trade and other receivables, loans receivable, and loans and borrowings are classified as financial instruments at amortised cost. After initial measurement, such instruments are subsequently measured at amortised cost using the effective interest rate (“EIR”) method. Amortised cost is calculated by taking into account any discount or premium on acquisition and fees or costs that are an integral part of the EIR. The amortisation based on EIR is included in profit or loss.
- *Fair value through OCI.* Derivative financial instruments designated as effective hedging instruments are accounted for at fair value through OCI.

Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)*De-recognition of financial assets*

A financial asset is de-recognised when the rights to receive cash flows from the asset have expired or the Group has transferred its rights to receive cash flows from the asset or has assumed an obligation to pay the received cash flows in full without material delay to a third party under a 'pass-through' arrangement; and either (a) the Group has transferred substantially all the risks and rewards of the asset, or (b) the Group has neither transferred nor retained substantially all the risks and rewards of the asset, but has transferred control of the asset.

Impairment of financial assets

The Group recognises loss allowances for expected credit losses ("ECLs") on financial assets measured at amortised cost and contract assets. These loss allowances are measured at an amount equal to lifetime ECLs. ECLs are a probability-weighted estimate of credit losses. For majority of receivables loss allowance is estimated using the provision matrix which specifies fixed provision rates depending on the number of days that a receivable is past due. The provision rates are based on the Group's historical experience and current expectations of future cash flows. Credit losses are measured at present value of all cash shortfalls, that is the difference between the cash flows due to the entity in accordance with the contract and the cash flows that the Group expects to receive. ECLs are discounted at the effective interest rate of the financial asset.

The carrying amount of the asset is reduced through the use of an allowance account and the amount of the loss is recognised in profit or loss. Financial assets together with the associated allowance are written off when there is no realistic prospect of future recovery and all collateral has been realised or has been transferred to the Group. If, in a subsequent year, the amount of the estimated impairment loss increases or decreases because of an event occurring after the impairment was recognised, the previously recognised impairment loss is increased or reduced by adjusting the allowance account. If a write-off is later recovered, the recovery is credited to the relevant costs in profit or loss.

De-recognition of financial liabilities

A financial liability is de-recognised when the obligation under the liability is discharged, cancelled or expires. When an existing financial liability is replaced by another from the same lender on substantially different terms, or the terms of an existing liability are substantially modified, such an exchange or modification is treated as the de-recognition of the original liability and the recognition of a new liability. The difference in the respective carrying amounts is recognised within profit or loss.

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Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)

Disclosures

Financial assets are as follows:

	31 December	
	2019	2018
Trade and other receivables at amortised cost (<i>Note 3.6</i>)	37,104	29,137
Other financial assets:		
Financial assets at fair value through profit or loss:		
Investments in City-Mobil (<i>Note 3.4</i>)	431	—
Cross-currency swap not designated as hedge	—	697
Other	125	—
Total financial assets at fair value through profit or loss	556	697
Financial assets at amortised cost:		
Short-term bank deposits in HK dollars	—	4,352
Loans receivable from related parties (<i>Note 5.3</i>)	16,814	5,067
Other deposits	407	1,307
Other	360	361
Total financial assets at amortised cost	17,581	11,087
Total other financial assets	18,137	11,784
Other current financial assets	(2,898)	(7,955)
Other non-current financial assets	15,239	3,829
Total financial assets	55,241	40,921
Total current financial assets	(40,002)	(37,092)
Total non-current financial assets	15,239	3,829

Loans receivable from related parties

In December 2019 the Group made a 12,560 loan to USM Telecom LLC (*Note 5.3*), a related party. The Group recognised the loan at fair value which was estimated by discounting the expected cash flows using the prevailing market rate of interest for a similar instrument. The difference between the fair value of the loan and cash received of 979, net of tax, has been recognised directly in retained earnings in equity as the loan is treated as a transaction with the shareholder.

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Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)

Other loans granted

During the year ended 31 December 2019 the Group made some loans to its associates in the total amount of 2,800 which were repaid in the same reporting period.

Financial liabilities are as follows:

	31 December	
	2019	2018
Trade and other payables at amortised cost	54,607	53,235
Financial liabilities at amortised cost:		
Loans and borrowings:		
Loans and borrowings	288,755	271,487
Ruble bonds	87,003	56,007
Total loans and borrowings	375,758	327,494
Total current loans and borrowings	(25,692)	(39,232)
Total non-current loans and borrowings	350,066	288,262
Lease liabilities (Note 3.2)	90,899	4,265
Current lease liabilities	(13,584)	(61)
Non-current lease liabilities	77,315	4,204
Other financial liabilities at amortised cost:		
Deferred and contingent consideration	568	—
Other liabilities	665	509
Total financial liabilities at amortised cost	467,890	332,268
Financial liabilities at fair value through profit and loss:		
Cross-currency swaps not designated as hedges	1,570	84
Total financial liabilities at fair value through profit and loss	1,570	84
Total other financial liabilities	2,803	593
Other current financial liabilities	(251)	(84)
Other non-current financial liabilities	2,552	509
Total financial liabilities	524,067	385,587
Total current financial liabilities	(94,134)	(92,612)
Total non-current financial liabilities	429,933	292,975

MegaFon

Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)

3.5.1. Cash and cash equivalents

Accounting policies

Cash and cash equivalents comprise cash on hand and deposits in banks with original maturities of three months or less.

Disclosures

Cash and cash equivalents are as follows:

	31 December	
	2019	2018
Cash at bank and on hand in		
Rubles	2,572	3,749
US dollars	607	553
Euros	68	216
Other	12	2
Short-term bank deposits in		
Rubles	49,292	232
US dollars	155	16,423
Euros	—	6,039
Total cash and cash equivalents	52,706	27,214

3.5.2. Loans and borrowings

Principal amounts outstanding under loans and borrowings are as follows:

	Interest Rate	Maturity	31 December	
			2019	2018
Loans and borrowings:				
Ruble loans – fixed rates	0% - 11.13%	2020-2024	236,850	230,855
Ruble loans – floating rates	6.9% – 7.32%	2021-2023	38,000	—
US dollar loans – fixed rate	0%	2020	71	6,340
US dollar loans – floating rates			—	20,598
Euro loans – floating rates	EURIBOR + 0.56%	2024-2027	14,684	15,575
Total loans and borrowings			289,605	273,368
Ruble bonds	7.2% - 9.9%	2021-2026 with put option in 2021 and 2023	85,000	55,000
Total			374,605	328,368
Total current			(23,703)	(37,909)
Total non-current			350,902	290,459

Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)

Loans and borrowings

In January-December 2019 the Group drew down from different banks and financial institutions 170,663 under fixed-rate and floating-rate Ruble-denominated facilities for terms of between one and five years to finance general corporate needs and repaid Ruble-denominated fixed-rate loans in the amount of 126,180.

In 2019 the Group early repaid approximately \$356 million (23,093 at the exchange rate as of payment date) of US dollar-denominated fixed and floating-rate loans, which were due at the end of 2021 and of 2022.

In October 2019 the Group received a loan in the amount of 1,921 for a term of up to 3 years from its associate AER (*Note 5.3*). The Group recognised the loan at fair value which was estimated by discounting the expected cash flows using the prevailing market rate of interest for a similar instrument. The difference between the fair value of the loan and cash received in the amount of 343 has been apportioned between the share of 24.3% relating to the Group's investment in AER and the remaining amount which was recognised in the consolidated income statement, in the 'Net gain/(loss) on financial instruments' line.

Ruble bonds

In February 2019 the Group placed its BO-001P-05 series bonds in the amount of 20,000 for a term of three years at an interest rate of 8.55% per annum to be paid semi-annually.

In March 2019 the Group placed its BO-001P-06 and BO-002P-01 series bonds in the total amount of 10,000 for a term of five years at an interest rate of 8.90% per annum to be paid semi-annually.

In April 2019 the Group placed its BO-002P-02 series bonds in the amount of 10,000 for a term of seven years at an interest rate of 8.90% per annum to be paid semi-annually.

In May 2019 the Group redeemed in full at par its BO-001P-01 bonds in an aggregate principal amount of 10,000. The Group initially issued these bonds in May 2016 with a maturity of three years at an interest rate of 9.95% per annum.

Covenant requirements

The majority of the Company's financing facilities contain restrictive covenants with certain permitted exceptions.

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Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)

3.5.3. Reconciliation of movements of liabilities to cash used in financing activities

	Liabilities			Equity		Total
	Loans and borrowings	Derivatives	Lease liabilities	Retained Earning	Treasury shares	
Balance as of 31 December 2018	327,494	(613)	4,265	151,766	(94,087)	388,825
ROUA recognised at 1 January 2019	—	—	88,651	—	—	88,651
Balance as of 1 January 2019	327,494	(613)	92,916	151,766	(94,087)	477,476
Proceeds from loans and borrowings, net of fees paid	265,524	—	—	—	—	265,524
Repayment of loans and borrowings	(213,934)	(270)	—	—	—	(214,204)
Interest paid	(32,962)	(899)	(9,664)	—	—	(43,525)
Purchase of outstanding shares	—	—	—	—	(86,574)	(86,574)
Sale of own shares	—	—	—	(3,232)	58,958	55,726
Lease payments	—	—	(11,864)	—	—	(11,864)
Total cash flows used in financing activities	18,628	(1,169)	(21,528)	(3,232)	(27,616)	(34,917)
Loss on disposal of non-current assets	—	—	187	—	—	187
Finance costs	35,027	1,110	9,536	—	—	45,673
Foreign exchange gain, net	(3,704)	—	—	—	—	(3,704)
(Gain)/loss on financial instruments, net	(260)	2,242	—	—	—	1,982
Assets-related other changes	(1,427)	—	9,788	—	—	8,361
Equity-related other changes	—	—	—	7,108	—	7,108
Balance as of 31 December 2019	375,758	1,570	90,899	155,642	(121,703)	502,166

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Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)

	Liabilities			Equity		Total
	Loans and borrowings	Derivatives	Finance lease liabilities	NCI	Treasury shares	
Balance as of 1 January 2018	264,110	3,842	4,222	55,536	(17,387)	310,323
Proceeds from loans and borrowings, net of fees paid	124,987	—	—	—	—	124,987
Repayment of loans and borrowings	(67,409)	(2,961)	—	—	—	(70,370)
Interest paid	(25,109)	(403)	(477)	—	—	(25,989)
Dividends paid to NCI	—	—	—	(247)	—	(247)
Purchase of outstanding shares	—	—	—	—	(76,700)	(76,700)
Finance lease payments	—	—	(8)	—	—	(8)
Total cash flows used in financing activities	32,469	(3,364)	(485)	(247)	(76,700)	(48,327)
Finance costs	26,125	485	493	—	—	27,103
Foreign exchange loss, net	7,447	1,096	—	—	—	8,543
Gain on financial instruments, net	—	(713)	—	—	—	(713)
Changes through OCI	—	(1,959)	—	—	—	(1,959)
Acquisition of subsidiaries and discontinued operations (<i>Notes 5.1,5.4</i>)	13	—	—	(55,265)	—	(55,252)
Assets-related other changes	(2,670)	—	35	—	—	(2,635)
Equity-related other changes	—	—	—	(288)	—	(288)
Balance as of 31 December 2018	327,494	(613)	4,265	(264)	(94,087)	236,795

Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)**3.5.4. Derivative financial instruments and hedging activities****Accounting policies**

Derivative financial instruments, which include foreign currency forwards and cross-currency swaps, are initially recognised in the consolidated statement of financial position at fair value on the date a derivative contract is entered into and are subsequently re-measured at their fair value. Fair values are obtained from quoted market prices and DCF models as appropriate. Derivatives are included within financial assets at fair value through profit or loss when fair value is positive and within financial liabilities at fair value through profit or loss when fair value is negative. Certain derivatives embedded in other financial instruments are treated as separate derivatives when their economic risks and characteristics are not closely related to those of the host contract and the combined instrument is not measured at fair value, with changes in fair value being recognised in profit or loss.

The Group has derivatives which it did not designate as hedges. The changes in the fair value of such derivative instruments are reported in the profit or loss.

When the Group enters into derivative instruments which it designates as cash flow hedges, at the inception of a hedge relationship, the Group formally designates and documents the hedge relationship to which the Group wishes to apply hedge accounting and the risk management objective and strategy for undertaking the hedge. At inception such hedges are expected to be highly effective in achieving offsetting changes in cash flows and are assessed on an ongoing basis to determine that they actually have been highly effective throughout the financial reporting periods for which they were designated. The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognised in OCI. The gain or loss relating to the ineffective portion is recognised immediately in profit or loss.

The Group uses derivatives to manage interest rate and foreign currency risk exposures. The Group does not hold or issue derivatives for trading purposes.

Disclosures

The Group had the following outstanding cross-currency swaps stated at their notional amounts:

		31 December 2019		31 December 2018	
	Original	Millions,	Millions,	Millions,	Millions,
	currency	original	Rubles	original	Rubles
		currency		currency	
Cross-currency swaps:					
not designated as hedges	Euro	209	14,492	97	7,708
not designated as hedges	US dollar	—	—	118	8,198
Total cross-currency swaps			14,492		15,906

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Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)

Derivatives not designated as hedging instruments

In February, March and June 2019 the Company entered into cross-currency swap agreements with a combined notional amount of Euro 143 million (9,916 at the exchange rate as of 31 December 2019) that limit the exposure from changes in the Euro exchange and interest rates on certain long-term debt.

In June 2019 the Group early settled cross-currency swap agreements with a combined notional amount of \$129 million (7,986 at the exchange rate as of 31 December 2019) following the early repayment of US dollar-denominated loans to which the cross-currency swaps related.

In August 2018, the Company entered into cross-currency swap agreements with a notional amount of \$129 million (8,962 at the exchange rate as of 31 December 2018) and Euro 106 million (8,423 at the exchange rate as of 31 December 2018) that limit the exposure from changes in US dollar and Euro exchange and interest rates on certain long-term debt.

The terms of the swap agreements did not meet the requirements for hedge accounting, therefore the Group reported all gains and losses from the change in fair value of these derivative financial instruments directly in the consolidated income statement.

Foreign currency forwards designated as cash flow hedges

During the year ended 31 December 2016 the Group entered into a number of US dollar forward purchase agreements that limited the exposure from changes in US dollar exchange rates on certain long-term debts. The forwards were designated and qualified as cash flow hedges of foreign currency risk. Forwards were fully settled in 2018 and earlier and affected consolidated income statement in those periods.

The table below presents the effect of the Group's derivative financial instruments designated as cash flow hedges on the consolidated income statement and consolidated statement of other comprehensive income for the year ended 31 December 2018:

	<u>2018</u>
Foreign currency forwards:	
Amount of gain recognised in OCI	863
Amount of loss reclassified from OCI into foreign exchange loss, net	1,096
Deferred tax on movements in OCI	<u>(392)</u>
Total in OCI	<u>1,567</u>

Loss on financial instruments

Net loss on financial instruments recognised in profit or loss for the year ended 31 December 2019 consisted mainly of 2,242 loss from change in fair value of cross-currency swaps not designated as hedges (31 December 2018: 713 gain).

Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)

3.5.5. Fair values

Accounting policies

The fair value of financial instruments recorded in the consolidated statement of financial position and/or disclosed in the notes that are traded in active markets at each reporting date is determined by reference to quoted market prices or dealer price quotations, without any deduction for transaction costs. For financial instruments not traded in an active market, the fair value is determined using appropriate valuation techniques, which include using recent arm's length market transactions, reference to the current fair value of another instrument that is substantially the same, a DCF analysis, or other valuation models.

The inputs to these models are taken from observable markets where possible, but where this is not feasible, a degree of judgment is required in establishing fair values. The judgments include considerations of inputs such as liquidity risk, credit risk and volatility. Changes in assumptions about these factors could affect the reported fair value of financial instruments.

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments by valuation technique:

- Level 1: quoted (unadjusted) prices in active markets for identical assets or liabilities;
- Level 2: other techniques for which all inputs which have a significant effect on the recorded fair value are observable, either directly or indirectly;
- Level 3: techniques which use inputs that have a significant effect on the recorded fair value that are not based on observable market data.

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Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)

Disclosures

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments that are carried in the consolidated financial statements:

		Carrying amount		Fair value	
		31 December		31 December	
		2019	2018	2019	2018
Financial assets:					
Financial assets at fair value through profit or loss:					
Investments in City-Mobil	Level 3	431	—	431	—
Cross-currency swaps not designated as hedges	Level 2	—	697	—	697
Other	Level 3	125	—	125	—
Financial assets at amortised cost:					
Short-term bank deposits	Level 2	—	4,352	—	4,352
Loans receivable from related parties	Level 2	16,814	5,067	16,814	5,067
Other deposits	Level 2	407	1,307	407	1,307
Other	Level 3	360	361	360	361
Total financial assets		18,137	11,784	18,137	11,784
Financial liabilities:					
Financial liabilities at amortised cost:					
Loans and borrowings	Level 2	288,755	271,487	305,689	283,473
Ruble bonds	Level 1	87,003	56,007	86,263	54,568
Deferred and contingent consideration	Level 2	568	—	568	—
Other liabilities	Level 3	665	509	665	538
Financial liabilities at fair value through profit or loss:					
Cross-currency swaps not designated as hedges	Level 2	1,570	84	1,570	84
Total financial liabilities		378,561	328,087	394,755	338,663

Valuation techniques and assumptions

Management has determined that cash, short-term deposits, other financial assets, trade receivables, trade payables, bank overdrafts and other current liabilities approximate their carrying amounts largely due to the short-term maturities of these instruments.

The Group, using available market information and appropriate valuation methodologies, where they exist, has determined the estimated fair values of its financial instruments. However, judgment is necessarily required to interpret market data to determine the estimated fair value.

Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Group could realise in a current market exchange.

The fair value of loans receivable from related parties approximates their carrying values.

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Notes to the consolidated financial statements (continued)

3.5. Financial assets and liabilities (continued)

The fair values of the Group's loans and borrowings and other liabilities carried at amortised cost, except for market quoted bonds, are determined by using a DCF method using a discount rate that reflects the issuer's borrowing rate as at the end of the reporting period. The own nonperformance risk as at 31 December 2019 and 2018 was assessed to be insignificant.

The Group, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks. The Group manages these risks and monitors their exposure on a regular basis.

The fair values of cross-currency swaps are based on a forward yield curve and represent the estimated amount the Group would receive or pay to terminate these agreements at the end of the reporting period, taking into account current interest rates, foreign exchange spot and forward rates, creditworthiness, nonperformance risk, and liquidity risks associated with current market conditions.

Disclosures

The following tables summarise the valuation of financial assets and liabilities measured at fair value on a recurring basis by the fair value hierarchy:

	Cross-currency swaps and other	Investments in City-Mobil	Total financial assets	Cross- currency swaps	Total financial liabilities
31 December 2019					
Level 1	—	—	—	—	—
Level 2	—	—	—	(1,570)	(1,570)
Level 3	125	431	556	—	—
Total as of 31 December 2019	125	431	556	(1,570)	(1,570)
31 December 2018					
Level 1	—	—	—	—	—
Level 2	697	—	697	(84)	(84)
Level 3	—	—	—	—	—
Total as of 31 December 2018	697	—	697	(84)	(84)

During the years ended 31 December 2019 and 31 December 2018 there were no transfers between levels of the fair value hierarchy.

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Notes to the consolidated financial statements (continued)

3.6. Trade and other receivables

The ageing analysis of trade and other receivables that are not impaired is as follows:

	31 December	
	2019	2018
Neither past due nor impaired	27,081	20,004
Past due but not impaired:		
Less than 30 days	3,362	2,949
30 - 90 days	2,476	4,364
More than 90 days	4,185	1,820
Total trade and other receivables	37,104	29,137

The following table summarises the changes in the impairment allowance for trade and other receivables for the years ended 31 December:

	2019	2018
Balance at beginning of year	3,540	3,191
Change in the impairment allowance	2,169	3,866
Discontinued operations (<i>Note 5.1</i>)	—	(288)
Accounts receivable written off	(2,773)	(3,229)
Balance at end of year	2,936	3,540

3.7. Inventory

Accounting policies

Inventory, which primarily consists of telephone handsets, portable electronic devices, accessories and USB modems, is stated at the lower of cost and net realisable value. Cost is determined using the weighted-average cost method. Net realisable value is the estimated selling price in the ordinary course of business less the estimated costs necessary to make the sale.

Disclosures

In 2019, inventories in the amount of 35,987 (2018: 25,863) were recognized as an expense during the year and included in 'Cost of revenue'. The amount of inventory write-down to net realisable value and other inventory losses recognised in 'Cost of revenue' line in the consolidated income statement for the year ended 31 December 2019 is 775 (2018: 1,108).

MegaFon

Notes to the consolidated financial statements (continued)

3.8. Non-financial assets and liabilities

Accounting policies

Value-added tax

Value added tax (“VAT”) related to revenues is generally payable to the tax authorities on an accrual basis when invoices are issued to customers. VAT incurred on purchases may be offset, subject to certain restrictions, against VAT related to revenues, or can be reclaimed in cash from the tax authorities under certain circumstances.

Management periodically reviews the recoverability of VAT receivables and believes the amount reflected in the consolidated financial statements is fully recoverable within one year.

Disclosures

Current non-financial assets are as follows:

	31 December	
	2019	2018
Prepayments for services	2,530	3,791
VAT receivable	4,065	3,051
Deferred costs	380	419
Prepaid taxes, other than income tax	456	502
Prepayments for inventory	1	3
Total current non-financial assets	7,432	7,766

Non-current non-financial assets are as follows:

	31 December	
	2019	2018
Deferred costs, non-current	8,587	7,033
Long-term advances	505	498
Total non-current non-financial assets	9,092	7,531

Current non-financial liabilities are as follows:

	31 December	
	2019	2018
Advances from customers	10,029	10,620
VAT payable	4,146	2,003
Current portion of deferred revenue	2,757	3,227
Taxes payable, other than income tax	1,085	1,589
Other current liabilities	247	222
Total current non-financial liabilities	18,264	17,661

MegaFon

Notes to the consolidated financial statements (continued)

3.8. Non-financial assets and liabilities (continued)

Non-current non-financial liabilities are as follows:

	31 December	
	2019	2018
Deferred revenue	3,957	3,789
Other non-current liabilities	43	106
Total non-current non-financial liabilities	4,000	3,895

3.9. Assets held for sale

As at 31 December 2018 the Group classified its investments in Forpost (*Note 5.3*) and another insignificant associate and the net assets of its subsidiary LLC “CoreClass” (*Note 5.4*) as assets held for sale. In January 2019 the Group sold its investments in Forpost and another insignificant associate for total consideration of approximately 270. The Group also sold 100% of LLC “CoreClass” for a cash consideration of 640 receivable over two years from the date of acquisition. The sales resulted in an insignificant gain.

3.10. Provisions

Accounting policies

Provisions are recognised when the Group has a present legal or constructive obligation as a result of past events, it is probable that an outflow of resources will be required to settle the obligation, and the amount can be reliably estimated. Provisions are not recognised for future operating losses.

Provisions are measured at the present value of the expenditures expected to be required to settle the obligation using a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the obligation. Any increase in the provision due to passage of time is recognised as finance costs.

Decommissioning provision

The Group has certain legal obligations related to rented sites for base stations and masts, which include requirements to restore the real estate upon which the base stations and masts are located upon their being decommissioned. Decommissioning costs are determined by calculating the present value of the expected costs to settle the obligation using estimated cash flows, and are recognised as part of the cost of the particular asset. The cash flows are discounted at the current pre-tax rate that reflects the risks specific to the decommissioning liability. The unwinding of the discount is expensed in profit or loss as finance costs. The estimated future costs of decommissioning are reviewed annually and adjusted as appropriate. Changes in estimated liability resulting from revisions of the estimated future costs or in the discount rate applied are added to or deducted from the cost of the asset, except where a reduction in the provision is greater than the unamortised recognised cost, in which case the recognised cost is reduced to nil and the remaining adjustment is recognised in the consolidated income statement.

MegaFon

Notes to the consolidated financial statements (continued)

3.10. Provisions (continued)

In determining the best estimate of the provision, assumptions and estimates are made in relation to discount rates, the expected cost to dismantle and remove the asset from the site, including long-term inflation forecasts, and the expected timing of those costs.

Disclosures

The following table describes the changes to the decommissioning provision for the years ended 31 December:

	2019	2018
Balance at beginning of year	5,117	4,378
Revisions in estimated cash flows	711	319
Net additions	69	21
Unwinding of discount	483	399
Balance at end of year	6,380	5,117

Revision of estimates affected the cost of property and equipment (*Note 3.1*) and 216 was recognised in 'Loss on disposal of non-current assets' in consolidated income statement for the year ended 31 December 2019.

4. EQUITY

Accounting policies

Ordinary shares are classified as equity. Incremental costs directly attributable to the issue of new shares are shown in equity as a deduction, net of tax, from the proceeds.

The Company's own issued equity instruments that are reacquired (treasury shares) are recognised at cost and deducted from equity. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Any difference between the carrying amount and the consideration received upon any subsequent sale is recognised in equity.

Disclosures

Share capital

As of 31 December 2019 and 2018, the Company had 100,620,000,000 authorised ordinary shares with a par value of 0.1 Rubles, of which 620,000,000 were fully paid issued shares, including 435,970,620 (2018: 480,383,463) outstanding shares and 184,029,380 (2018: 139,616,537) shares classified as treasury shares (held through its wholly owned subsidiary, MegaFon Finance LLC).

Transactions with own shares

During August-September 2018 the Group purchased through the Company's wholly owned subsidiary MegaFon Investments (Cyprus) Limited by way of a tender offer 115,317,504 of the ordinary shares and GDRs, representing 18.6% of the Company's issued shares, for 76,700 including transaction costs.

MegaFon

Notes to the consolidated financial statements (continued)

4. EQUITY (continued)

On 10 December 2018 the Group cancelled all remaining GDRs held by members of the Group and received the corresponding number of ordinary shares.

Upon this cancellation of the GDRs the Group, together with its controlling shareholders (*Note 1*), then held more than 75% of the Company's issued ordinary shares, which, according to the Federal Law "On Joint Stock Companies", required that a mandatory tender offer be made to the other shareholders to acquire the shares held by them.

Accordingly, the Company's Board of Directors, at a meeting held on 9 January 2019, approved the making of a mandatory tender offer for the remaining outstanding ordinary shares (other than those held by the Group and related companies) at a price of 659.26 Rubles per ordinary share.

As of 7 March 2019, the expiration date of the mandatory tender offer, a total of 126,246,094 ordinary shares (or 20.36% of the issued ordinary shares) had been tendered.

On 28 March 2019 the Group sold 86,800,000 of its ordinary shares with a total cost of 58,958 to USM Telecom LLC, a related party, for cash consideration of 55,726 (or 642 Rubles per share) which was paid in November 2019.

On 6 June 2019 the Group completed the buy-out of the remaining shareholders who had not tendered by acquiring the remaining 4,966,749 ordinary shares, which constituted approximately 0.8% of the issued ordinary shares, for cash consideration of 659.26 Rubles per ordinary share.

Total cash consideration for ordinary shares purchased during the year ended 31 December 2019 amounted to 86,574 including transaction costs.

Accordingly, at 31 December 2019 the Group held 29.68% of the Company's issued ordinary shares which, together with the issued ordinary shares held by its other related companies, constituted 100% of all the issued ordinary shares of the Company.

Annual dividend payment

No dividends were declared in respect of the 2019 or 2018 financial years.

MegaFon

Notes to the consolidated financial statements (continued)

4. EQUITY (continued)

Other capital reserves

The disaggregation of other capital reserves and changes of other comprehensive income by each type of reserve in equity is shown below:

	Foreign currency translation reserve	Cash flow hedge reserve	Share- based compen- sation reserve	Property and equipment revaluation reserve	Reserve fund	Transac- tions with non-con- trolling interests	Total other capital reserves
As of 1 January 2018	(1,076)	(1,567)	1,488	—	15	(23)	(1,163)
Foreign currency translation	(566)	—	—	—	—	—	(566)
Change in fair value of cash flow hedges (<i>Note 3.5.4</i>)	—	1,567	—	—	—	—	1,567
Discontinued operations (<i>Note 5.1</i>)	57	—	—	—	—	—	57
As of 31 December 2018	(1,585)	—	1,488	—	15	(23)	(105)
Foreign currency translation	425	—	—	—	—	—	425
Revaluation	—	—	—	57,610	—	—	57,610
Other movements	(6)	—	—	—	—	—	(6)
As of 31 December 2019	(1,166)	—	1,488	57,610	15	(23)	57,924

The foreign currency translation reserve is used to record exchange differences arising from the translation of the financial statements of foreign operations.

The cash flow hedge reserve is used to record the accumulated impact of derivatives designated as cash flow hedges (*Note 3.5.4*).

The share-based compensation reserve is used to recognise the value of equity-settled share-based payment transactions provided to employees, including key management personnel, as part of their remuneration. During 2019 and 2018 the Group did not have any equity-settled share-based programmes. The amount of the reserve relates to previous years awards that expired unexercised.

The property and equipment revaluation reserve is used to record upward revaluation to fair values of assets which are carried in the financial statements at revalued amounts (*Note 3.1*).

The reserve on transactions with NCI is used to record differences arising as a result of transactions with NCI that do not result in a loss of control.

The reserve fund has been established according to the requirements of Russian law and is used to cover the Company's losses, redemption of its bonds and re-purchase of its own shares in the absence of other capital resources.

5. ADDITIONAL NOTES

5.1. Discontinued operations

In January 2018 the Group established an entity named JSC MF Technologies to which in May 2018 the Group contributed 11,500,100 Class A shares of MGL, representing approximately 5% of the total shares (and approximately 59% of the voting shares) of MGL, through a series of transactions. After that, in June 2018, the Group sold a 55% interest in JSC MF Technologies to LLC Financial Investments, Gazprombank and LLC RT-Business Development (a subsidiary of Rostec) for an aggregate cash consideration of \$247.5 million (15,510 at the exchange rate as of the payment day).

The sale resulted in decreasing the Group's interest in MGL to approximately 12% of the total issued shares, or approximately 31% of the voting rights. Accordingly, the Group determined that it had lost control over MGL and discontinued consolidating this subsidiary starting from 9 June 2018.

The Group accounted for its remaining interest in MGL as an associate as it believed that it still had a significant influence over MGL through its remaining shareholding.

The fair value of the remaining interest in MGL had been estimated in the amount of 46,052 at 9 June 2018. The fair value of the Group's interest in MGL's Class A shares had been estimated based on the selling price of the shares in the above-mentioned transaction, and the fair value of the Group's interest in MGL's ordinary shares had been estimated based on the market quote for the shares.

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Notes to the consolidated financial statements (continued)

5.1. Discontinued operations (continued)

Profit/(loss) from discontinued operations for the year ended 31 December 2018 is presented below:

	2018
Revenue	30,439
Expenses	(32,879)
(Loss)/profit before tax from discontinued operations	(2,440)
Income tax	(543)
(Loss)/profit from discontinued operations, net of tax	(2,983)
Gain on sale of discontinued operations and revaluation of the remaining investment in MGL	18,208
Income tax on gain on sale of discontinued operations and the revaluation gain	(3,641)
Profit for the year from discontinued operations, net of tax	11,584
Attributable to equity holders of the Company	13,987
Attributable to NCI	(2,403)
	11,584

Cash flows generated from the sale of a portion of the Group's interest in MGL described above are presented below:

Cash received from discontinued operations	15,510
Cash disposed of with discontinued operations	(8,565)
Net cash inflow from sale	6,945

Cash flows generated by MGL for the years ended 31 December 2018 are presented below:

	2018
Net cash flows from operating activities	4,825
Net cash flows used in investing activities	(11,934)
Net cash flows used in financing activities	(13)
Net cash flows generated by MGL	(7,122)

MegaFon

Notes to the consolidated financial statements (continued)

5.2. Share-based compensation

Accounting policies

No share-based compensation arrangements were in place during 2019. During 2018 the only share-based compensation was that relating to equity-settled transactions incurred by MGL. The cost of those equity-settled transactions was recognised over the period in which the service conditions were fulfilled in Profit from discontinued operations (*Note 5.1*) while a corresponding amount was recorded as an increase in NCI.

5.3. Related parties

The following tables provide the total amount of transactions that have been entered into with related parties and balances of accounts with them for the relevant financial years:

	For the years ended	
	31 December	
	2019	2018
Revenues from USM group	71	12
Revenues from Euroset	—	127
Revenue from MGL's equity accounted associates	—	141
Revenues from Svyaznoy group	11,400	2,394
Revenues from MGL	168	3
	11,639	2,677
Services from USM group	164	1,039
Services from Euroset	—	228
Services from Garden Ring	318	1,836
Services from MGL's equity accounted associates	—	67
Services from Svyaznoy group	3,168	2,230
Services from MGL	32	730
Services from AER	15	—
Services from Forpost	—	167
	3,697	6,297
Other non-operating expenses	221	281
	31 December	2018
	2019	2018
Due from USM group	11,344	3
Due from Garden Ring	5,525	5,038
Due from Svyaznoy group	13,305	3,591
Due from MGL	22	7
Due from Forpost	—	91
	30,196	8,730
Due to USM group	332	1,861
Due to AER	1,608	—
Due to Svyaznoy group	302	933
Due to MGL	70	780
Due to Forpost	—	958
	2,312	4,532

MegaFon

Notes to the consolidated financial statements (continued)

5.3. Related parties (continued)

Terms and conditions of transactions with related parties

Outstanding balances as of 31 December 2019 and 31 December 2018 are unsecured. As of 31 December 2019 and 31 December 2018, the Group has not recorded any impairment of receivables relating to amounts owed by related parties. The assessment is undertaken each financial year by examining the financial position of the related party and the market in which the related party operates.

During 2019 the Group provided guarantees for obligations payable by the Svyaznoy group in the amount of up to 12,700 (*Note 5.8*).

USM group

The outstanding balances and transactions with the USM group relate to operations with USM Telecom LLC, USM Holding Company LLC, the Group's ultimate controlling party, and companies in the USM group.

In March 2019 the Group sold its ordinary shares to USM Telecom LLC for total consideration of 55,726 which was paid in November 2019 (*Note 4*).

In December 2019 the Group made a 12,560 interest-free loan to USM Telecom LLC repayable on or before 30 June 2021 (*Note 3.5*).

The Group is a member of the Not-for-profit Partnership "Development, Innovations, Technologies" (the "Partnership") which was established by companies in the USM group. The Partnership is required to incur education, science and other social costs as well as to maintain certain social infrastructure assets in Skolkovo Innovation Centre which are not owned by MegaFon and not recorded in the consolidated statement of financial position. The Group's accrued contributions to the Partnership of 221 during the year ended 31 December 2019 (2018: 190) are included into other non-operating expenses in the consolidated income statement.

AER loan

AER is an associate of the Group (*Note 3.4*). In October 2019 the Group received an interest-free loan in the amount of 1,921 for a term of up to 3 years from its associate AER (*Note 3.5*).

Svyaznoy

Svyaznoy group is the Group's associate (*Note 3.4*) and before the disposal Euroset was the Group's joint venture with PJSC VimpelCom. The Group had a dealership and equipment sales agreement with Euroset and now has a dealership and equipment sales agreement with the Svyaznoy group which qualifies as a related party transaction. Dealer commissions for connection of new subscribers which represent incremental costs of obtaining a customer contract are deferred and recognised in sales and marketing expenses over the expected contract term.

MegaFon

Notes to the consolidated financial statements (continued)

5.3. Related parties (continued)

Garden Ring

Garden Ring, which owns and operates an office building in the center of Moscow, is the Group's joint venture with Sberbank. The Group has a lease agreement with Garden Ring which qualifies as a related party transaction. Following the adoption of IFRS 16 the Group recognised an asset in the amount of 6,368 and a liability of 6,761 in respect of the lease as at 31 December 2019. Utilities expenses in the amount of 318 for the year ended 31 December 2019 were recognised directly in operating expenses in the consolidated income statement.

The Group also has a loan receivable from Garden Ring. The balance due from Garden Ring at 31 December 2019 consists mainly of the loan receivable. Interest income of 2,426 was recognised in respect of the loan for the year ended 31 December 2019.

MGL

In 2019 MGL was the Group's associate. During the year ended 31 December 2019 the Group purchased software from MGL in the amount of approximately 278.

Compensation to key management personnel

Members of the Board of Directors and the Management Board of the Company are the key management personnel. The amounts recognised as employee benefits expense to key management personnel of the Group for the years ended 31 December are as follows:

	<u>2019</u>	<u>2018</u>
Short-term employee benefits	460	588
Long-term incentive programme	233	82
Total	693	670

Notes to the consolidated financial statements (continued)

5.4. Business combinations

Accounting policies

The Group applies the acquisition method of accounting and recognises the assets acquired, the liabilities assumed and any NCI in the acquired company at the acquisition date, measured at their fair values as of that date. For some acquisitions the Group may elect to measure an NCI in the acquiree at its proportionate interest in the identifiable net assets of the acquiree.

The identification of assets acquired and liabilities assumed as a result of those acquisitions, determining the fair value of assets acquired and liabilities assumed as well as any contingent consideration and quantification of resulting goodwill requires management's judgment and often involves the use of significant estimates and assumptions, including assumptions with respect to future cash inflows and outflows, discount rates, terminal growth rates, licence and other asset useful lives and market multiples, among other items.

Results of subsidiaries acquired and accounted for by the acquisition method have been included in operations from the relevant date of acquisition.

Any contingent consideration to be transferred by the Group is recognised at fair value at the acquisition date. Subsequent changes in the fair value of the contingent consideration classified as an asset or liability that is a financial instrument within the scope of IFRS 9, *Financial Instruments*, are recognised in accordance with IFRS 9 in the consolidated income statement. If the contingent consideration is not within the scope of IFRS 9, it is measured in accordance with the appropriate IFRS.

Acquisition-related costs are expensed as incurred and included in general and administrative expenses.

2018 acquisitions

Safe City

In June 2018 the Group acquired a 100% interest in LLC "UK TechnoInvestProject" (subsequently renamed into LLC "CoreClass"), a Russian systems integrator, for a cash consideration of 530. The primary reason for the acquisition was to gain access to software and expertise for providing services to government sector clients under the government programme "Safe City". The purchase consideration was mainly allocated to software in the amount of 416.

Notes to the consolidated financial statements (continued)

5.5. Financial risk management

The Group's principal financial liabilities, other than derivatives and lease obligations, comprise loans and borrowings, and trade and other payables. The main purpose of these financial liabilities is to finance the Group's operations. The Group has trade and other receivables, and cash and cash equivalents that derive directly from its operations. The Group also enters into derivative transactions.

The Group is exposed to market risk, credit risk and liquidity risk. The Group's senior management oversees the management of these risks.

The Group's senior management is supported by the Finance and Strategy Committee of the Board of Directors that advises on financial risks and the appropriate financial risk governance framework for the Group. The Finance and Strategy Committee provides assurance to the Group's senior management that the Group's financial risk-taking activities are governed by appropriate policies and procedures and that financial risks are identified, measured and managed in accordance with the Group's policies. All derivative activities for risk management purposes are carried out by specialist teams that have the appropriate skills, experience and supervision. It is the Group's policy that no trading in derivatives for speculative purposes shall be undertaken.

The Company's Board of Directors reviews and agrees policies for managing each of these risks, which are summarised below.

Market risk

Market risk is the risk that the fair value of future cash flows of a financial instrument will fluctuate because of changes in market prices. Market price risks that mostly impact the Group comprise two types of risk: interest rate risk and currency risk. Financial instruments affected by market risk include: loans and borrowings, cash deposits and derivative financial instruments.

The sensitivity analyses in the following sections relate to the position as of 31 December 2019 and 2018. The sensitivity analyses have been prepared on the basis that the amount of net debt, the ratio of fixed-to-floating interest rates of the debt and derivatives and the proportion of financial instruments in foreign currencies are all constant and on the basis of the hedge designations in place at 31 December 2019 and 2018.

Interest rate risk

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates. The Group's exposure to the risk of changes in market interest rates relates primarily to the Group's long-term debt obligations with floating interest rates.

The Group manages its interest rate risk by having a balanced portfolio of fixed and variable rate loans and borrowings.

At 31 December 2019 approximately 90% of the Group's loans and borrowings (including the effect of cross-currency swaps) are at a fixed rate of interest (2018: 94%).

Notes to the consolidated financial statements (continued)

5.5. Financial risk management (continued)*Interest rate sensitivity*

The following table demonstrates the sensitivity to a reasonably possible change in interest rates on loans and borrowings. With all other variables held constant, the Group's profit before tax is affected through the impact on floating rate borrowings as follows:

	<u>Increase/decrease in basis points</u>	<u>Effect on profit before tax</u>
Year ended 31 December 2019		
Rubles	+25	(95)
Rubles	-25	95
Year ended 31 December 2018		
US Dollar	+7	(16)
US Dollar	-7	16

The analysis is prepared assuming the amount of variable rate liability outstanding at the balance sheet date was outstanding for the whole year.

Foreign currency risk

Foreign currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates. The Group's exposure to the risk of changes in foreign exchange rates relates primarily to the Group's financing activities (when cash deposits and loans and borrowings are denominated in a different currency from the Group's functional currency).

A significant portion of the Group's liabilities is denominated in Euro. If the Ruble continued to fluctuate against the Euro (or the US dollar), this could impact the Group's earnings.

To minimise its foreign exchange exposure to fluctuations in foreign currency exchange rates, the Group is migrating most of its foreign currency linked costs to Ruble based costs to balance assets and liabilities and revenues and expenses denominated in Rubles. In order to manage the foreign currency risk the Group is also focused on increasing the proportion of Ruble loans through refinancing and hedging activities.

When necessary the Group enters into cross-currency swap agreements. These derivative financial instruments were used to limit exposure to changes in foreign currency exchange rates on certain of the Group's long-term debts denominated in foreign currencies (*Note 3.5.4*).

Overall, the share of Ruble loans and borrowings (including the effect of cross-currency swaps) amounted to 100% as of 31 December 2019 (2018: 92%).

In accordance with the Group's policies, the Group does not enter into any treasury management transactions of a speculative nature.

MegaFon

Notes to the consolidated financial statements (continued)

5.5. Financial risk management (continued)

Foreign currency sensitivity

The following table demonstrates the sensitivity to a reasonably possible change in the US dollar and Euro exchange rates, with all other variables held constant, of the Group's profit before tax (due to changes in the fair value and future cash flows of monetary assets and liabilities). The Group's exposure to foreign currency changes for all other currencies is not material.

	<u>Change in foreign exchange rates</u>	<u>Effect on profit before tax</u>
Year ended 31 December 2019		
US dollar	+15%	104
US dollar	-15%	(104)
Euro	+10%	(3)
Euro	-10%	3
Year ended 31 December 2018		
US dollar	+20%	(353)
US dollar	-20%	353
Euro	+15%	(242)
Euro	-15%	242
HK dollars	+20%	871
HK dollars	-20%	(871)

The movement in the pre-tax effect is a result of monetary assets and liabilities denominated in currencies other than the functional currency of the Company.

Credit risk

Credit risk is the risk that a counterparty will not meet its obligations under a financial instrument or customer contract, leading to a financial loss. The Group is exposed to credit risk from its operating activities (primarily for trade receivables) and from its financing activities, including deposits with banks and financial institutions and other financial instruments.

The Group deposits available cash in the Russian Federation with various banks which are rated BB+ to BBB- based on Standard&Poors/Fitch or Ba1 to Baa3 based on Moody's. Deposit insurance is either not offered or only offered in *de minimis* amounts in respect of bank deposits within the Russian Federation. To manage the concentration of credit risk, the Group allocates available cash to domestic branches of international banks and a limited number of Russian banks. A majority of these Russian banks are either owned or controlled by the Russian government.

The Group extends credit to certain counterparties, principally international and national telecommunications operators, for roaming services, to certain dealers and to customers on post-paid tariff plans. The Group minimises its exposure to the risk by ensuring that credit risk is spread across a number of counterparties, and by continuously monitoring the credit standing of counterparties based on their credit history and credit ratings reviews. Other preventative measures to minimise credit risk include obtaining advance payments, bank guarantees and other security.

Notes to the consolidated financial statements (continued)

5.5. Financial risk management (continued)

The maximum exposure to credit risk at the reporting date is the carrying value of each class of financial assets disclosed in *Note 3.5*. The Group considers the concentration of risk with respect to trade receivables to be low, as its customers are located in several jurisdictions and industries and operate in largely independent markets. Concentrations of credit risk with respect to trade receivables are limited given that the Group's customer base is large and unrelated. Due to this management believes there is no further credit risk provision required in excess of the normal impairment allowance for trade and other receivables.

The Group monitors its credit risk with regards to loans extended to Garden Ring and USM Telecom LLC (*Note 3.5*). This assessment is undertaken each financial year by examining the financial position of the debtor and the market in which the debtor operates. As at 31 December 2019 and 2018, the credit risk was estimated as low, no impairment losses were identified.

Liquidity risk

The Group monitors its risk relating to a shortage of funds using a recurring liquidity planning tool. The Group's objective is to maintain a balance between continuity of funding and flexibility through the use of bank loans. Approximately 7% of the Group's loans and borrowings will mature in less than one year as of 31 December 2019 (2018: 11%) based on the carrying value of loans and borrowings reflected in the consolidated financial statements. The Group assessed the concentration of risk with respect to refinancing its debt and concluded it to be low.

As of 31 December 2019, the Group has a net current asset position. The Group believes it will continue to be able to generate significant operating cash flows and that adequate access to sources of funding and significant amount of available credit lines are sufficient to meet the Group's requirements. Additionally, the Group can defer capital expenditures if necessary in order to meet short-term liquidity requirements. Accordingly, Group management believes that cash flows from operating and financing activities will be sufficient for the Group to meet its obligations as they become due.

MegaFon

Notes to the consolidated financial statements (continued)

5.5. Financial risk management (continued)

The table below summarises the maturity profile of the Group's financial liabilities based on contractual undiscounted payments:

	Less than 1 year	1-3 years	4-5 years	More than 5 years	Total
31 December 2019					
Loans and borrowings	60,623	252,902	150,495	14,267	478,287
Trade and other payables	54,607	—	—	—	54,607
Lease liabilities	20,261	40,048	33,052	34,009	127,370
Deferred and contingent consideration	—	568	—	—	568
Long-term accounts payable	—	260	—	—	260
Total 31 December 2019	135,491	293,778	183,547	48,276	661,092
31 December 2018					
Loans and borrowings	69,174	177,491	140,715	41,138	428,518
Trade and other payables	53,235	—	—	—	53,235
Finance lease liabilities	550	1,193	1,192	5,509	8,444
Long-term accounts payable	—	199	—	—	199
Total 31 December 2018	122,959	178,883	141,907	46,647	490,396

Capital management

Capital includes equity attributable to the Group's shareholders. The primary objective of the Group's capital management is to ensure that it maintains a healthy credit rating and healthy capital ratios in order to secure access to debt and capital markets at all times and maximise shareholder value. The Group manages its capital structure and makes adjustments to it in light of changes in economic conditions.

The Net Debt to OIBDA ratio is an important measure to assess the capital structure in light of the need to maintain a strong credit rating. Net Debt represents the carrying amount of interest-bearing loans and borrowings less cash and cash equivalents and current and non-current bank deposits. As of 31 December 2019 the Net Debt to OIBDA ratio was 2.11 (2018: 2.37).

Some loan agreements also have covenants based on Net Debt to OIBDA ratios. The Group believes it has complied with all the capital requirements imposed by external parties.

Collateral

The Group did not pledge collateral as security for its financial liabilities at 31 December 2019 or 2018. 100% of the shares of Garden Ring (*Note 3.4*) have been pledged as security for loans received by Garden Ring from Sberbank, which are due to be repaid in 2026.

MegaFon

Notes to the consolidated financial statements (continued)

5.6. Group information

The consolidated financial statements of the Group include the following significant subsidiaries, joint ventures and associates of MegaFon:

Legal entity	Type	Principal activities	Country of incorporation	% equity interest	
				2019	2018
JSC MegaFon Retail	subsidiary	Retail	Russia	100	100
LLC NetByNet Holding	subsidiary	Broadband internet	Russia	100	100
LLC Scartel	subsidiary	Wireless services	Russia	100	100
LLC MegaFon Finance	subsidiary	Transactions with treasury shares	Russia	100	100
MegaFon Investments (Cyprus) Limited	subsidiary	Financing	Cyprus	100	100
JSC MegaLabs	subsidiary	New telecom services development	Russia	100	100
CJSC TT mobile	subsidiary	Integrated telecom	Tajikistan	75	75
AER Holding PTE.LTD (<i>Note 3.4</i>)	associate	e-commerce	Singapore	24.3	—
DTSRetail Limited (<i>Note 3.4</i>)	associate	Retail	Russia	25	25
LLC MF Technologies (<i>Note 3.4</i>)	associate	Holding company	Russia	45	45
JSC Sadovoe Koltso (<i>Note 3.4</i>)	joint venture	Corporate office	Russia	49.999	49.999

The Company holds interests in material subsidiaries, associates and joint ventures through a number of intermediary holding companies.

5.7. Segment information

Operating segments are reported in a manner consistent with the internal reporting provided to the chief operating decision-maker (“CODM”). The CODM is responsible for allocating resources and assessing the performance of the operating segments. The Company’s CEO has been designated as the CODM.

The Group manages its telecommunication business primarily based on eight geographical operating segments within Russia, which provide a broad range of voice, data and other telecommunication services, including wireless and wireline services, interconnection services, data transmission services and value added services. The CODM evaluates the performance of the Group’s operating segments based on revenue and operating income before depreciation and amortisation (“OIBDA”). Total assets and liabilities are not allocated to operating segments and are not analysed by the CODM.

Operating segments with similar economic characteristics, such as forecasted OIBDA, have been aggregated into an integrated telecommunication services segment, which is the only reportable segment as of 31 December 2019. Around 1.6% of the Group’s revenues and results are generated by segments outside of Russia. No single customer represents 10% or more of the consolidated revenues.

Management has presented the performance measure OIBDA because it believes that this measure is relevant to an understanding of the Group’s financial performance. OIBDA is not a defined performance measure in IFRS. The Group’s definition of OIBDA may not be comparable with similarly titled performance measures and disclosures by other entities.

MegaFon

Notes to the consolidated financial statements (continued)

5.7. Segment information (continued)

Reconciliation of OIBDA to profit from continuing operations for the years ended 31 December is presented below:

	2019	2018
OIBDA	151,618	124,157
Depreciation	(68,050)	(49,254)
Amortisation	(20,340)	(16,116)
Loss on disposal of non-current assets	(623)	(337)
Finance costs	(45,195)	(25,927)
Finance income	2,097	1,634
Share of loss of associates and joint ventures and investment impairment loss	(5,277)	(2,829)
Other non-operating expenses	(2,087)	(1,677)
(Loss)/gain on financial instruments, net	(1,982)	713
Foreign exchange gain/(loss), net	2,084	(1,271)
Profit before tax from continuing operations	12,245	29,093

Disaggregation of revenue

In the following table revenue is disaggregated by major products and service lines:

	2019	2018
Wireless services	280,375	276,076
Wireline services	30,431	30,941
Sales of equipment and accessories	38,155	28,532
Total external revenue	348,961	335,549
Intra-group revenue elimination	—	(8)
Total revenue	348,961	335,541

The Group's revenue derives from contracts with customers. Revenue from sales of equipment and accessories is recognised at a point in time (generally, the time of sale), while service revenue is recognised over time as the services are rendered to clients.

Revenue recognised under construction contracts for the year ended 31 December 2019 is nil (2018: 598).

5.8. Commitments, contingencies and uncertainties

Russian operating environment

During 2018 and 2019, the Russian economy was impacted by significant fluctuations in crude oil prices and the value of the Russian Ruble, as well as sanctions imposed on Russia by several countries. The combination of the above resulted in a higher cost of capital, increased inflation and uncertainty regarding economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects.

In addition, the first months of 2020 have seen significant global market turmoil triggered by an outbreak of coronavirus. Together with other factors, this has resulted in a sharp decrease in the oil prices and stock market indices worldwide, as well as a depreciation of the Russian Ruble.

Notes to the consolidated financial statements (continued)

5.8. Commitments, contingencies and uncertainties (continued)

These developments are further increasing the level of uncertainty in the Russian business environment.

Management believes it is taking appropriate measures to support the sustainability of the Group's business during the current worldwide pandemic. However, further deterioration of the economic situation may negatively impact the results and financial position of the Group. Currently it is not feasible to assess the amount of the possible impact.

4G/LTE licence capital commitments

In July 2012, the Federal Service for Supervision in Communications, Information Technologies and Mass Media granted the Company licences and allocated frequencies to provide services under the 4G/LTE standard in Russia.

Under the terms and conditions of these licences, the Company is obligated to provide 4G/LTE services in each population center with over 50,000 inhabitants in Russia by the end of December 2019. The Group is also obligated to make capital expenditures of at least 15,000 annually toward the 4G/LTE roll-out until the network is fully deployed.

Under the 4G/LTE licences acquired at frequency distribution auctions and from other operators via acquisition of licence-holding entities, the Company is obligated to provide 4G/LTE services in each population center with over 10,000 inhabitants in Russia by the end of the seven-year period starting from the date of obtaining the licences, i.e., by mid-April 2023.

As of the date these consolidated financial statements were authorised for issue the Group was fully compliant with these capital expenditure commitments.

Equipment purchases agreements

In 2014 the Group entered into two separate 7-year agreements with two suppliers to purchase equipment and software for 2G/3G/4G network construction and modernisation. The software usage agreements contain various termination options, however the Group is specifically committed under the agreements to pay at least an amount equal to 50% of the fees due over the remaining term of the agreements for each base station in use as at the date of termination. The amount of the commitments at 31 December 2019 is 5,896 (31 December 2018: 7,356).

Social infrastructure expenses

From time to time, the Group may determine to maintain certain social infrastructure assets which are not owned by the Group and not recorded in the consolidated financial statements as well as to incur education, science and other social costs. Such activities may be conducted in collaboration with non-governmental organisations. These expenses are presented in other non-operating expenses in the consolidated income statement (*Note 5.3*).

Notes to the consolidated financial statements (continued)

5.8. Commitments, contingencies and uncertainties (continued)

Taxation

Russian and Tajik tax, currency and customs legislation, including transfer pricing legislation, are subject to varying interpretations and changes, which can occur frequently. Management's interpretation of such legislation as applied to transactions and activities of the Group may be challenged by the relevant regional and federal authorities.

Recent events within Russia and Tajikistan suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of the legislation and as a result, it is possible that transactions and activities that have not been challenged in the past may now be challenged. Therefore, significant additional taxes, penalties and interest may be assessed.

Fiscal periods remain open to review by the authorities in respect of taxes for the three calendar years preceding the current year. Under certain circumstances reviews may cover longer periods.

The Group's management believes that its interpretation of the relevant legislation is appropriate and is in accordance with the current industry practice, and that the Group's tax, currency and customs positions will be sustained. However, the interpretations of the relevant authorities could differ.

As of 31 December 2019 the Group's management estimated the possible effect of additional taxes, before fines and interest, if any, on these consolidated financial statements, if the authorities were successful in enforcing different interpretations being taken by them, to be in the amount of up to approximately 928.

Svyaznoy guarantees

During 2019 the Group provided guarantees for obligations payable by the Svyaznoy group in the amount of up to 12,700 (*Note 5.3*). The guarantees remain in effect for one year after maturity of the underlying obligation. The Group assesses the likelihood of its having to incur any liability under these guarantees as remote.

Litigation

The Group is not a party to any material litigation, although in the ordinary course of business, the Company and some of the Group's subsidiaries may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which they operate. In the opinion of management, the Company's and its subsidiaries' liability, if any, in all pending litigation, other legal proceedings or other matters, will not have a material effect on the financial condition, financial performance or liquidity of the Group.

Anti-terror laws

On 7 July 2016 the President of the Russian Federation signed a package of anti-terror laws. The package requires telecommunications operators to store all data, including that from phone calls, messages, and data transmitted by customers for certain time periods, effective from 1 July 2018.

Notes to the consolidated financial statements (continued)

5.8. Commitments, contingencies and uncertainties (continued)

This is requiring the Group to establish additional data centers and invest in data-processing technologies.

Based on its current understanding of the law's requirements, the Group expects that the implementation of the changes may cost it approximately 25,000-30,000 over the three years beginning from 2020.

5.9. Events after the reporting date

Changes in estimates

Starting from 1 January 2020 the Group revised useful lives for its property and equipment considering the past experience and expectations derived from the analysis of technological trends, the Group's networks upgrade practices and other factors impacting useful lives. The revised useful lives are as follows:

Telecommunications network	5 to 20 years
Buildings and structures	5 to 100 years
Vehicles, office and other equipment	3 to 10 years