MEGAFON

Interim condensed consolidated financial statements
(Unaudited)

For the three months ended 31 March 2018

Contents

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Independent Auditors' Report on Review of Interim Condensed Consolidated Financial Statements

To the Board of Directors and Shareholders
PJSC MegaFon

Introduction

We have reviewed the accompanying interim condensed consolidated statement of financial position of PJSC MegaFon (the "Company") and its subsidiaries (the "Group") as at 31 March 2018, the related interim condensed consolidated income statement and interim condensed consolidated statements of other comprehensive income, changes in equity and cash flows for the three-month period then ended, and notes to the interim condensed consolidated financial statements (the "interim condensed consolidated financial statements"). Management is responsible for the preparation and presentation of these interim condensed consolidated financial statements in accordance with IAS 34 *Interim Financial Reporting*. Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410 *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim condensed consolidated financial statements consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the interim condensed consolidated financial statements as at 31 March 2018 and for the three-month period then ended are not prepared, in all material respects, in accordance with IAS 34 *Interim Financial Reporting*.

Akylbek Y. A.
JSC "KPMG"
Moscow, Russia
20 June 2018

MegaFon

Interim condensed consolidated income statement

(In millions of Rubles, except per share amounts)

	Note	Three months ended 31 March 2018 (Unaudited)	2017
Revenue		**91,484**	**86,254**
Operating expenses			
Cost of revenue		25,523	24,168
Sales and marketing expenses		6,596	6,225
General and administrative expenses		27,600	23,741
Depreciation		12,846	14,405
Amortisation		6,044	4,272
(Gain)/loss on disposal of non-current assets	8	(99)	79
Total operating expenses		**78,510**	**72,890**
Operating profit		**12,974**	**13,364**
Finance costs		(5,960)	(5,901)
Finance income		504	420
Share of loss of associates and joint ventures		(951)	(1,055)
Other non-operating expenses		(257)	(411)
Gain on financial instruments, net		678	186
Foreign exchange loss		(16)	(1,207)
Profit before tax		**6,972**	**5,396**
Income tax expense	10	2,166	1,217
Profit for the period		**4,806**	**4,179**
Profit/(loss) for the period			
Attributable to equity holders of the Company		5,828	3,884
Attributable to non-controlling interest		(1,022)	295
		4,806	**4,179**
Earnings per share, Rubles			
Basic and diluted, profit for the period attributable to equity holders of the Company		10	7

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

Interim condensed consolidated statement of other comprehensive income

(In millions of Rubles)

	Note	Three months ended 31 March 2018 (Unaudited)	2017
Profit for the period		**4,806**	**4,179**
Other comprehensive (loss)/income items that may be reclassified to profit or loss in subsequent periods:			
Foreign currency translation difference, net of tax		(82)	398
Net movement on cash flow hedges, net of tax	9	(216)	(439)
Net other comprehensive loss that may be reclassified to profit or loss in subsequent periods		**(298)**	**(41)**
Total comprehensive income for the period, net of tax		**4,508**	**4,138**
Total comprehensive income for the period			
Attributable to equity holders of the Company		5,585	3,652
Attributable to non-controlling interest		(1,077)	486
		4,508	**4,138**

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

MegaFon

Interim condensed consolidated statement of financial position

(In millions of Rubles)

	Note	31 March 2018 (Unaudited)	31 December 2017 (Audited)
Assets			
Non-current assets			
Property and equipment	8	216,046	220,705
Intangible assets, other than goodwill	8	125,082	128,140
Goodwill	5	78,584	73,218
Investments in associates and joint ventures	5	14,446	28,567
Non-current financial assets	9	4,315	3,585
Non-current non-financial assets	4	7,819	4,558
Deferred tax assets		3,896	3,829
Total non-current assets		**450,188**	**462,602**
Current assets			
Inventory		9,899	10,045
Current non-financial assets		7,999	7,446
Prepaid income taxes		1,648	2,586
Trade and other receivables		26,533	26,520
Other current financial assets	9	10,553	16,097
Cash and cash equivalents		36,757	36,147
Assets held for sale	5	45,168	284
Total current assets		**138,557**	**99,125**
Total assets		**588,745**	**561,727**
Equity and liabilities			
Equity			
Equity attributable to equity holders of the Company		116,724	109,773
Non-controlling interests		56,073	55,536
Total equity		**172,797**	**165,309**
Non-current liabilities			
Loans and borrowings	9	228,274	212,097
Other non-current financial liabilities	9	4,527	4,540
Non-current non-financial liabilities		10,978	10,181
Provisions		4,470	4,378
Deferred tax liabilities		27,951	28,792
Total non-current liabilities		**276,200**	**259,988**
Current liabilities			
Trade and other payables		38,979	50,535
Loans and borrowings	9	33,721	52,013
Other current financial liabilities	9	4,196	3,853
Current non-financial liabilities		32,580	29,186
Income taxes payable	10	782	843
Liabilities related to assets held for sale	5	29,490	—
Total current liabilities		**139,748**	**136,430**
Total equity and liabilities		**588,745**	**561,727**

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

Interim condensed consolidated statement of changes in equity

(In millions of Rubles)

For the three months ended 31 March 2018 and 31 March 2017

		Attributable to equity holders of the Company									
		Ordinary shares		Treasury shares							
	Note	**Number of shares**	**Amount**	**Number of shares**	**Amount**	**Capital surplus**	**Retained earnings**	**Other capital reserves**	**Total**	**Non-controlling interests**	**Total equity**
As of 1 January 2017		**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**129,890**	**(1,430)**	**124,166**	**(43)**	**124,123**
Profit for the period		—	—	—	—	—	3,884	—	3,884	295	**4,179**
Other comprehensive income/(loss)		—	—	—	—	—	—	(232)	(232)	191	**(41)**
Total comprehensive income		—	—	—	—	—	**3,884**	**(232)**	**3,652**	**486**	**4,138**
Equity-settled share-based compensation		—	—	—	—		—	—	—	790	**790**
Acquisition of MGL		—	—	—	—	—	—	—	—	56,187	**56,187**
As of 31 March 2017 (unaudited)		**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**133,774**	**(1,662)**	**127,818**	**57,420**	**185,238**
As of 31 December 2017		**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**115,230**	**(1,163)**	**109,773**	**55,536**	**165,309**
Adjustment on initial application of IFRS 15, net of tax	3	—	—	—	—	—	1,366	—	**1,366**	—	**1,366**
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 period		—	—	—	—	—	5,828	—	5,828	(1,022)	**4,806**
Other comprehensive loss		—	—	—	—	—		(243)	(243)	(55)	**(298)**
Total comprehensive income/(loss)		—	—	—	—	—	**5,828**	**(243)**	**5,585**	**(1,077)**	**4,508**
Equity-settled share-based compensation		—	—	—	—	—	—	—	—	1,587	**1,587**
Acquisition of subsidiaries		—	—	—	—	—	—	—	—	27	**27**
As of 31 March 2018 (unaudited)		**620,000,000**	**526**	**24,299,033**	**(17,387)**	**12,567**	**122,424**	**(1,406)**	**116,724**	**56,073**	**172,797**

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

MegaFon

Interim condensed consolidated statement of cash flows

(In millions of Rubles)

	Note	Three months ended 31 March 2018 (Unaudited)	2017
Operating activities			
Profit before tax		6,972	5,396
Adjustments to reconcile profit before tax to net cash flows:			
Depreciation		12,846	14,405
Amortisation		6,044	4,272
(Gain)/loss on disposal of non-current assets		(99)	79
Gain on financial instruments, net		(678)	(186)
Foreign exchange loss		16	1,207
Share of loss of associates and joint ventures		951	1,055
Change in impairment allowance for receivables and other non-financial assets		884	713
Finance costs		5,960	5,901
Finance income		(504)	(420)
Equity-settled share-based compensation		1,587	790
Other non-cash items		42	(34)
Working capital adjustments:			
Decrease in inventory		146	321
Increase in trade and other receivables		(1,446)	(1,036)
Increase in non-financial assets		(573)	(722)
(Decrease)/increase in trade and other payables		(5,606)	375
Increase in non-financial liabilities		1,058	480
Change in VAT, net		2,960	2,643
Income tax paid		(2,473)	(1,875)
Net cash flows from operating activities		**28,087**	**33,364**
Investing activities			
Purchase of property, equipment and intangible assets	8	(20,825)	(20,269)
Acquisition of subsidiaries, net of cash acquired	5	(5,491)	(32,575)
Proceeds from sale of property and equipment	8	373	14
Payment of contingent consideration		—	(1,190)
Proceeds from sale of subsidiaries, net of cash		—	(43)
Loans granted		(164)	—
Repayments of loans granted		—	890
Net change in short-term deposits	9	3,344	(5,091)
Interest received		408	424
Net cash flows used in investing activities		**(22,355)**	**(57,840)**
Financing activities			
Proceeds from borrowings, net of fees paid		24,281	78,254
Repayment of borrowings		(23,937)	(45,458)
Interest paid		(5,561)	(5,266)
Dividends paid to equity holders of the Company		—	(2,839)
Finance lease payments		(2)	(6)
Net cash flows (used in)/received from financing activities		**(5,219)**	**24,685**
Net increase in cash and cash equivalents		513	209
Net foreign exchange difference		97	(1,806)
Cash and cash equivalents at beginning of period		36,147	31,922
Cash and cash equivalents at end of period		**36,757**	**30,325**

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

1. General

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 ("Russia") 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.

MegaFon lists its ordinary shares on the Moscow Exchange and its ordinary shares represented by Global Depositary Receipts, or GDRs, on the London Stock Exchange, in each case under the symbol ''MFON''.

Among its consolidated subsidiaries is Mail.Ru Group Ltd ("MGL"), a leading company in the Russian-speaking internet market. MegaFon owns a 15.2% equity interest (which represents 63.8% of the voting shares) in MGL. MGL is traded on the London Stock Exchange under the symbol MAIL *(Note 13)*.

As of 31 March 2018, the Group is primarily owned by USM group, which is an indirect controlling shareholder, and by JSC Gazprombank ("Gazprombank"), which is a major banking institution in the Russian Federation, another major shareholder.

2. Basis of preparation

These interim condensed consolidated financial statements have been prepared in accordance with IAS 34, *Interim Financial Reporting*, and should be read in conjunction with the annual consolidated financial statements of the Group for the year ended 31 December 2017.

These interim condensed consolidated financial statements are unaudited and do not include all the information and disclosures required in the annual IFRS financial statements. The Company omitted disclosures which would substantially duplicate the information contained in its 2017 audited consolidated financial statements, such as accounting policies and details of accounts which have not changed significantly in amount or composition. Additionally, the Group has provided disclosures where significant events have occurred subsequently to the issuance of its 2017 audited consolidated financial statements and the 2017 audited consolidated financial statements of MGL.

The interim condensed consolidated financial statements are presented in millions of Rubles, except for per share amounts which are in Rubles, unless otherwise indicated.

The interim condensed consolidated financial statements were authorised for issue by the Company's Chief Executive Officer ("CEO") and Chief Accountant on 20 June 2018.

3. Significant accounting policies

The accounting policies and methods of computation applied in the preparation of these interim condensed consolidated financial statements are consistent with those disclosed in the annual consolidated financial statements of the Group for the year ended 31 December 2017, except for the adoption of new standards and interpretations effective from 1 January 2018.

The Group has adopted IFRS 15, *Revenue from Contracts with Customers*, and IFRS 9, *Financial Instruments*, from 1 January 2018. A number of other new standards are effective from 1 January 2018 but they do not have an effect on the Group's interim condensed consolidated financial statements.

IFRS 15 Revenue from Contracts with Customers

IFRS 15 is a comprehensive revenue recognition guidance that replaces the following previous revenue recognition standards: International Accounting Standards ("IAS") 18, *Revenue*, IAS 11, *Construction Contracts*, International Financial Reporting Interpretations Committee ("IFRIC") Interpretation 13, *Customer Loyalty Programmes*, IFRIC 15, *Agreements for the Construction of Real Estate*, IFRIC 18, *Transfers of Assets from Customers*, and SIC-31, *Revenue – Barter Transactions Involving Advertising Services*.

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services.

The Group has applied IFRS 15 using the modified retrospective method with the cumulative effect of initially applying it to contracts that are not completed at the date of initial application (1 January 2018) and therefore recognized as an adjustment to the opening balance of retained earnings at 1 January 2018.

The key impact of the transition to IFRS 15 is an increase in customer acquisition costs assets of 1,707, an increase in deferred tax liabilities of 341 and a corresponding increase in the opening retained earnings of 1,366 at 1 January 2018.

With regards to the internet segment, as a result of changes to principal versus agent evaluation in terms of IFRS 15, the Group's revenue from online advertising and community IVAS and corresponding costs of revenue have been decreased to show the applicable contracts on a net basis. There is no impact on the opening retained earnings for the internet segment.

See *Note 4* for more details on the impact from the implementation of IFRS 15 and additional disclosures.

3. Significant accounting policies (continued)

The details of the new significant accounting policies and the nature of the changes to previous accounting policies are presented below:

a) Customer acquisition costs

The Group pays its dealers commissions for connecting new customers. Before the adoption of IFRS 15, revenue sharing commissions were recognised evenly during the services rendering period, generally a twelve-month period from the date a new subscriber is activated. With implementation of IFRS 15, the Group identified dealer commissions, which represent incremental costs of obtaining a customer contract, and deferred such costs for an expected contract term.

The expected contract term is estimated based on historical information adjusted for any significant trends observed in the market and the Group's marketing strategies.

b) MGL agent-vs-principal revenue accounting policy changes

The Group, via MGL, enters into arrangements whereby it provides display advertising and some other services in social communities which are controlled by third parties but are operated on MGL's platforms. Previously the Group concluded that it is a principal in such arrangements because from the perspective of the advertisers the Group renders these services, and hence the Group has exposure to the significant risks and rewards associated with placing advertisements.

IFRS 15 requires the Group to assess whether it controls a specified good or service before it is transferred to a customer. The Group has determined that it does not control advertising services before these services are transferred to end customers, as the Group does not control the social communities where these advertisements are placed, and the social communities have full discretion in providing access to advertising space which they control and establish prices for placing of advertisements, and hence, the Group is an agent rather than a principal in these arrangements.

IFRS 9 Financial Instruments

IFRS 9 sets out requirements for recognising and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. This standard replaces IAS 39, *Financial Instruments: Recognition and Measurement*.

IFRS 9 introduced a number of changes to accounting for financial instruments, including changes to classification and measurement of financial assets, financial assets impairment methodology involving expected credit losses model, and changes to hedge accounting.

The adoption of IFRS 9 did not have a material impact on the Group's interim condensed consolidated financial statements.

4. IFRS 15

The following tables summarise the impacts of adopting IFRS 15 on the Group's interim condensed consolidated statement of financial position as of 31 March 2018 and its interim condensed consolidated income statement and statement of other comprehensive income for the three months then ended for each of the line items affected. There was no material impact on the Group's interim condensed consolidated statement of cash flows for the three months ended 31 March 2018.

Impact on the interim condensed consolidated statement of financial position is presented below:

	As of 31 March 2018		
	As reported	**Adjustments**	**Amounts without adoption of IFRS 15**
Assets			
Non-current non-financial assets	7,819	(3,259)	4,560
Current non-financial assets	7,999	404	8,403
Total assets	**588,745**	**(2,855)**	**585,890**
Equity and liabilities			
Equity			
Equity attributable to equity holders of the Company	116,724	(1,816)	114,908
Non-controlling interests	56,073	—	56,073
Total equity	**172,797**	**(1,816)**	**170,981**
Non-current liabilities			
Deferred tax liabilities	27,951	(453)	27,498
Total non-current liabilities	**276,200**	**(453)**	**275,747**
Current liabilities			
Trade and other payables	38,979	(586)	38,393
Total current liabilities	**139,748**	**(586)**	**139,162**
Total equity and liabilities	**588,745**	**(2,855)**	**585,890**

4. IFRS 15 (continued)

Impact on the interim condensed consolidated income statement is presented below:

	Three months ended 31 March 2018		
	As reported	**Adjustments**	**Amounts without adoption of IFRS 15**
Revenue	**91,484**	**408**	**91,892**
Operating expenses			
Cost of revenue	25,523	408	25,931
Sales and marketing expenses	6,596	562	7,158
Total operating expenses	**78,510**	**970**	**79,480**
Operating profit	**12,974**	**(562)**	**12,412**
Profit before tax	**6,972**	**(562)**	**6,410**
Income tax expense	2,166	(112)	2,054
Profit for the period	**4,806**	**(450)**	**4,356**

As at 31 March 2018, the Group had 3,259 of deferred customer acquisition costs within non-current non-financial assets. The amount of costs amortised into sales and marketing expenses for the three months ended 31 March 2018 is 1,015.

As at 31 March 2018, the Group had 24,865 of receivables and nil contract assets from contracts with customers within trade and other receivables.

As at 31 March 2018, the Group had 21,972 of contract liabilities from contracts with customers within current non-financial liabilities and 10,477 of contract liabilities within non-current non-financial liabilities.

As at 31 March 2018, unsatisfied performance obligations on a long-term construction contract amounted to 800. The unsatisfied performance obligations are expected to be recognised as revenue before the end of the current year.

The Group used the practical expedients 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 and for contracts which give the Group a right to consideration from a customer in an amount that corresponds directly to the value of services rendered to date.

5. Business combinations and assets held for sale

Euroset

In February 2018 MegaFon and VEON Ltd ("VEON") terminated their Euroset joint venture agreement. MegaFon acquired a 50% interest in Euroset from VEON, resulting in MegaFon's owning 100% of Euroset. VEON made a cash payment of approximately 1,200 in respect of its share of Euroset's liabilities and obligations. Also, by the date of acquisition, VEON had acquired the rights to Euroset's lease agreements for approximately 1,700 outlets.

Euroset is a retail chain, whose primary activities are sales of mobile phones, audio devices, other portable gadgets and accessories, and provision of customer subscription and payment collection services for major telecommunication operators in Russia.

The primary reason for the acquisition of VEON's interest was to enable MegaFon to contribute 100% of the Euroset shares to the Svyaznoy group and acquire an interest in the largest retail chain in the technology sector *(Note 13)*.

Accordingly, assets and related liabilities of Euroset have been presented as assets held for sale and liabilities related to assets held for sale as at 31 March 2018. Financial results of Euroset after the acquisition of the remaining 50% interest have been presented in the interim condensed income statement line «Share of loss of associates and joint ventures» in the amount of 255.

ESForce Holding Limited

In January 2018 MGL, and thereby the Group, acquired a 100% interest in ESForce Holding Limited ("ESForce"), one of the world's largest e-sports organisations, for a cash consideration of 5,659 and contingent consideration based on performance indicators determined at the end of 2018. The contingent consideration measured at fair value amounted to 1,132 as of 31 March 2018. The primary reason for the acquisition was to enhance the Group's position in the e-sports market.

The table below includes the provisional allocation of the purchase price to the acquired net assets of ESForce based on their estimated fair values:

Assets	
Property and equipment	694
Intangible assets	723
Trade and other receivables	161
Other assets	390
Cash and cash equivalents	239
	2,207
Liabilities	
Deferred tax liabilities	126
Trade and other payables	432
Other liabilities	299
	857
Total identifiable net assets at fair value	**1,350**
Goodwill arising on acquisition	5,468
Non-controlling interest	(27)
Purchase consideration transferred	**6,791**

5. Business combination and assets held for sale (continued)

Goodwill is mainly attributable to the potential of ESForce to further enhance its leadership position in the e-sports market and synergies with the Group's other operations. Goodwill is not expected to be deductible for income tax purposes.

Intangible assets mainly include trademarks and customer base, and are amortised over the period of 2 to 5 years.

6. 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 ("VAS"). 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 a telecom segment.

MGL represents an internet operating and reportable segment. Currently the Group's CODM does not review the operating results of MGL on any level lower than the level of the consolidated financial statements of MGL, accordingly, no further operating segments have been identified following this acquisition of MGL.

Around 1.4% of the Group's telecom revenue and results are generated by segments outside of Russia. The information about the breakdown of revenue from customers of the internet segment by the customers' country of domicile is not available to the management of the Group, and it considers that the cost to develop such information would be excessive. No single customer represents 10% or more of the consolidated revenue.

The income statement items for each segment, as presented to the CODM, are shown below:

Three months ended 31 March 2018	**Telecom (MegaFon)**	**Internet (MGL)**	**Eliminations**	**Group**
Revenue				
External customers	76,455	15,029	—	**91,484**
Inter-segment	4	65	(69)	**—**
Total revenue	**76,459**	**15,094**	**(69)**	**91,484**

6. Segment information (continued)

Three months ended 31 March 2018	Telecom (MegaFon)	Internet (MGL)	Eliminations	Group
OIBDA				
External customers	30,587	1,178	—	**31,765**
Inter-segment	(21)	61	(40)	**—**
Total OIBDA	**30,566**	**1,239**	**(40)**	**31,765**

Three months ended 31 March 2017	Telecom (MegaFon)	Internet (MGL)	Eliminations	Group
Revenue				
External customers	74,494	11,760	—	**86,254**
OIBDA	**29,031**	**3,089**	**—**	**32,120**

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.

Reconciliation of OIBDA to consolidated profit before tax for the three months ended 31 March:

	2018	**2017**
OIBDA	**31,765**	**32,120**
Depreciation	(12,846)	(14,405)
Amortisation	(6,044)	(4,272)
Gain/(loss) on disposal of non-current assets	99	(79)
Finance costs	(5,960)	(5,901)
Finance income	504	420
Share of loss of associates and joint ventures	(951)	(1,055)
Other non-operating expenses	(257)	(411)
Gain on financial instruments, net	678	186
Foreign exchange loss	(16)	(1,207)
Profit before tax	**6,972**	**5,396**

6. Segment information (continued)

Disaggregation of revenue

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

	Three months ended 31 March	
	2018	**2017**
Wireless services	64,388	62,714
Wireline services	6,451	6,077
Sales of equipment and accessories	5,620	5,703
Total telecom segment revenue	**76,459**	**74,494**
Online advertising	6,557	4,877
MMO games	3,753	3,208
Community IVAS	3,843	3,247
Other revenue	941	428
Total internet segment revenue	**15,094**	**11,760**
Inter-segment elimination	(69)	—
	91,484	**86,254**

Revenue from sales of equipment and accessories is recognised at a point in time, while other telecom segment service revenue is recognised over time as the services are rendered to clients. Approximately 55% of internet segment revenue is recognised at a point in time and 45% is recognised over time as the services are rendered.

7. Seasonality of operations

The Group’s telecom services are impacted by seasonal trends throughout the year. Revenue and operating profits in the second half of the year are usually expected to be higher than in the first six months. Higher revenue during the period July to September is mainly attributable to increased demand for telecom services during the peak holiday season. Higher revenue also occurs in the month of December, due to increased demand for telecom services and equipment from subscribers. Also the number of working days is significantly higher in the second half of a calendar year than in the first half of the year due to long public holidays in January and May in Russia, which further contributes to higher revenue in the second half of the year.

The Group’s internet services are impacted by seasonal trends due to the seasonal nature of advertising and online games. Revenue and operating profits are usually expected to be higher in the second half of the year than in the first six months. Higher sales during the second half of the year are mainly attributed to the fact that a large portion of advertising budgets is spent in the last quarter of the year and to the increased demand for online games following the end of the summer vacation period.

This information is provided to allow for a better understanding of the Group’s results; however, management has concluded that these impacts on the results are not ‘highly seasonal’ as considered by IAS 34.

8. Property, equipment and intangible assets

During the three months ended 31 March 2018, the Group acquired property and equipment with a cost of 7,857 (31 March 2017: 7,628). Assets with a net book value of 330 were disposed of by the Group during the three months ended 31 March 2018 (31 March 2017: 94), resulting in a net gain on disposal of 159 (31 March 2017: loss 82). Capitalised borrowing costs were 382 and 370 for the three months ended 31 March 2018 and 2017, respectively.

During the three months ended March 31, 2018, the Group acquired intangible assets with a cost of 1,885 (2017: 1,869).

9. Financial assets and liabilities

Ruble bonds

On 19 February 2018 the Group placed its Series BO-001P-04 Ruble denominated exchange bonds, in an aggregate principal amount of 20,000. The bonds have a term of 3 years following placement. The coupon rate was set at 7.2% per annum, payable semiannually.

On 7 March 2018 the Group redeemed in full at par its Series 06 and 07 Ruble denominated bonds in an aggregate principal amount of 20,000. The Group initially issued these bonds in March 2013 with a maturity of 10 years at a coupon rate of 8% per annum. The coupon rate was to be re-set after five years and the Group had the right to redeem the bonds on the last day of the coupon period for which the coupon rate was defined. The redemption of the bonds was effected pursuant to the Group’s exercise of this right.

Loan receivable

In February 2018 the loan due from Strafor was extended to April 2018 and was converted into Rubles so that the amount due including interest as of the conversion date was 1,724. The Strafor loan was also assigned to and assumed by Lonestar Enterprises Ltd (“Lonestar”), another company related to the Svyaznoy group as part of the Svyaznoy deal *(Note 13)*. As at 31 March 2018 the loan has been reclassified from financial assets to assets held for sale *(Note 5)*.

9. Financial assets and liabilities (continued)

Fair values

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments:

		Carrying amount		Fair value	
		31 March 2018 (Unaudited)	**31 December 2017**	**31 March 2018 (Unaudited)**	**31 December 2017**
Financial assets					
Financial assets at fair value through profit or loss:					
Financial investments in associates	Level 3	250	264	250	264
Financial derivatives under lease and hosting contracts	Level 3	588	150	588	150
Derivative financial assets over the equity of investee	Level 3	362	122	362	122
Convertible loans	Level 3	287	—	287	—
Loans and receivables at amortised cost:					
Short-term bank deposits	Level 2	4,188	7,656	4,188	7,656
Loans receivable from Garden Ring and Lonestar	Level 2	4,703	6,357	4,703	6,436
Other deposits	Level 2	3,968	4,976	3,968	4,706
Long-term accounts receivable	Level 2	273	—	255	—
Other loans	Level 2	249	157	249	157
Total financial assets		**14,868**	**19,682**	**14,850**	**19,491**
Financial liabilities					
Financial liabilities at amortised cost:					
Loans and borrowings	Level 2	205,836	208,143	228,021	234,969
Ruble bonds	Level 1	56,159	55,967	52,296	56,299
Finance lease obligations	Level 3	4,225	4,222	4,225	4,222
Other liabilities	Level 3	317	329	328	343
Financial liabilities at fair value through OCI:					
Foreign currency forwards designated as cash flow hedges	Level 2	4,181	3,842	4,181	3,842
Total financial liabilities		**270,718**	**272,503**	**289,051**	**299,675**

9. Financial assets and liabilities (continued)

Valuation techniques and assumptions

Management has determined that cash, short-term deposits, other loans, 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 Garden Ring and Lonestar (the former Strafor loan) approximates their carrying value.

The fair value of the Group’s other deposits relating to cash received under certain contracts with customers is determined by using a discounted cash flow (‘DCF’) method using a discount rate that reflects the bank deposit rates the Group would get in the market as at the end of the reporting period.

The fair values of the Group’s loans and borrowings and other liabilities carried at amortised cost, except for market quoted Ruble bonds, are determined by 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 March 2018 and 31 December 2017 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 foreign currency forwards are based on a forward yield curve and represent the estimated amount the Group would receive or pay to terminate these agreements at the reporting date, taking into account foreign exchange spot and forward rates, creditworthiness, nonperformance risk, and liquidity risks associated with current market conditions.

During the three months ended 31 March 2018 there were no transfers between levels of the fair value hierarchy.

10. Income tax

The Group calculates the income tax expense for the period using the tax rate that would be applicable to the expected total annual earnings.

The major components of income tax expense for the three months ended 31 March in the interim condensed consolidated income statement are as follows:

	2018	**2017**
Current income tax	3,508	3,436
Deferred income tax	(1,342)	(2,219)
Total income tax expense	**2,166**	**1,217**

11. Related parties

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

	Three months ended 31 March	
	2018	**2017**
Revenue from Telia group	—	75
Revenue from Euroset	49	121
Revenue from MGL’s equity accounted associates	40	29
	89	**225**
Services from USM group	272	219
Services from Telia group	—	203
Services from Euroset	228	207
Services from Garden Ring	398	405
Services from MGL’s equity accounted associates	4	—
	902	**1,034**

	31 March 2018	**31 December 2017**
Due from USM group	531	1
Due from Euroset	—	1,473
Due from Garden Ring	4,807	4,777
Due from MGL’s equity accounted associates	47	77
	5,385	**6,328**
Due to USM group	675	1,271
Due to Euroset	—	92
Due to Garden Ring	—	142
Due to MGL’s equity accounted associates	3	2
	678	**1,507**

11. Related parties (continued)

Terms and conditions of transactions with related parties

Outstanding balances as of 31 March 2018 and 31 December 2017 are unsecured. There have been no guarantees provided or received for any related party receivables or payables. As of 31 March 2018 and 31 December 2017, the Group has not recorded any impairment of receivables relating to amounts owed by related parties. This assessment is undertaken each financial year by examining the financial position of the related party and the market in which the related party operates.

USM group

The outstanding balances and transactions with USM group relate to operations with Garsdale Services Investment Limited ("Garsdale"), the Group's parent, USM Holdings Limited, an indirect owner of Garsdale, and their consolidated subsidiaries.

The Group purchased billing system and related support services from PeterService, another member of the USM group, in the amount of 945 and 960 during the three months ended 31 March 2018 and 2017, respectively.

Telia group

The transactions with Telia group relate to operations with various companies in that Group. Revenue and cost of services are principally related to roaming agreements between MegaFon and members of the Telia group located outside Russia and a wireline interconnection agreement with Telia Carrier Russia.

In October and November 2017 Telia Company sold its entire interest in MegaFon to Gazprombank and other institutional investors. Consequently, Telia group ceased to be a related party.

Euroset

Euroset was the Group's joint venture with PJSC VimpelCom until February 2018 when MegaFon acquired the remaining 50% interest in Euroset from VEON *(Note 5)*. The Group has a dealership agreement with Euroset which qualifies as a related party transaction.

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. The Group also has loan receivable from Garden Ring. The balance due from Garden Ring at 31 March 2018 consists mainly of the loan receivable.

12. Commitments, contingencies and uncertainties

Operating environment

During 2017 and the three months ended 31 March 2018, the Russian economy was negatively impacted by sanctions imposed on Russia by several countries. Ruble exchange and interest rates continued to fluctuate. The combination of the above resulted in reduced access to capital, 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. Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

4G/LTE licence capital commitments

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

Under the terms and conditions of this licence, the Company is obligated to provide 4G/LTE services in each population center with over 50,000 inhabitants in Russia by 2019. The Company 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 other 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 licence, i.e. by 2023.

As of the date these interim condensed 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 for years four through seven of the agreements for each base station in use as at the date of termination while receiving a credit against these commitments for fees already paid. The amount of the commitments at 31 March 2018 is 9,381 (31 December 2017: 8,675).

12. 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 March 2018 the Group's management estimated the possible effect of additional taxes, before fines and interest, if any, on these interim condensed 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 1,197.

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. This would require the Group to establish additional data centers and invest in data-processing technologies. The potentially significant capital expenditures required to do this would negatively impact the Group's cash flow generation, diverting resources from investment in growth, which could potentially impact future revenue and OIBDA.

Based on the current understanding of the law's requirements, the Group expects that the implementation of the changes may cost it approximately 35,000-40,000 over the next five years.

13. Events after the reporting date

City-Mobil

In April 2018 the Group via its telecom business subsidiary JSC MegaLabs ("MegaLabs") acquired a 18.37% interest, and via MGL acquired a further 15.75% interest, in LLC City-Mobil ("Citi-Mobil"), a taxi aggregator, for a cash consideration paid in full in the same month.

Shortly after the acquisition MegaLabs and MGL and the remaining shareholders of Citi-Mobil made additional capital contributions to Citi-Mobil. As a result, MegaLabs' share increased to 29.61% and MGL's share increased to 25.38%.

The total contributions of the Group for the acquisition of the shares in Citi-Mobil currently held amounted to approximately 1 150.

MegaFon's voting interest in Citi-Mobil does not entitle the Group to control Citi-Mobil as of the date these interim condensed consolidated financial statements are authorised for issue. However, the holding gives the Group significant influence over the investee. Accordingly, the Group will not consolidate Citi-Mobil, but will account for it as an associate.

The primary reason for the acquisition was to expand the range of the Group's digital services and products.

Neosprint (frequencies)

In April 2018 the Group acquired a spectrum in the 3.4GHz-3.6GHz band for Moscow through the purchase of 100% of the shares of 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 subject to adjustments for claims, if any, and payable within three months from the date of acquisition.

13. Events after the reporting date (continued)

Svyaznoy

In May 2018 the Group acquired a share in DTSRetail Limited ("Svyaznoy group"), which will amount to 25% of shares plus one share after completion of certain conditions, in exchange for contributing 100% of shares of Euroset to the Svyaznoy group and the Lonestar loan (the former Strafor loan) in the amount 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 to take part in future development of omnichannel networks.

Safe City

In June 2018 the Group acquired 100% of shares of LLC 'TechnoInvestProject' ("Safe City"), 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".

MGL

In January 2018 the Group set up an entity JSC MF Technologies to which in May 2018 it contributed the 11,500,100 Class A shares of MGL through a series of transactions. After that, in June, the Group sold a 55% interest in JSC MF Technologies to LLC Financial Investments (a subsidiary of USM Holdings Limited), Gazprombank and LLC RT - Business Development (a subsidiary of Rostech) for an aggregate cash consideration of $247.5 million (14,173 at the exchange rate as of 31 March 2018). The sale has resulted in the Group's interest in MGL decreasing approximately to 12%, or 31% of the voting rights. Accordingly, the Group will lose control over MGL, discontinue consolidating the subsidiary and thereafter account for its interest in MGL as an equity method investment.