



Annual report 2016



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To get more information, please visit our corporate web site:

www.sistema.com



Sistema today

Sistema PJSC is the largest private investor in the real sector of the Russian economy. Sistema's investment portfolio mostly comprises Russian companies operating in sectors including telecoms, agriculture, retail, real estate, high-tech, pharma and forest products. Sistema is a controlling shareholder in most of its portfolio companies.

SISTEMA'S VISION

Sistema's mission is to build a first-class Russian investment company that grows long-term shareholder value by efficiently managing its asset portfolio and achieving high returns on investment.

APPROACH

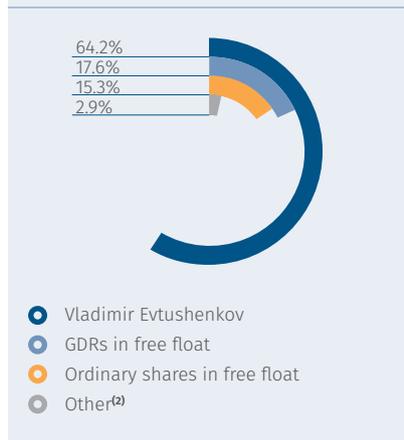
Sistema improves the operational efficiency of its acquired assets through restructuring and by working with industrial partners to enhance expertise and mitigate financial risks.

VALUE CREATION MODEL

Sistema's investment model aims to monetise its portfolio of assets by accumulating cash from incoming dividends and proceeds from asset sales, and subsequently either

- 1 investing in new, high-potential investment projects capable of generating high returns on invested capital;
- 2 distributing profit to shareholders in the form of dividends;
- 3 investing in the development of existing assets to increase their value

Sistema PJSC's shareholding structure⁽¹⁾



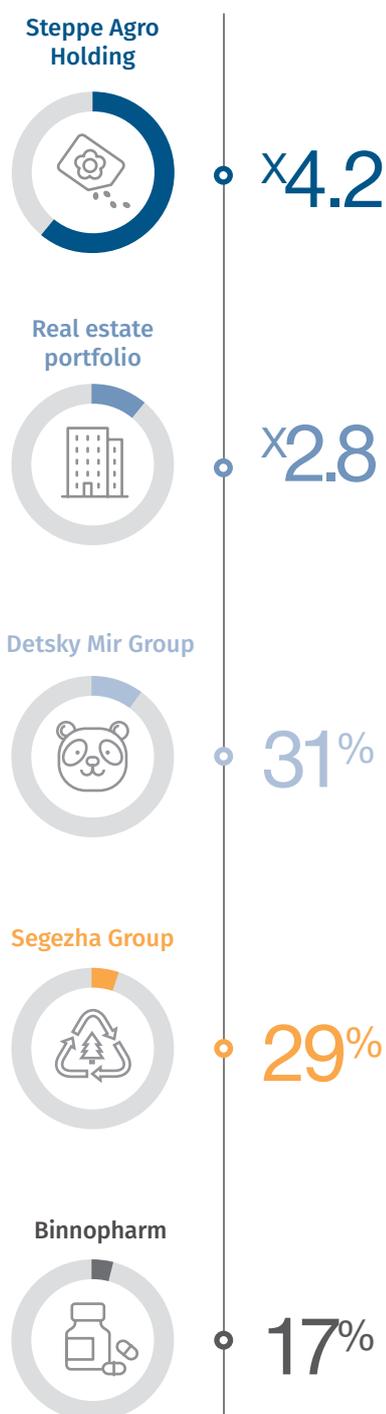
STRUCTURE OF SHAREHOLDERS' EQUITY

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

⁽¹⁾As of 31 March 2017.

⁽²⁾Ordinary shares and GDRs owned by Sistema Group companies, Sistema's management and members of the Board of Directors.

Sistema's fastest growing assets (Year-on-year revenue growth in 2016)



KEY PERFORMANCE INDICATORS IN 2016

RUB **698** bn
Revenue

15.2%

Share of non-public companies and Detsky Mir in consolidated OIBDA

RUB **100** bn
Cash inflows from investments⁽¹⁾

6%

Dividend yield on Sistema shares in 2016

KEY EVENTS IN 2016 AND SINCE THE END OF THE REPORTING PERIOD

IPO of Detsky Mir

In February 2017, Detsky Mir's shares were listed on the Moscow Exchange. Detsky Mir's market capitalisation at the start of trading was approximately RUB 62.8bn. Following the offering Sistema's stake in Detsky Mir amounted to 52.1%. Sistema raised approximately RUB 12.9bn from the transaction.



Monetisation of the transport business

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



Progressive dividend policy

In April 2016, Sistema's Board of Directors adopted a new dividend policy. In line with the new policy, total dividends recommended for each reporting year will be, at a minimum, the higher of either an amount equivalent to a dividend yield of at least 4%, or RUB 0.67 per ordinary share

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



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To get more info about dividends, please visit

[Strategic progress section](#)

⁽¹⁾At the Corporate Centre (management accounts).

CEO's statement



Dear shareholders,

In 2016, Sistema made significant progress towards strategic objectives, and reported steady growth in key financial indicators. Despite challenging macroeconomic conditions, we delivered robust growth at our portfolio companies, successfully monetised a number of investments, reduced our debt burden and increased payouts to shareholders.

Consolidated revenue and adjusted OIBDA increased by 2.8% and 5.7%, respectively, in 2016. We continued to benefit from MTS's leading position in the Russian market, stable cash flow and focus on shareholder returns. In the face of tough competition and a challenging operating environment, MTS increased its subscriber base to 109.9m subscribers and increased revenue by 2.1% thanks to the implementation of its 3D strategy (Data, Differentiation and Dividends).

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

Detsky Mir continued to implement a strategy focused on aggressive organic development and market consolidation, with a 31.4% revenue increase driven by a 12.3% growth in like-for-like sales, completion of a ramp-up of stores opened in previous years and continued expansion of the retail chain. Detsky Mir opened 101 new stores in 2016, expanding its retail chain to 525 stores. Financial performance also continued to improve, with SG&A expenses as a percentage of revenue in particular decreasing further due to continued automation of key business processes.

Our timber holding, Segezha, achieved high operating and financial results due to an increase in production capacity and sales in almost all key segments. In 2016, the group sold a record number of paper sacks and more than doubled production of sawn timber with the acquisition and successful integration of Lesosibirsk Woodworking Plant No.1, Russia's largest vertically integrated woodworking enterprise, located in the Krasnoyarsk region.

Segezha Group is implementing a large-scale investment programme to overhaul Segezha Pulp and Paper Mill and increase production capacity for sack paper, paper sacks and birch plywood.

In 2016 Sistema continued to actively invest in the agricultural business to create one of the largest and most efficient agricultural holdings in the Russian market. In 2016, our agricultural assets in Steppe Agro Holding more than doubled their land bank to 315,000 ha, quickly scaled up major business lines and achieved excellent operating results including an all-time high crop yield of more than 1m tonnes of grain, about 46,000 tonnes of tomatoes and cucumbers, and more than 16,000 tonnes of apples. Milk production within the dairy farming segment exceeded 36,000 tonnes.

In 2016, the aggregate OIBDA of Sistema's agricultural assets reached RUB 4bn, with an OIBDA margin of above 34%. We are confident that Steppe Agroholding operates in the most promising segments of the agricultural business and is managed by one of the best teams in this fast-growing market, and we will continue to actively invest in this business in 2017.

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

One of the Corporation's key priorities during 2016 and the first quarter of 2017 was effective monetisation of investments. We are proud that in February 2017 Sistema reopened the Russian IPO market for foreign investors, with the successful listing of Detsky Mir with a total placement

volume of approximately RUB 19.2bn. Detsky Mir achieved a solid valuation of roughly 9 EV/2016 EBITDA, representing a fivefold increase since 2012. Along with other notable monetisations, including the sale of stakes in MTS in 2016 and 2017 and the successful disposal of 50% in SG-trans in August 2016, this IPO allowed us to raise additional funds to achieve our strategic objectives.

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

We have devoted considerable attention to improving corporate governance and creating the optimal incentive system within our business model. This is why in May 2016 the Board of Directors approved a programme introducing co-investment by members of the management team in the equity of Sistema and its subsidiaries. Under this programme, the heads of Sistema's functions and departments annually invest portions of their total annual income in shares of the Corporation, while Sistema's investment portfolio managers invest portions of their total annual income in shares of assets in their portfolios. We are confident that this system helps align the interests of shareholders and management, and facilitates the adoption of the best management decisions by our team.

Progress in strategy implementation allowed Sistema to continue increasing payouts to shareholders. Last year, we adopted a new dividend policy that significantly increased the transparency

and predictability of our dividend payments. In accordance with this policy, the Corporation's dividends will correspond to either the minimum annual dividend yield, or the minimum dividend per share, whichever is larger. In April 2017, the Board of Directors of Sistema updated the dividend policy to increase the minimum annual dividend yield from 4% to 6% and the minimum dividend per share from RUB 0.67 to RUB 1.19, which confirms our confidence in our chosen strategy, our assets and the markets in which we operate.

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

I would like to thank our investors, the Sistema team and employees of our portfolio companies, as well as everyone who has supported and continues to support the Corporation in its activities. I believe that in 2017 we will continue to make progress with the goal of maximising the Corporation's shareholder value and growing it to benefit the whole of the Russian economy.



Mikhail Shamolin

President of Sistema PJSC

Structure of shareholders' equity

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

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

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

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

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

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

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

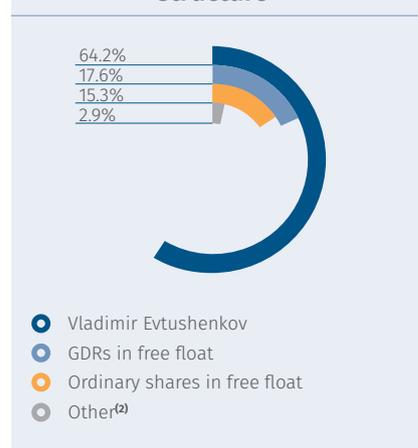
SISTEMA GDR AND ORDINARY SHARE PRICES PERFORMANCE⁽³⁾

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

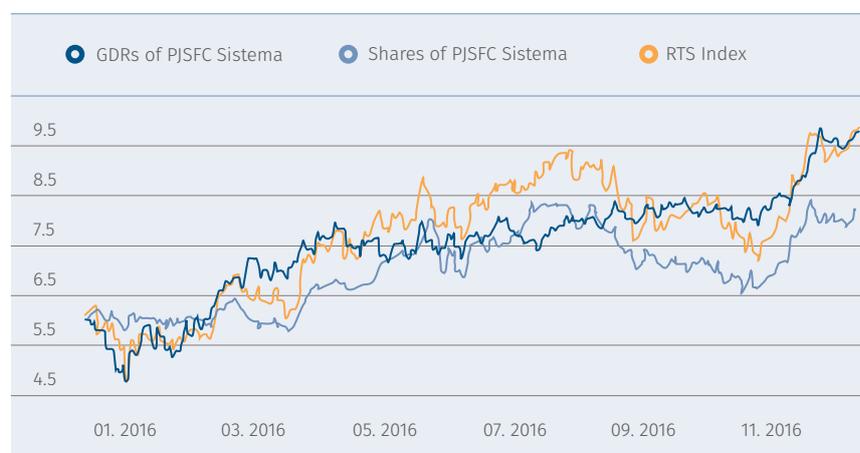
On the first trading day of 2016, Sistema's GDRs on the LSE closed at USD 6.04, for a total market capitalisation of USD 2,914.3m. On the last trading day of the year, the closing price was USD 9.00, for a total market capitalisation of USD 4,342.5m.

The highest GDR closing price of 2016, USD 9.00, was achieved on the final trading day of the year. On 8 December, ordinary shares rose to a maximum

Sistema PJSC's shareholding structure⁽¹⁾



of RUB 23.49. The lowest GDR closing price was seen on 21 January 2016 (USD 5.06), while the lowest price for the ordinary shares was registered on 7 April 2016 (RUB 16.99). The average daily trading volume on the LSE was 395,144 GDRs, while the average trading volume on MOEX was 6,891,000 ordinary shares.



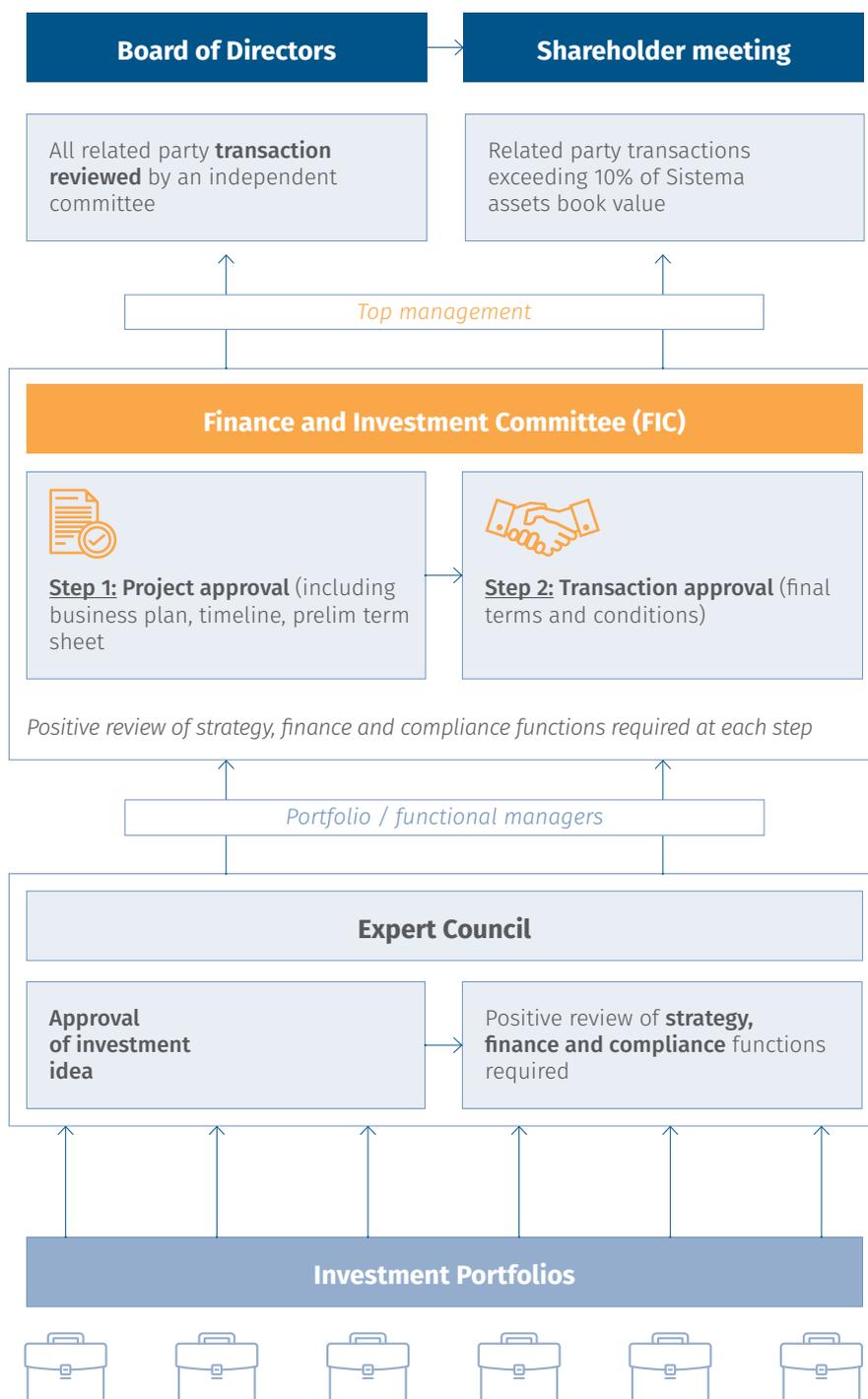
⁽¹⁾ As of 31 March 2017.

⁽²⁾ Ordinary shares and GDRs owned by Sistema Group companies, Sistema's management and members of the Board of Directors.

⁽³⁾ Source: Bloomberg.

Mission and strategy

RIGOROUS INVESTMENT PROCESS IN PLACE



- 2 Multi-step investment process with streamlined procedures set in Sistema's internal documents
- 2 Potential investment projects are **registered in Sistema's Ideas Bank** and analysed by investment portfolios
- 2 Each project requires thorough initial preparation prior to review by Expert Council and FIC and **needs to be approved separately by strategy, finance and compliance functions**
- 4 ≈ 10% of M&A ideas analysed by investment portfolios reach Expert Council and FIC.

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More info in section [Portfolio companies](#)

SISTEMA'S VISION

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VALUE CREATION MODEL

Sistema's investment model aims to monetise its portfolio of assets by accumulating cash from incoming dividends and proceeds from asset sales, and subsequently either

- 1 investing in new, high-potential investment projects capable of generating high returns on invested capital;
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BASIC INVESTMENT STRATEGY PRINCIPLES



Generation of returns on investment above the long-term cost of capital (**IRR>WACC**) with **payback period of**

5-7 years



Focus on investments with a **positive net cash flow**;



Acquisition of assets with acceptable debt levels

Debt/OIBDA of the acquired asset

<3.0x



Maintaining the **consolidated debt/EBITDA** ratio at

2.5x or less



Substantial dividend payouts pursuant to dividend policy

INVESTMENT CRITERIA



Sectors and industries:

Sistema mostly buys assets in sectors that are complementary to those in which it already operates, making it possible to leverage existing expertise and build synergies with its existing portfolio. It also invests in new attractive industries, including export-oriented sectors, where it has expertise or partners with relevant expertise.



Geography:

Sistema sees Russia and other CIS countries as its highest-priority investment locations, while also considering opportunities for further expansion to support future growth and diversity its FX and country risks.



Asset size:

Sistema focuses on large and medium-sized assets with the potential to become market leaders through synergies, industry consolidation, and efficient investment and operational strategies

SISTEMA'S GOALS FOR THE NEXT THREE TO FIVE YEARS

- 1 Maximising total shareholder return (TSR)
- 2 Creating undisputed leaders in key industries, in particular agriculture, forest products, healthcare, etc.
- 3 Dividend yields for shareholders above the market average
- 4 Raising and managing external capital
- 5 Increasing the share of assets other than MTS to approximately

70%
of the portfolio

- 6 Reducing market capitalisation discount to NAV



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More information
in section
[Dividends](#)

MEDIUM-TERM GOALS OF SISTEMA AS AN INVESTMENT COMPANY



Consistent implementation of portfolio strategy:

- Generating substantial cash flows to Sistema through portfolio monetisation and higher dividends from portfolio companies
- Diversifying the asset portfolio by acquiring large and medium-sized export-oriented companies in Russia capable of generating revenues in foreign currencies for Sistema's benefit



Creating value in current portfolio companies:

- Transforming existing assets into new industry leaders by applying best business practices
- Restructuring and supporting portfolio companies operating in segments that are most vulnerable to negative macroeconomic factors and are struggling to implement their strategies
- Implementing best corporate governance practices at subsidiaries, including appointing independent directors to their boards.



Developing international investment platforms in Europe, Asia and the US to:

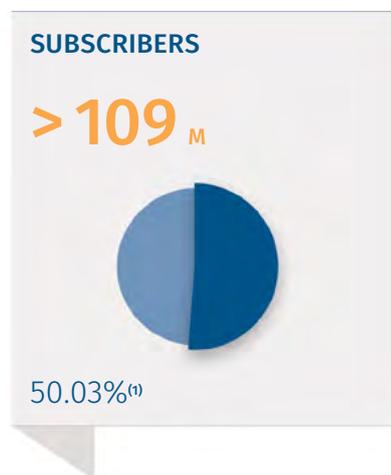
- Raise funds from co-investors
- Ensure extra points of growth for the asset portfolio by entering export markets.

CO-INVESTMENT PROGRAMME

In May 2016, Sistema adopted a programme for senior management of the Company to participate in the share capital of Sistema and Group companies ("the Programme").

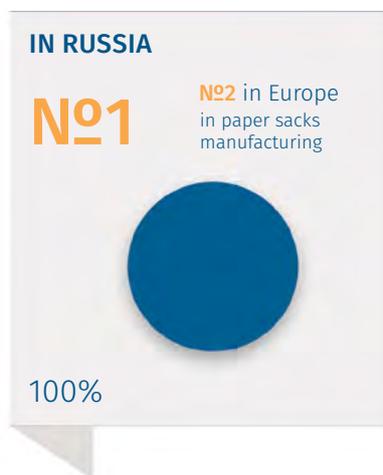
Under the Programme, heads of Sistema's investment portfolios have the obligation to make a one-off investment equal to a substantial part of their total annual income in shares and participatory interests of existing assets under their management. Heads of investment portfolios also invest a portion of their total annual income in shares and participatory interests of each of new assets acquired under their management during a year. Heads of Sistema's functional subdivisions invest a substantial part of their total annual income in the Company's shares every year.

Investment portfolio



MTS

A leading telecom operator in Russia and other CIS countries



Segezha Group

A major forest holding that performs a full cycle of logging and advanced wood processing operations



Detsky Mir

The biggest children's goods retailer in Russia and Kazakhstan. Successful IPO in February 2017



Steppe Agro Holding

Highly efficient agricultural enterprises operating in the crop farming, animal breeding, fruit and vegetable growing segments



Medsi

Russia's largest national privately owned chain of clinics offering a full range of healthcare services



MTS Bank

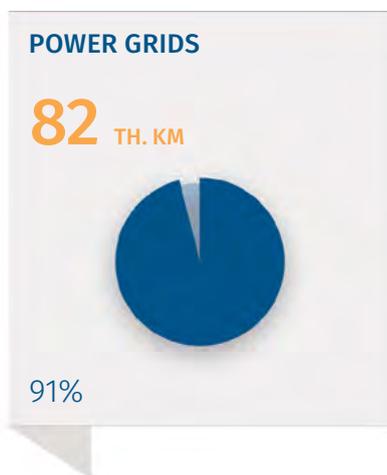
One of Russia's 50 largest banks by assets



Real estate assets

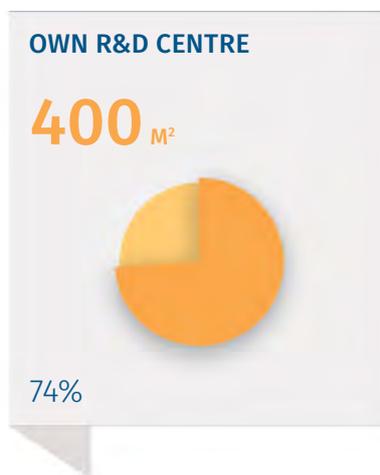
Rental business comprises ~472,000 m² of commercial properties in Moscow

⁽¹⁾ Here and thereafter Sistema's stake in the company's capital.



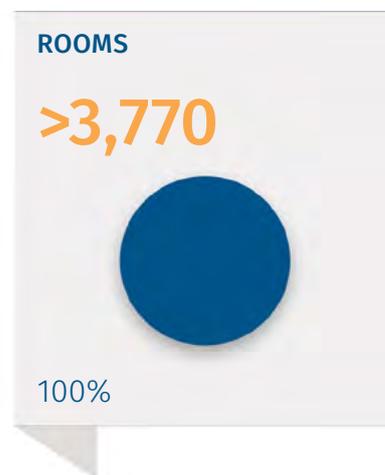
BPGC

One of Russia's biggest power grid companies. Total installed sub-station capacity of more than 22,000 MVA



Binnopharm

One of Russia's largest full-cycle pharmaceutical companies



Sistema Hotel Management

17 hotels in Russia and abroad



RTI

Russia's largest high-tech company in the defence, microelectronics, comprehensive communication and security systems industries



Concept Group

A fast-growing retailer that is one of Russia's leading women's and children's clothes and underwear retailers



Kronstadt Group

One of Russia's leading developers and manufacturers of high-tech products

Strategic progress

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about cases in
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Growth prospects and strategic development of portfolio companies:

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- >> Agroholding Steppe
- >> Real-estate assets
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- >> Medsi
- >> Binnopharm
- >> RTI
- >> MTS Bank
- >> Other investments
- >> Funds

Key events



CORPORATE GOVERNANCE

New progressive dividend policy

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

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

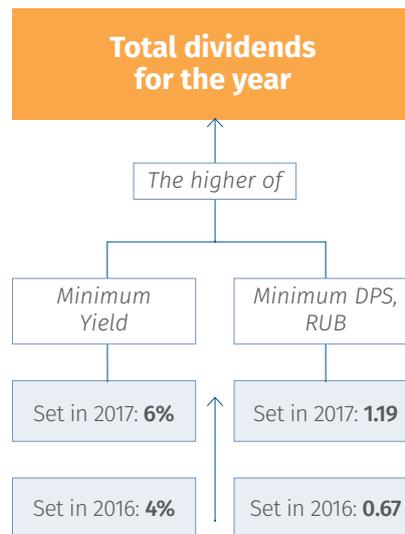
Sistema will seek to distribute dividends twice per year, based on its results for the first nine months and the full year.

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

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

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

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



Sistema’s dividends: continuing growth, RUB bn	
2016	11.5*
2015	6.5
2014	4.5

* In accordance with the Board of Directors recommendations for approval by the Annual General Meeting of shareholders

Co-investment Programme

Under the Programme, heads of Sistema’s investment portfolios have the obligation to make a one-off investment equal to a substantial part of their total annual income in shares and participatory interests of existing assets under their management. Heads of investment portfolios also invest a portion of their total annual income in shares and participatory interests of each of new assets acquired under their management during a year. Heads of Sistema’s functional subdivisions invest a substantial part of their total annual income in the Company’s sharesevery.





MONETISATION OF INVESTMENTS

Detsky Mir Group's IPO

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

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

History of Detsky Mir's valuation, RUB bn

Feb 2017	62.8
2015	42.2
2013	18.0
2012	13.1

Sale of the stake in SG-trans

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

RUB **6.0**bn

Trade amount of 50% of SG-trans



NEW PROJECTS

Development of Sistema's land bank



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

Acquisition of Lesosibirsk LDK No. 1

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



NEW PROJECTS

The merger of SSTL's telecommunications business with RCom

In 2016, Sistema and Reliance Communications Ltd ("RCom") continued to work towards the merger of SSTL's telecommunications business with RCom.

The transaction has been approved by India's two main stock exchanges (NSE and BSE), the Securities and Exchange Board of India (SEBI), the Competition Commission of India (CCI), and the Bombay and Rajasthan High Courts. All necessary shareholder and creditor approvals have also been properly secured.

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

Development of the hotel business

In November 2016, Sistema's subsidiary Sistema Hotel Management agreed to acquire nine Regional Hotel Chain (RHC) hotels from VIYM, a company managing the private equity funds in the CIS and Europe, for RUB 2.6bn.

The hotels include Courtyard by Marriott Paveletskaya (Moscow), Holiday Inn Express (Voronezh) and seven Park Inn hotels in Astrakhan, Volgograd, Izhevsk, Kazan, Novosibirsk, Sochi, and Yaroslavl, and have a total of 1,379 rooms with floor space of 87,613 sq m. The hotels have total external debt of RUB 4bn. All of the hotels were built over the past five years and do not currently require any capital investments. The hotels opened in 2014-2015 – Holiday Inn Express (Voronezh), Park Inn (Volgograd), Park Inn (Novosibirsk) and Park Inn (Sochi) – have significant potential for increased profitability when they achieve their target performance indicators.



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For more details about Sistema's hotel business see:
[Other Investments.](#)



OTHER EVENTS

Changing ownership stake in MTS

During 2016, Sistema conducted a number of transactions to sell MTS shares, bringing Sistema's effective stake in MTS's share capital to 50.03%.

As a result of the sales, Sistema raised RUB 18.1bn in 2016; an additional RUB 4.7bn was received in the first quarter of 2017 from participating in MTS's share buyback programme.

Restructuring of Rusnano's put option

In October 2016, Sistema signed an agreement with Rusnano to restructure an option agreement dated 15 May 2014 with respect to shares of Mikron.

Under the terms of restructuring, in 2017 Sistema will acquire from Rusnano 20.42% of Mikron shares for RUB 8.1bn, of which RUB 4.8bn were paid in 2016 and RUB 3.3bn will be paid on or before 29 December 2017. The option agreement signed on 15 May 2014 gave Rusnano the right to sell a stake in Mikron to Sistema for RUB 8.1bn between 31 October 2016 and 1 November 2017.

Financial results

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

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

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

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

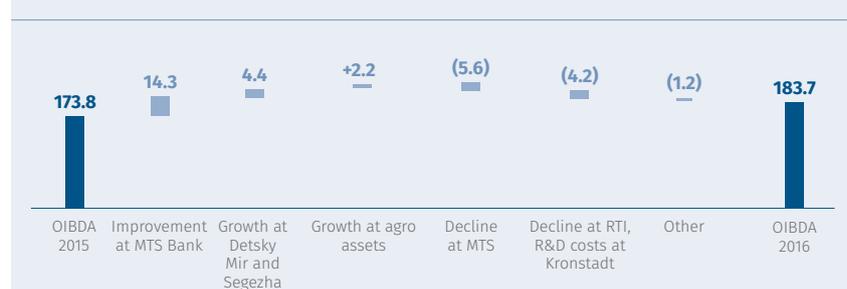
Key financials and overview of the group's operations under IFRS

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

Analysis of Group consolidated revenue, RUB bn



Analysis of Group adjusted OIBDA, RUB bn



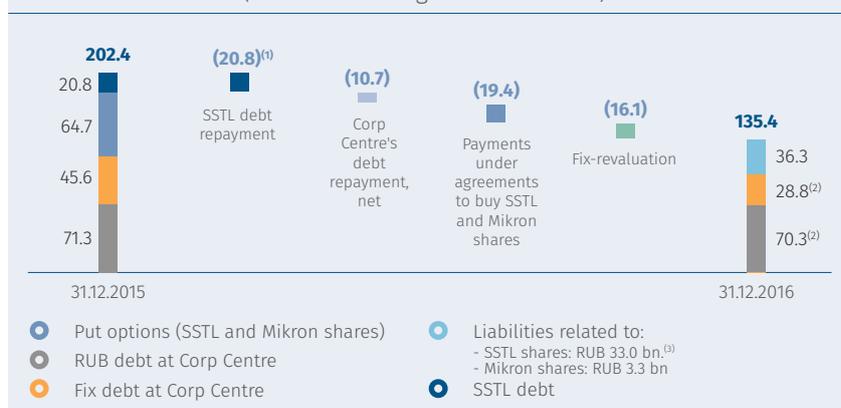
Impressive growth of key assets:

- 1 MTS:** continuing revenue growth and stablest OIBDA margin among Russian mobile operators (38.5% in 2016)
- 2 Detsky Mir and Segezha Group:** revenue growth of 31.4% and 28.7% and adjusted OIBDA growth of 32.6% and 37.6%, respectively
- 3 Steppe Agro Holding:** acquisition of 136,000 ha of agricultural land; four-fold increase in revenue and OIBDA
- 4 Real estate:** 2.8x revenue growth and OIBDA margin around 40%
- 5 Medsi and Binnopharm:** revenue growth of 14.4% and 16.9% and OIBDA growth of 72.4% and 114.7%, respectively

- 1 The Corporate Centre's financial liabilities decreased by approximately 33% during 2016
- 2 Foreign currency liabilities as a proportion of total financial liabilities decreased to 46%** at the end of 2016, compared 61% at the start of the year
- 3 Key drivers of debt reduction in 2016: (i) early repayment of SSTL's debt guaranteed by Sistema; (ii) payments to the Russian budget for SSTL shares, (iii) payment to Rusnano for Mikron shares, (iv) early repayment of RUB 10bn bonds with a coupon rate of 17% in August 2016.

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

Corporate Centre's financial liabilities, RUB bn (based on management accounts)



Key financials under RAS

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

Revenue structure

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

Structure of other incomes and expenses

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

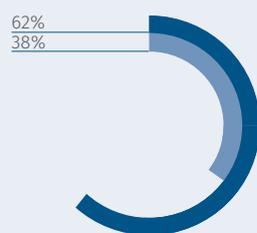
⁽¹⁾ RUB amounts recalculated at the RUB/USD exchange rate as of 31 December 2015.

⁽²⁾ Including the effect of currency hedging of the Corporate Centre's bank debt.

⁽³⁾ Liabilities to Rosimushchestvo concerning SSTL shares are denominated in US dollars.

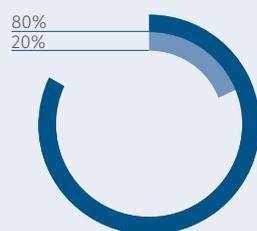
Sistema generally possesses considerable amounts of equity along with the ability to raise debt funding without creating the risk of doubt about its ability to repay such loans. Most of the Group's borrowed funds are long-term liabilities. Neither receivables nor payables are overdue.

Equity capital and liabilities



- Equity
- Debt

Structure of liabilities



- Long-term
- Short-term

Performance indicators

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

Financial stability indicators

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

Information about fuel and energy consumption

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

Credit ratings

In November 2016, Sistema terminated its contractual relationship with Moody's on the grounds that two international ratings is sufficient for creditors and investors in the Corporation's debt securities.

Moody's has revoked all of Sistema's ratings. Any ratings assigned by Moody's to Sistema Group companies from now on will be based exclusively on public information and issued at the sole discretion of the agency.

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

Dividends

In 2016, Sistema's Board of Directors approved a revised dividend policy.

In line with the new policy, total dividends recommended for each reporting year will be, at a minimum, the higher of either an amount equivalent to a dividend yield of at least 4%, or RUB 0.67 per ordinary share.

RUB 3.7^{bn}

the total amount of dividends, distributed for the first six months of 2016 (or RUB 0.38 per ordinary share)

The Corporation also set itself the goal of paying dividends twice a year: for the first half of a reporting year and for a full reporting year.

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

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

DIVIDENDS DISTRIBUTED FOR FY 2015

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

DIVIDENDS DISTRIBUTED FOR THE FIRST SIX MONTHS OF 2016

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

OMITTED DIVIDENDS

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

	2012	2013	2014	2015	2016 (for FY 2015)	2016 (H1 2016)
Total dividends, RUB	2,702,000,000	9,264,000,000	19,879,000,000	4,535,500,000	6,465,500,000	3,667,000,000
Dividend per share, RUB	0.28	0.96	2.06	0.47	0.67	0.38
Date of dividend announcement	30.06.2012	29.06.2013	28.06.2014	27.06.2015	25.06.2016	23.09.2016
Payable date	24.08.2012	26.08.2013	31.07.2014	29.07.2015	27.07.2016	20.10.2016

MTS



PJSC Mobile TeleSystems is a leading telecom operator in Russia and the CIS. MTS Group has more than 109m mobile subscribers in Russia, Armenia, Ukraine, Turkmenistan and Belarus.



The company also provides fixed-line telephony, broadband Internet access and television services in Moscow (through its subsidiary MGTS) and all federal districts of Russia. The company has more than 6,000 retail outlets in Russia. MTS also offers financial services, including the MTS Wallet application.

decline in revenue from fixed-line telephony, zero growth of mobile revenue and a slowdown in two significant market segments: land-line Internet access and pay television.

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

50.03%

Sistema's stake

SECTOR OVERVIEW⁽¹⁾

According to preliminary estimates, revenue growth in the Russian telecom market slowed from 0.8% in 2015 to 0.6% in 2016, due to the ongoing

2016 financial performance

(RUB m)	2016	2015	Change
Revenue	435,692	426,639	2.1%
Adjusted OIBDA ⁽²⁾	167,647	173,255	(3.2%)
Operating income	86,065	90,198	(4.6%)
Net income attributable to Sistema	25,377	26,460	(4.1%)
Net debt	265,850	310,937	(14.5%)
CAPEX	86,149	106,537	(19.1%)

⁽¹⁾ Sources: ACM-Consulting (report 2016); J'Son&Partners Consulting; articles in Vedomosti and Kommersant dated 16 January 2017; reports of MTS, Euroset, Svyaznoy, TMT Consulting, Comnews.

⁽²⁾ Incl. share in MTS Bank's net loss.

Leadership



**Andrey
Dubovskov**
President



Ron Sommer
*Chairman
of the Board
of Directors*

The aggregate number of mobile subscribers in Russia grew by 1.5% during the year, to 255.6m people. Mobile Internet remains the main driver of revenue growth. In 2016, leading operators tested and launched commercial IMS-based services (Voice over LTE (VoLTE) and Wi-Fi calling) in the Moscow region, which they later plan to roll out to other regions of Russia.

At present, one of the main barriers to mass uptake of VoLTE technology is low penetration of smartphones supporting this technology (at most 5% at the end of H1 2016).

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

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

BUSINESS DEVELOPMENT IN 2016

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

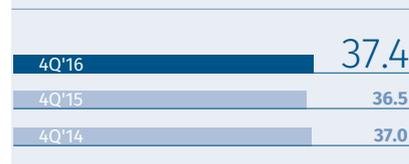
In 2016, MTS Russia maintained a positive revenue growth rate, 2.4% YoY, while revenue from the mobile business remained approximately the same as in 2015.

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

As for its investment programme, MTS allocated significant amounts for network construction (CAPEX as a proportion of revenue in Russia amounted to 20% in 2016). The company continued building out 2G/3G/4G networks throughout the year. The number of 4G base stations exceeded 28,000, covering all 83 regions of operations. MTS therefore plans no significant spending on network construction in the next few years and sees potential for CAPEX reduction in future periods.

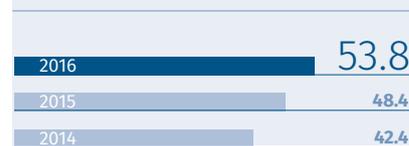


MTS share in subscriber base in Russia*, %



* based on 3M subscriber activity

Smartphones penetration on MTS network, %



49.0%

share of mobile Internet users
in MTS's active one-month
subscriber base

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

BUSINESS DEVELOPMENT STRATEGY

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

In April 2016, the Board of Directors approved a new dividend policy for 2016-2018, under which MTS intends to pay dividends of RUB 25-26 per



ordinary share and RUB 50-52 per ADR, with a guaranteed minimum payout of RUB 20 per ordinary share and RUB 40 per ADR per calendar year. Dividends paid for calendar 2016 amounted to RUB 52bn. The Board of Directors asked management to consider the possibility of organising a share buy back and subsequent redemption to guarantee shareholder returns for three years (2016-2018) of up to RUB 30bn. The first buy-back programme was announced in Q4 2016, and MTS bought 3,069,409 shares for a total RUB 747m. In Q1 2017, it announced another buy-back and acquired 32,061,256 shares for RUB 9.3bn.

2016 FINANCIAL PERFORMANCE

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

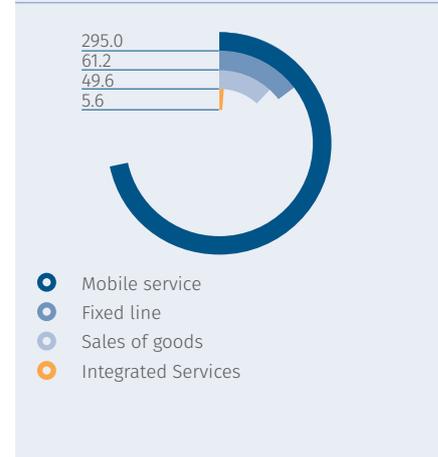
RUB **52** bn

dividends paid for 2016

MTS revenue by geography in 2016, RUB bn



MTS revenue by type in Russia in 2016, RUB bn



Detsky Mir Group



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



SECTOR OVERVIEW ⁽²⁾

The size of Russia's children's goods market in 2016 was RUB 519.5bn. Analysts project that the market will grow by an average of about 1.5% per year, and will reach RUB 554.4bn by 2020. After double-digit growth in 2011-2013, the market found itself in a period of long-term stagnation. The current economic situation has forced Russians to reconsider their approach to purchases of children's goods. Since 2015 consumer behaviour shifted, with a greater emphasis on cheaper products. Online stores have also become an increasingly popular sales channel, offering both a wide range of products and good prices, as well as

giving buyers time to evaluate, select and consult. At the same time, the children's goods market is among the most resilient to crises (together with FMCG), and showed growth after both the crisis of 2008-2009 and the crisis of 2014-2015.

In 2016, several children's goods retailers left the market, which led to a short-term drop in the market share of specialised retailers; however, specialised retailers remain the main sales channel for this segment, along with hyper- and supermarkets.

72.6%

Sistema's stake⁽¹⁾

⁽¹⁾ Sistema's stake after Detsky Mir's IPO in February 2017: 52.1%.

Leadership



Vladimir
Chirakhov
CEO



Christopher Alan
Baxter
*Chairman
of the Board
of Directors*

2016 financial performance

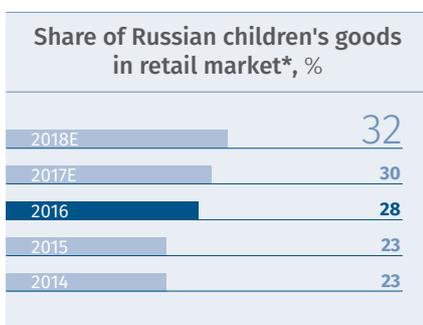
(RUB m)	2016	2015	Change
Revenue	79,547	60,544	31.4%
Adjusted OIBDA	8,203	6,185	32.6%
Operating income	6,620	3,805	74.0%
Adjusted net income attributable to Sistema	2,775	2,167	28.0%
Net debt	12,193	16,425	(25.8%)

⁽²⁾ According to data from Ipsos Comcon and Detsky Mir Group.

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

BUSINESS DEVELOPMENT IN 2016

In February 2017, Detsky Mir completed its IPO on the Moscow Exchange. The share offering was 2.1x oversubscribed, with a placement price RUB 85 per share, implying a market capitalisation of RUB 62.8bn and an EV/2016 EBITDA multiple of roughly 9x. Trading commenced on 10 February 2017 under the ticker DSKY. The success of Detsky Mir's IPO can be seen as recognition of the company's outstanding performance in recent years.



Detsky Mir Group growth

	2014	2015	2016
Stores, totally	390	491	596
New stores	71	104	101
Retail space, th. sq m	322	425	525

Share of Detsky Mir's private labels in goods turnover

	2014	2015	2016
Footwear	64%	69%	81%
Apparel	65%	71%	74%
Oversized goods	30%	30%	32%

As of 31 December 2016, Detsky Mir Group had 525 stores (480 Detsky Mir stores and 45 ELC stores) in 171 Russian cities and seven cities in Kazakhstan. The company delivered significant growth during the past two years, opening 103 new Detsky Mir stores and 1 ELC in 2015, and another 100 Detsky Mir stores and 1 ELC store in 2016. The Group's total selling space as of 31 December 2016 was 596,000 sq m. Detsky Mir's market share in Russia's specialised children's goods retail was 44% in 2016 (compared to 32% in 2015), while the company had 17% of Russia's total market for children's goods including non-specialised hyper- and supermarkets (vs. 13% in 2015). Detsky Mir is absolute No 1 player in the children's goods market and c. 3x size of the 2nd largest competitor.

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

525

Detsky Mir stores,
as of 31 December 2016

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

Further centralisation of supply via Detsky mir's own warehouse in the village of Bekasovo (the Moscow region) was another key business development projects during the year. Having own warehouse allowed the company to reduce logistics costs, increase

centralisation of supplies, improve stock management and, ultimately, increase turnover.

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

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

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

4.4

RUB bn paid Detsky Mir in 2016 - record-high dividends, including RUB 3.0bn to Sistema



BUSINESS DEVELOPMENT STRATEGY

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

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

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

share of centralised supplies to 75-80% of the purchase costs for goods that passed through the warehouses by 2019.

2016 FINANCIAL PERFORMANCE

Detsky Mir's revenue grew by 31.4% year-on-year in 2016, driven by 12.3% growth in like-for-like⁽²⁾ sales, completion of ramp-up of stores opened in previous years and continued expansion of the retail chain. The online store remains the fastest-growing sales channel, with more than two-fold growth in sales in 2016.

Adjusted OIBDA increased by 32.6% in 2016 on the back of improved operating efficiency.

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

⁽²⁾ Like-for-like growth includes only DM stores in Russia that have been in operations for at least 12 full calendar months.

Segezha Group



Segezha Group is Russia's largest vertically integrated forest holding, with a full cycle of logging and advanced wood processing. It has a global presence and a diversified product portfolio.



The Group comprises forest, wood processing and pulp & paper assets in Russia and Europe. Its production facilities are located in eight countries and six regions of Russia. Segezha's products are available in 88 countries. Its enterprises employ 13 thousand people.

Anti-dumping duties introduced by China in April 2016 (for virtually all producers from Europe, North America and Japan) have created advantages for paper sack producers from Russia and Canada.

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

100%

Sistema's stake

SECTOR OVERVIEW⁽¹⁾

Sack paper

The global market for unbleached sack paper continues growing steadily. The projected CAGR for global consumption till 2020 is 2.3%, with growth mostly driven by demand from Asian countries.

Leadership



Kamil Zakirov (*)
President



Sergey Pomelov(**)
*Chairman
of the Board
of Directors*

*as of 31 December 2016 — Sergey Pomelov

**as of 31 December 2016 — Ali Uzdenov

2016 financial performance

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

⁽¹⁾Sources: Indufor, FAO.

Paper sacks

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

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

Birch plywood

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

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

Sawn timber

The global market of sawn softwood timber grew by 1.5% YoY in 2016. Consumption in Asia-Pacific, Central Asia and some Middle Eastern countries (key markets for Segezha Group) is expected to grow by 1%-3% per annum till 2020. The biggest consumers of sawn timber are the US and China.

The US gets sawn timber mostly from Canadian producers. China (the world's second biggest market) has had one of the highest growth rates of demand for sawn timber. In 2016, it continued increasing supply from Russia, and the share of Russian producers reached 50% of its total imports.

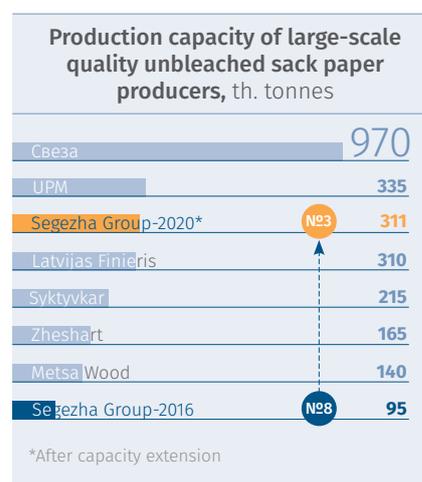
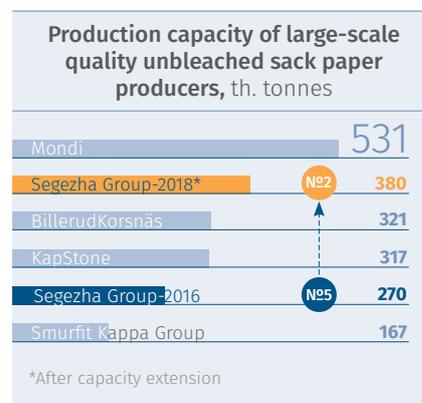
BUSINESS DEVELOPMENT IN 2016

Paper and Packaging

In 2016, Segezha exported paper and packaging to 53 countries. Paper supplies to South Africa grew six-fold, to South Korea four-fold, and to Saudi Arabia, Mexico, China, Turkey and Kuwait two-fold. While the Russian market of industrial sacks shrank, Segezha Group increased its market share thanks to a more successful pricing policy than foreign competitors. In 2017, the Group plans to start selling sacks in some new countries in the Middle East, Africa and Latin America, while maintaining its current share of the European market.

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

Segezha PPM is the world No.4 and Russia's No.1 producer of unbleached sack paper, accounting for 70% of Russia's total output. Exports account for 92% of paper sales, excluding intra-group supply (Russia, Europe).



Segezha Group:

No. 1

in Russia and No.2 in Europe for paper sacks manufacturing

No. 1

in Russia and No.4 globally for manufacturing of quality unbleached sack paper

Wood processing (sawn timber)

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

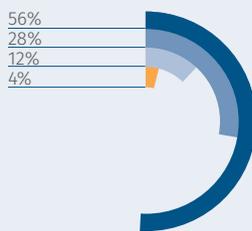
Lesosibirsk LDK No.1, which was acquired in early 2016, reported strong financial and operational performance during the year. The plant modernised its production facilities, optimised business processes and improved management efficiency. Segezha Group is beginning to work with new timber species that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

Segezha Group:

No 5

*in Russia and No7 globally
for manufacturing of large-size
birch plywood*

Segezha Group revenue by business segments in 2016



- Paper & Paper sacks
- Wood processing
- Plywood
- Forestry

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

Plywood and wood boards

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

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

Prefab houses

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

Production

- 1 Sales of paper sacks grew in 2016 vs. previous year thanks to the commissioning of a new production facility. As a result, Segezha Group beat its own record and manufactured 1.2bn paper sacks last year.
- 2 By expanding paper sack production, the Group increased consumption of its own paper. As a result, sales of sack paper to outside buyers fell year-on-year. In 2016, Segezha Group manufactured 286,400 t of paper, the same amount as in 2015, despite the stoppage at the Segezha PPM for modernisation works.
- 3 Sawn timber sales more than doubled YoY thanks to acquisition of Lesosibirsk LDK and increased output of other enterprises, which was achieved through a set of measures aimed at enhancing efficiency.
- 4 Sales of birch plywood grew in 2016 vs. 2015. The slump in sales in Q4 2016 was due to a temporary decline in demand from customers following a rise in demand in Q2 and Q3 caused by the strengthening of the ruble.
- 5 Logging in Q4 grew by 62.2%, thanks to the takeover of LWP's logging area, upgrade of the logging fleet with machines with higher productivity, and the management's efforts to encourage more logging.

BUSINESS DEVELOPMENT STRATEGY

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

Production parameters

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

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



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

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

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

2016 FINANCIAL PERFORMANCE

Segezha Group's revenue grew by 28.7% in 2016, which was achieved by increasing production capacity, expanding the geography of paper sack sales, and acquisition of Lesosibirsk LDK, which contributed RUB 5.7bn to the Group's revenue in 2016.

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

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

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

Steppe Agro Holding



JSC Steppe Agro Holding is a major player in the Russian agricultural sector, and owns a diversified portfolio of assets in four key segments: crop farming, dairy farming, fruit farming and vegetable farming.



Agro Holding's assets are located in four regions of southern Russia – Krasnodar, Stavropol, Rostov and Karachai-Cherkessia – which offer the most favourable climate, crop yields and logistics. Steppe Agro Holding holds a 50% equity stake in RZ Agro⁽¹⁾, a joint venture with the Louis Dreyfus family.

SECTOR OVERVIEW⁽²⁾

Crop farming

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

88.1%
Sistema's stake

Leadership



Konstantin Averin
CEO



Ali Uzdenov
Chairman of the Board of Directors

Financial results of Steppe Agro Holding

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

Financial results of RZ Agro

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

⁽¹⁾ RZ Agro's results are not consolidated into Steppe's financial results.

⁽²⁾ Sources: Russian Federal Statistics Service, USDA, FAO, the Russian Federal Customs Service



International prices for agricultural produce continued falling in 2016, which is a serious negative factor for the industry. Wheat prices hit a low vs. the 10-year average, but the depreciation of the rouble offset the negative effect from the decline of international prices for Russian agricultural producers.

Dairy farming

Russia has seen a gradual decline in milk output over the last five years. The main reason is the decline in output from household farms (which in 2016 accounted for 44% of Russia's total milk output). Marketable milk accounted for an estimated 66% of Russia's total milk output in 2016. This low share results in a deficit of milk suitable for processing, higher milk prices and a need to import milk. Imports accounted for an estimated 20% of Russia's total milk consumption.

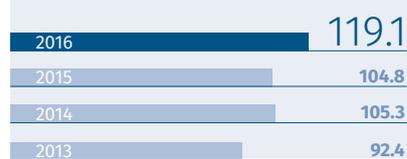
The total number of milk-producing dairy cows in Russia in 2016 was 8.3m, down 8% in the last five years, mainly due to the reduction of livestock kept by household farms and inefficient producers leaving the market. The decrease is offset by the gradual growth of milk yield per cow: in 2016, the average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

Fruit farming

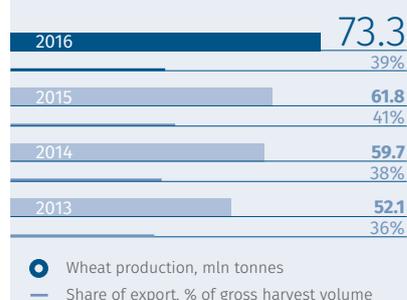
Fruit farming in Russia has delivered continued growth, including apple production. However, despite increasing output and the continued embargo on certain food imports from Western countries, dependence on imports remains high: imported apples account for about 36% of consumption.

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

Gross harvest volume of grain and legumes in Russia, mn tonnes



Gross harvest volume and export of wheat in Russia



Production of raw milk in Russia, mn tonnes



Vegetable farming

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

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

BUSINESS DEVELOPMENT IN 2016

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

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

171,800

**tonnes was the gross wheat harvest
of the new assets**

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

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

* pro forma including five farms in the Krasnodar region and OJSC Rodina.

** net of assets acquired in November and December 2016

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

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

* pro forma including five farms in the Krasnodar region and OJSC Rodina.

** net of assets acquired in November and December 2016

Crop farming

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

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

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

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

Dairy farming



Steppe Agro Holding achieved a substantial improvement in its operational results from 2015.

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

Fruit farming

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

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

Vegetable farming

Yuzhny Agricultural Complex (acquired by Steppe Agro Holding in December 2015) is Russia's biggest producer of protected-ground vegetables, with 144 ha of greenhouses.

Operational results of dairy farming

	2014	2015	2016	2016/2015
Number of milk-producing cows	3,084	3,272	3,700	13%
Gross milk yield, K t	27.9	30.2	36.2	20%

Operational results of fruit farming

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

* Based on management accounts (proforma).

Operational results of vegetable farming

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

* Based on management accounts (proforma).

In 2016, its gross harvest of tomatoes and cucumbers grew by 22% to 45,800 t due to an increase in land used for production from 118.5 ha in 2015 to 130.5 ha in 2016, and an increase in the average yield from 31.6 kg/sq m in 2015 to 35.1 kg/sq m in 2016.

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



BUSINESS DEVELOPMENT STRATEGY

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

HA **315,000**

*land bank of Agroholdin Steppe
as of 31 December 2016*

The operational strategy envisages increasing the assets' efficiency and fully unlocking their production potential:

Crop farming



through introduction of new agricultural technologies, optimisation of crop rotation, expansion of the fleet of high-power machines and increase of land in freehold.

Fruit farming



through achieving maximum yields of intensive orchards and increasing the share of produce sold as own brand.

Dairy farming



through maintaining yield per cow at >10,000 p.a. and ensuring compliance with European standards.

Vegetable farming



through optimisation of the variety split, increase of the share of produce sold during the high season (November-May) and the share of produce sold as own brand.

Real estate assets

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

100%

Sistema's stake in Leader Invest and Business Nedvizhimost



Leadership (Business Nedvizhimost)



Stanislav
Khatskevich*
CEO



Leonid Monosov
*Chairman
of the Board
of Directors*

*as of 31 December 2016: Igor Shabdurasulov

Leader Invest

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

Business Nedvizhimost

Business Nedvizhimost is managing, leasing and operating commercial real estate. The company owns over 300,000 sq m of real properties in Moscow, and also has assets in Saint Petersburg. Business Nedvizhimost comprises 100% of Mosdachtrest charter capital (rental assets).

Leadership (Leader Invest)



Yevgeny Rubtsov
CEO



Felix
Evtushenkov
*Chairman
of the Board
of Directors*

Financial performance (Leader Invest, Business Nedvizhimost and Mosdachtrest)⁽¹⁾

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

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

SECTOR OVERVIEW⁽¹⁾

Residential properties

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

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

Given the prospects of launch of projects and new stages in existing housing projects, an increase in the volume of supply can be expected in 2017.



Commercial real estate

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

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

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

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

BUSINESS DEVELOPMENT IN 2016

Leader Invest

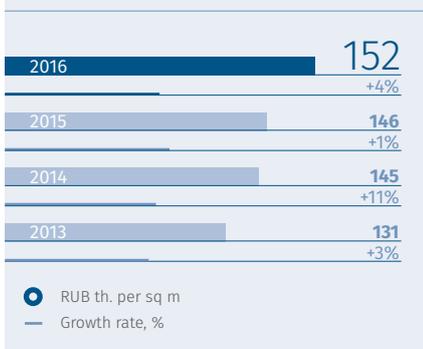
In 2016, the company shifted its focus from infill construction, where it has certain experience, to comprehensive development projects. Diversification of the portfolio through the inclusion of large-scale projects ensures the company's continuous operations until at least 2019.

SQ. M 872,000
are of project **ZIL Yug**

SQ. M 472,000
are of project **Nagatino i-Land**

SQ. M 243,000
are of project **120 Lobachevskogo St.**

Prices in the primary housing market of Moscow, Comfort Class



⁽¹⁾Sources: Rosreestr, Metrium Group, JLL, Knight Frank, ILM and NAI Becar



Largest completed projects

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

Infill development is represented by 42 projects with a total area of 520,000 sq m. The average area of one project is small and amounts to 12,000 sq m, with the implementation period of 2.5 years.

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

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

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

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

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

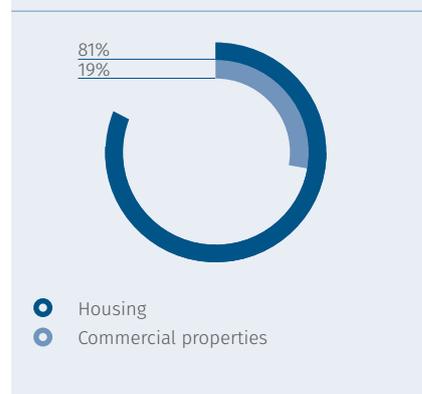
Largest projects with launched construction

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

Leader Invest portfolio structure by class



Leader Invest portfolio structure by segments



Business Nedvizhimost

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

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

In 2017, Business Nedvizhimost plans to develop a chain rental product on the basis of its own properties.

The company developed a work plan providing for the commercial use of each property released by MGTS and partially renovated six properties. To attract the largest number of potential tenants, the company plans to start a complete renovation of seven properties with a total area of 28,500 sq m in 2017.



BUSINESS DEVELOPMENT STRATEGY

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

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

2016 FINANCIAL PERFORMANCE

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

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

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

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

BPGC

Bashkir Power Grid Company



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



91.0%

Sistema's stake

Leadership



Dmitry
Sharovатов
CEO



Vadim Pavlus
*Chairman
of the Board
of Directors*

SECTOR OVERVIEW

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

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

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

2016 financial performance

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

The key changes in power grid regulations in 2016 included:

- 1 introduction of standard tariff rates, determining the amount of utility connection fee;
- 2 permission to regional regulators to transfer reasonable expenses (and withdrawals) for five years for big TGOs with at least 10% share in regional revenue;
- 3 toughening of criteria for granting the TGO status.

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

The key macroeconomic factor having impact on the business of BPGC Group is inflation. The main customers of grid transmission services in Bashkortostan are large industrial enterprises and, given that the Russian government expects the country's economic growth to resume, net power supply may grow in 2017.

BUSINESS DEVELOPMENT IN 2016

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

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

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

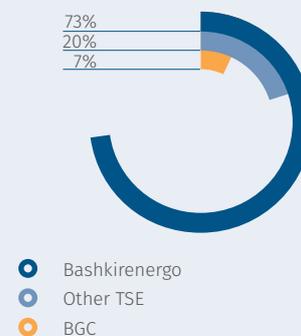
In 2016, the company's investment programme was increased by 24% due to implementation of a large project - construction of the Gvardeiskaya 220 kV substation with a 220 kV supply main worth RUB 801.9m. Last year, the company also put into operation some large grid infrastructure facilities: the Zubovo 110 kV substation and the Irek 110 kV substation.

Investment in the project of comprehensive reconstruction of power grids in Ufa (Smart Grid) amounted to RUB 796.2m in 2016. Financing for 2017 is projected at RUB 967m.

BPGC investment programme, RUB bln, VAT included

2019E	4.0
2018E	4.2
2017E	4.6
2016	5.4
2015	4.0

BPGC companies share in regionals revenue, %



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

24,232

**number of utility connections
grew by 11.3% in 2016**

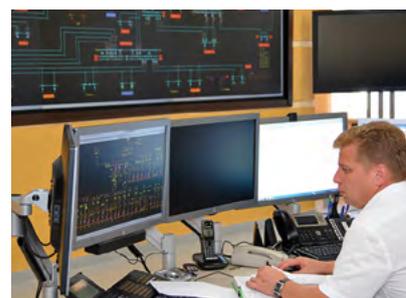
Production parameters

Parameter	Year		Change
	2015	2016	
Distribution grids (Bashkirenergo)			
Power in, m kWh	21,806	22,286	+2.2%
Power out, m kWh	20,013	20,452	+2.2%
Losses in distribution grids, %	8.22	8.23	+0.01 p.p.
Number of connections	21,765	24,232	11.3%
Connected power, MW	454	394	-13.2%
Transmission grids (BGC)			
Power in, m kWh	21,797	24,979	+14.6%
Power out, m kWh	21,500	24,658	+14.7%
Losses in transmission grids, %	1.36	1.29	-0.07 p.p.

BUSINESS DEVELOPMENT STRATEGY

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

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



2016 FINANCIAL PERFORMANCE

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

35.1%

OIBDA margin
in 2016

20%

reduction of maintenance costs – as a result of Smart Grid technology

Medsi Group



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



100%

Sistema's stake

Leadership



Elena Brusilova
President



Vladimir Aleksandrovsky⁽¹⁾
*Chairman
of the Board
of Directors*

SECTOR OVERVIEW ⁽²⁾

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

The size of the Russian private healthcare market was RUB 679.6bn in 2016. However, the growth rate fell almost by half, from 12% in 2015 to 7%.

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

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

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

2016 financial performance

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

⁽¹⁾ As of 31 December 2016: Vasil Latsanich

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

BUSINESS DEVELOPMENT IN 2016

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

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

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

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

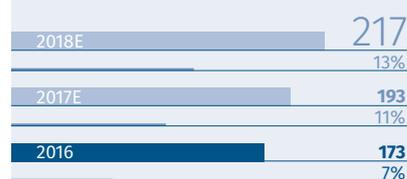


The new clinicodiagnostic centre in Krasnaya Presnya, which opened in December 2015, is positioned as the company's second flagship asset. In 2016, it opened consultation rooms in all medical disciplines with expert-level equipment, with consultations provided by highly qualified doctors (the centre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

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

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

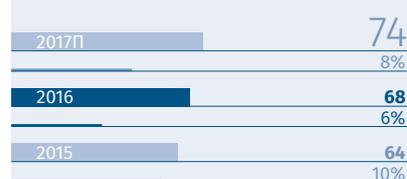
Market volume of commerce medical industry in Moscow⁽¹⁾



● Market volume, RUB bln.
— Growth rate, %

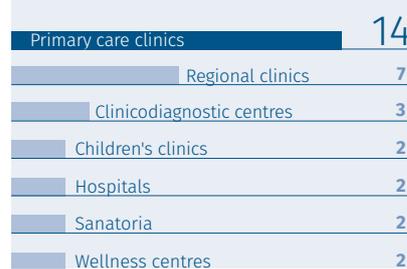
⁽¹⁾Including VHI

Market volume of VHI in Moscow



● Market volume, RUB bln.
— Growth rate, %

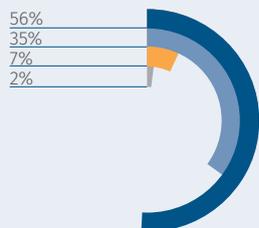
Medsi's assets



RUB **154** mln

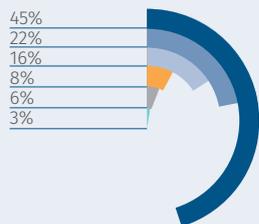
aggregate amount
for provided treatment
to over 1,200 Medsi's patients

Medsi revenue by clients in 2016, %



- Insurance
- Private
- Corporate
- Others

Medsi revenue by assets in 2016, %



- Clinics
- CDC at Belorusskaya
- Children's clinics
- Hospitals
- Other
- CDC at Krasnaya Presnya

Operating performance

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

BUSINESS DEVELOPMENT STRATEGY

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

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



2016 FINANCIAL PERFORMANCE

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

Binnopharm



JSC Binnopharm is a Russian full-cycle pharmaceutical company with an in-house R&D division

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

74%

Sistema's stake

Leadership



Alexey Chupin
CEO



Dmitry Zubov
*Chairman
of the Board
of Directors*



SECTOR OVERVIEW⁽¹⁾

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

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

The share of foreign medications on the Russian market slumped from 73% in 2015 to about 71% in 2016 in monetary terms. In physical terms, the share of imported drugs remained virtually unchanged at 40%. Domestic

manufacturers still hold the strongest positions in the hospital segment (accounting for 36% in monetary terms and 76% in physical terms). This trend reflects the government's policy towards import substitution in the pharmaceutical market and is the first result of corresponding legislative initiatives, notably, the decree adopted in 2015 that prohibits foreign products to participate in government tenders if there are bids from two or more Russian-made products.

Most experts expect the market's moderate growth in rouble terms (around 7%) to continue in 2017. The main growth driver will be recovery of consumption and substantial inflation in the retail segment.

2016 financial performance

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

⁽¹⁾ Source: DSM.

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

**Medicine average price
growth rate in Russia, %**

Year	Growth rate, %
2016	4%
2015	14%
2014	14%
2013	7%

BUSINESS DEVELOPMENT IN 2016

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

1. Opening of an R&D centre with an area of 400 sq m and 7 laboratories. The centre employs over 30 people, many of them with doctoral degrees. Over 20 drugs are now at various stages of development and registration.
2. Active promotion of proprietary products (Noben, Salbutamol, Beclomethasonum, Theopec, Combipec) in the retail segment. The company signed 70 contracts with pharmacy chains (32% of the market) covering 11,522 pharmacies. Binnopharm's products are now available in every fourth pharmacy in Russia.
3. Acquisition of LLC Alpharm, a manufacturer of two medications of the pharmacy segment, Kipferon and Prostopin. The acquisition allowed Binnopharm to enter the OTC drugs market and secure potential commercial advantages by using own interferon substance for manufacturing of Kipferon.

4. Obtaining exclusive rights for promotion and sale of third-party products in Russia. Licence agreements were signed with German Medice and Russian BIS, which provided efficient and quality drugs in such segments as neurology, pediatrics, anti-viral and cold-relief medications, for distribution and promotion.

Progress made:

The share of proprietary drugs in revenue grew from 43% to 78%.

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

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

Binnopharm will continue expanding its product portfolio in 2017. It expects to launch proprietary drugs that are currently undergoing market authorisation.

Production capacity

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

It also plans to sign licence agreements to sell third-party products and carry out projects of contract-based manufacturing for foreign partners.

BUSINESS DEVELOPMENT STRATEGY

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

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

The company's investment strategy envisages acquisition of smaller pharmaceutical producers complementary to its business or of portfolios of drugs and brands. Key criteria for selecting acquisition targets are the drugs belonging to the commercial segment and target nosologies of Binnopharm, and the possibility to transfer manufacturing to Binnopharm and use its commercial structures for promotion.

2016 FINANCIAL PERFORMANCE

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

RTI



RTI is a major holding company in the field of defence and microelectronic solutions, which integrates high-tech research and manufacturing companies. RTI comprises OJSC RTI Systems Concern and PJSC Mikron.



RTI's enterprises have their own R&D infrastructure and implement projects in radio and space technologies, security and microelectronics that are unique in terms of their scale and complexity.

INDUSTRY ⁽¹⁾

Defence Solutions

One of the main trends in the defence sector is the optimisation of State budgets; however, RTI's key segment (radars) was affected to a lesser extent by this trend due to its high priority

for national defence. In 2016, the technological focus was on improving high-precision weapons systems and increasing the effectiveness of decision support information systems. The company continued to aim at import independence of the entire manufacturing chain, including components and firmware.

> 600⁰⁰⁰
integrated circuits
 Mikron produced in 2016

87.0%

Sistema's stake

Leadership



Igor Bevzyuk
 CEO



Sergey Boev
 Chairman
 of the Board
 of Directors

Financial results in 2016

(RUB m)	2016	2015	Change
Revenue w/o NVision ⁽²⁾	44,588	63,679	(29.7%)
Revenue	44,588	77,287	(42.3%)
Adjusted OIBDA	4,036	7,030	(42.6%)
Operating (loss) / income	275	4,548	(94.0%)
Adjusted net loss attributable to Sistema	(2,418)	(2,074)	-
Net debt	27,053	26,743	1.2%

⁽¹⁾Source: Ministry of Finance of the Russian Federation.

⁽²⁾The Information and Communication Technologies segment was divested in H2 2015.

Microelectronics

The demand for microelectronics is growing in the global market, which creates opportunities for increasing the sales of chips, diodes and sensors produced by the Group. A continuing shift from architecture of systems and services to cloud and distributed solutions creates additional demand for telecommunications microchips, solid-state memory and microprocessors suitable for the processing of Big Data.

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



BUSINESS DEVELOPMENT IN 2016

Defence Solutions

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

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

The next step will be the radar station Voronezh-VP, also being developed by RTI Group.

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

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

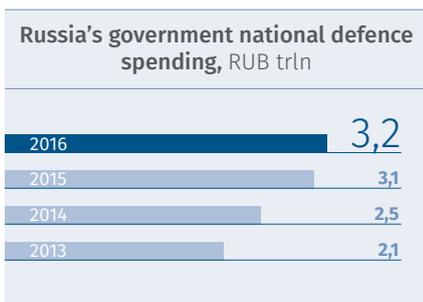
Microelectronics

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

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

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

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



⁽¹⁾In accordance with the orders of the President of the Russian Federation Vladimir Putin and Prime Minister Dmitry Medvedev.

> 30%

of all supplies of Russian microelectronics manufacturers are provided by Mikron

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

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

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

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

STRATEGY

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

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

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

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

2016 FINANCIAL PERFORMANCE

The decrease in revenue in 2016 was a result of RTI's spinning off NVision in 2015 and a reduction in the volume of work under a major contract in the field of State defence orders, which was implemented in 2015 and 2014. In addition, there was a decline in revenues of key segments of Defence Solutions and Microelectronics due to late signing of contracts for 2017.

Adjusted OIBDA decreased in 2016 in line with the revenue, as well as due to the recognition of impairment losses on accounts receivable and inventories. Adjusted OIBDA margin remained at the level of 9.1% in 2016.

In December 2016, RTI Group's debt portfolio was restructured as a result of conclusion of loan agreements with VTB Bank. The loan agreements provide for a deferment of a significant portion (about 60%) of RTI Group's debt until 2021 to be followed by annual settlement payments through the end of 2026, as well as a grace period for interest payments. The rest of the debt was refinanced via 5-year revolving lines of credit, which gave RTI Group additional flexibility in managing working capital.

MTS Bank



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

86.7%

Sistema's stake

Leadership



Ilya Filatov
*Chairman of the
Management
Board*



Vsevolod Rozanov
*Chairman
of the Board
of Directors*



SECTOR OVERVIEW

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

Positive macroeconomic trends resulted in a further decrease of credit risks both in the retail and corporate sectors. Under these circumstances, the Russian banking sector continued to successfully adapt to the new operational environment: banks revised

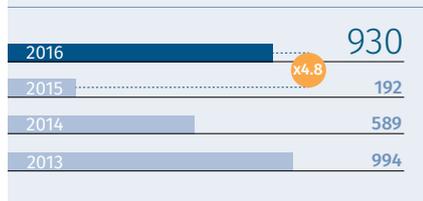
their risk management models, and began cutting costs by optimising business processes and shutting down non-profitable segments.

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

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

Project, RUB bn	2016	2015	%
Revenue	20,233	25,619	(21.0%)
Interest income	16,411	20,458	-19.8%
Fee income	3,242	3,416	-5.1%
Financial result before SG&A	4,834	(8,870)	-
Operating expenses (SGS&A)	(7,395)	(7,983)	-
Operating loss	(3,282)	(17,658)	-
Net loss attributable to Sistema	(2,827)	(15,282)	-
Net assets	20,238	8,743	131.5%
Retail loan portfolio	44,157	59,570	-22.5%
Capital adequacy H1.0	20.2%	18.5%	1.7 p.p.

Russian banks net profit, RUB bln



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

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

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

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

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

BUSINESS DEVELOPMENT IN 2016

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

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

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

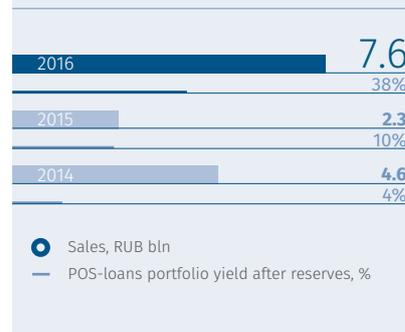
In accordance with the strategy of cooperation with MTS, the bank launched a line of SMART debit cards, which offer free mobile communications and mobile Internet for MTS subscribers. The product has attracted over 320,000 new customers to the bank, and the accrued data on their payment behaviour will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

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

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



Sales of POS-loans in MTS stores



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

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

No 38

for the size of capital among
Russian banks

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

BUSINESS DEVELOPMENT STRATEGY

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

No 47

for the size of assets among Russian banks

No 36

for individual deposits among Russian banks



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

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

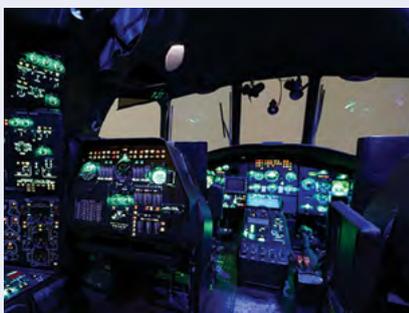
2016 FINANCIAL PERFORMANCE

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



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

Other assets

IKT


100%

Sistema's stake

CONCEPT


KRONSHTADT

LLC Kronshtadt Group is a Russian high-tech company that engineers and manufactures knowledge-intensive products and solutions for the production, deployment, and safe use of sophisticated air, sea, and land-based systems. The Group's substantial intellectual and engineering potential, its portfolio of key technologies and competences and state-of-the-art manufacturing resources enable it to create high-tech products and solutions that are in demand in Russia and are also able to successfully compete on international markets. Sistema's equity holding in Kronshtadt is 100%.

In 2016, Kronshtadt Group successfully completed work under some key government contracts, including supply of correcting stations for the differential sub-system of the GLONASS/GPS global navigation satellite system, 18 module Kamaz-5350 driving simulators with a motion generation system and 14 sets of electronic conduct-of-fire trainers for the schools and training centres of the Russian Defence Ministry. Kronshtadt

developed and supplied to a foreign customer a full flight simulator for the state-of-the-art transport and combat helicopter Mi-35M designed for efficient training of flight crews.

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

After Sistema acquired Kronshtadt in 2015, the Group sold all non-core assets, shut down loss-making projects, signed new long-term contracts and entered new markets. This has had a serious impact on its financial performance.

CONCEPT GROUP

Concept Group has been active in the Russian market for over 10 years and is a leader in the segment of women's and children's fashion and underwear. The company has two own retail chains under the brands Acoola and Concept Club with an aggregate of over 400 stores, many of which are franchised. Concept Group operates under a multi-brand and multi-channel business model, which ensures stable revenue growth due

to the diversification of proceeds. A professional team of fashion designers located in the company's head office in St Petersburg is in charge of developing collections for all brands of the Group. Manufacturing takes place at partner factories in China, Bangladesh, Uzbekistan, India, Russia and Kyrgyzstan, with mandatory quality control.

[Continue](#)



RUB **10.9** bn

Concept Group revenue
in 2016



3,771

room number of rooms under
Sistema's management in 2016

CONCEPT GROUP

Continue ●

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

HOTEL ASSETS

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

Development of the Russian hotel market will be driven by the country's hosting of the World Cup 2018, growth of foreign tourism (6% in 2016) and development of domestic tourism, which has been demonstrating two-digit growth (15% in 2016). Last year, hotel occupancy reached unprecedented figures, with RevPar (revenue per available room) growing by 19% to RUB 11,500.

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

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

The average income per room for Moscow hotels increased by 14%, and prices are expected to continue growing in 2017. Room rates are estimated to increase by 10%-30%.

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

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

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

Sistema's hotel assets

Hotel	Rooms in 2016	Rooms in 2015
Cosmos Hotel	1,777	1,777
Savoy Westend Hotel	116	116
Principe Forte dei Marmi	28	28
Yelets	-	131
Altay Resort	78	78
Leopard Lodge	9	9
Intourist Kolomenskoye	259	259
Onego Palace	103	103
Izumrudny Les	22	-

Park Inn Kazan	151	-
Park Inn Astrakhan	132	-
Park Inn Izhevsk	161	-
Park Inn Yaroslavl	167	-
Park Inn Sochi	153	-
Holiday Inn Express Voronezh	145	-
Park Inn Volgograd	149	-
Park Inn Novosibirsk	150	-
Courtyard by Marriott Paveletskaya Moscow	171	-
Total	3,771	2,501



In November 2015, Sistema signed binding documents to merge its Indian telecom business with Reliance Communications Ltd (RCom), one of India's biggest telecom operators.

SISTEMA SHYAM TELESERVICES LTD.

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

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

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

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

Funds

Sistema Venture Capital is a corporate venture fund of Sistema, focused on investing in Internet companies at the growth stage. Sistema owns 100% of the fund.⁽¹⁾

RUB 10^{bn}

Target fund size

Fund's life: Indefinite

Investment focus:

Cognitive technology, web projects in the sphere of communitainment, VR/AR (visual/augmented reality) projects, new generation networks (SDN, NFV).

Investment criteria:



Global technology, focus on mobile devices for B2C products;



proven business model or MVP demonstrating operating income;



a strong team with technological and industry expertise, founders remain in charge of operations.

SISTEMA VENTURE CAPITAL Performance in 2016

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

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

Investments

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

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



amounts of photo and video data in real-time mode to detect people's faces and run them against multi-million databases. The company's technological partners are Intel, Cisco, Facebook and Google.

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

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

[Continue](#) 



⁽¹⁾As of 31 March 2017 Sistema's stake is 80%.

SISTEMA VENTURE CAPITAL

Continue 

YouDo.com - Russia's biggest online service connecting customers with service providers for performing household errands and business tasks. A user can publish a task on the YouDo.com website or in a mobile app (available for iOS and Android), set the price and select a provider among those who respond to the announcement. All providers are checked by the service and are

assessed by users, which guarantees the high quality of their work. The project is a winner of a grant from Start Fellows, Runet and Golden Website awards, semifinalist of the Forbes' startup competition, and one of Russia's top 50 startups according to PricewaterhouseCoopers and Digital October.

Ozon - one of the biggest players in the Russian e-commerce segment, growing by 20%-30% per annum. The company's strategy is aimed at accelerating growth and building a significant market share to support a subsequent IPO.

Ozon has some unique competitive advantages: its business model (an online supermarket with an extremely broad product mix; its own chain of warehouses and distribution centres, which allows for quick delivery); a strong brand, sufficient funds to implement its strategy; transparency and qualified investors/shareholders who are known to the market.

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

USD **100** bn

Target fund size

Fund's life: 7 years (with a possibility of a 3-year extension)



SISTEMA RUSNANO CAPITAL

Performance in 2016

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

Investment focus:

Technology, microelectronics, automated control systems, special communications systems, software for comprehensive security systems, robotics and on-board control systems, energy and energy efficiency. Geographically, the fund is focused on Russia, the European Union and Israel; 50% of investment will go to "Russia-related companies" that use nanotechnology.



Investment criteria:

The average ticket is USD 5-20m; allowed targets: companies at the growth stage or at the late venture stage with a working product (the latter may not take up more than 20% of the portfolio).

Sistema Capital Partners (SCP) is an investment arm of Sistema, which invests Russian institutional capital in developed real estate markets in Europe and the United States. The company was established in December 2015 and comprises leading professionals from the Russian and international real estate market.

EUR **446** mln
Fund size (AUM)

EUR **208** mln
Fund size
(capital invested by Sistema and co-investors)

Fund's life: Indefinite

Investment focus:
Real estate

Investment criteria:
Real estate in countries with a stable macroeconomic situation, high market liquidity (annual amount of transactions in the market) and competitive cost of debt. Sistema acts as an anchor investor, attracting Russian co-investors.

SISTEMA CAPITAL PARTNERS

SCP also offers legal support for transactions and asset management for Western institutional investors looking at Russian commercial real estate. SCP manages the publicly traded Luxembourg fund Arista SICAV-SIF.

Performance in 2016

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

Investments

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

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



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

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



Sistema Asia Fund Pte. Ltd. - is a venture fund of Sistema.

USD **50** mln

Fund size

Fund's life: Indefinite.

Investment focus:

High-tech companies in India and Southeast Asia at the medium development stage (Series B and later investment rounds), oriented towards mass and corporate markets.

Investment criteria:

An enthusiastic, persistent and goal-oriented team with tech and industry expertise, founders with complementary skills, founders remain in charge of operations;

The market size should be minimum USD 1bn today or within three years;

Established industry leaders or companies moving towards leadership;

Positive economic performance with a large safety margin (high gross margin);

Clear and transparent strategy for reaching investment breakeven;

Confidence about exit/obtaining liquidity through strategic sale or IPO.

SISTEMA ASIA FUND

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

Performance in 2016

In 2016, the fund concentrated on the Indian market; it plans to enter the Southeast Asian market in 2017, but will retain its investment focus on India. The fund's offices are situated in Singapore and New Delhi.

In 2016, Sistema Asia Fund became a noticeable player on the Indian venture capital market, closing 4 deals with such renowned international investors as Accel Partners, Amazon, Mayfield, and with Indian A league funds such as Helion Ventures, and Ventureast.

Investments

Seclore – the EDRM (Enterprise Digital Rights Management) system developed by the company allows corporations to control use of files within and outside the company. It has more than 5m users from 600 companies in 29 countries. Advanced and reliable EDRM solutions and innovations related to access to protected documents via browsers gained Seclore an award for successful growth from Frost & Sullivan, resulted in its inclusion in the top 50 fast-growing tech companies according to Deloitte and brought it the Cool Vendor title from Gartner. The company has representative offices in the United States, India, the Netherlands, UAE, Saudi Arabia and Singapore.

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

Wooplr – a female fashion mobile platform. The company has developed a mobile shopping application with customised offers for users. Wooplr redefines web communication and sales of women's clothing, using a very scalable platform with a viral approach. The female fashion segment of the Indian Internet is so far underdeveloped, but it is growing at an extremely rapid pace. According to some estimates, this market will amount to USD 20bn by 2020, with fast fashion accounting for 50% of it. Wooplr has created an integrated platform that brought together 200 brands, 10,000 opinion leaders and 3m female customers.

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

Risks

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

The Corporation has introduced **an integrated enterprise risk management (ERM) system**

based on international standards, recommendations and practices of risk management designed to provide a reasonable guarantee that the strategic goals will be achieved and to ensure that risks will be kept at a level acceptable to the shareholders and the management of the Corporation.

SISTEMA'S ERM SYSTEM

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

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

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

EXTERNAL RISKS

Risks related to changes in the political and economic situation in Russia are material to Sistema, because most of the Corporation's business is conducted in the Russian Federation. Additionally, many of its subsidiaries operate in transitional economies, including Ukraine, Armenia, Belarus, Turkmenistan and India, and therefore are also exposed to material external risks. A significant portion of products produced by the Group's companies is sold in the CIS, Southeast Asia, Eastern Europe and North Africa. In case of any major political turmoil in these regions, the Group's business in the regions may be discontinued or put on hold, which may lead to material losses.

Financial risks

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

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

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

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

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

An unfavourable macroeconomic environment in many countries where Sistema's assets operate may make it necessary to re-evaluate goodwill at some of the assets.

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

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

Political and social risks

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

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

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

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

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

Legal risks

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

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

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

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

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

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

Minority shareholders of Sistema's subsidiaries may contest or vote against the Company's transactions, which may limit Sistema's capability to complete investment transactions and restructure businesses.

If the Russian Federal Anti-Monopoly Service concludes that Sistema or one of its material subsidiaries has violated any of the existing anti-monopoly laws, this may result in serious administrative sanctions involving losses for the Corporation. The Federal Anti-Monopoly Service may also prevent the Corporation and its portfolio companies from closing and/or delivering on certain transactions, which may also limit Sistema's capacity to do investment deals and restructure businesses.

Taxation

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

Russian law on transfer pricing may make it necessary to introduce adjustments to price-setting practices used at Sistema Group's companies and result in additional tax liabilities related to some transactions.

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

Securities markets

A deterioration of the geopolitical environment, the imposition of sanctions on Russian companies, a worsening of the macroeconomic environment and capital and investor flight from the Russian market led to a reduction in valuations of Russian companies in 2014-2016.

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

RISKS RELATED TO SISTEMA'S ACTIVITIES

Implementation of the business strategy

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

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

Acquisition, integration, disposal or restructuring of assets

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

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

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

Sistema may struggle with building an efficient system for managing and controlling new assets. The top risks in this area include:

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

If any of the above risks materialise, the relevant asset may lose part of its value and/or experience a deterioration in financial performance.

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

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

If one or several of the specified risks materialise, the Corporation may lose potential profit and thus see an impact on its financial performance.

Management and key personnel

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

Cash flows from subsidiaries and affiliates

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

Overdependence on MTS

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

Borrowings

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

Loan covenants

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

Licences and permits

Operations of Sistema Group's companies are regulated by different government bodies and agencies issuing and renewing licences, approvals and permits, and also depend on applicable laws, regulations and standards. Regulating authorities to a large extent rely on their own judgment when interpreting and implementing legal requirements, issuing and extending licences, approvals and permits, and monitoring compliance with such licences.

There is no guarantee that existing licences and permits, including those issued to the Group's companies, will be extended, that new licences and permits will be issued, or that the companies will be able to comply with the terms of such licences. There is no guarantee either that existing or future licences or permits will not be suspended or revoked on some grounds. Any of these circumstances can have material negative consequences for Sistema's business.

Privatised companies

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

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

Anti-corruption rules

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

Competition

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

Brand quality and reputation

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

RISK APPETITE

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

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

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

Corporate Governance system

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Corporate governance system

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

CORPORATE GOVERNANCE PRINCIPLES

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

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

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

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

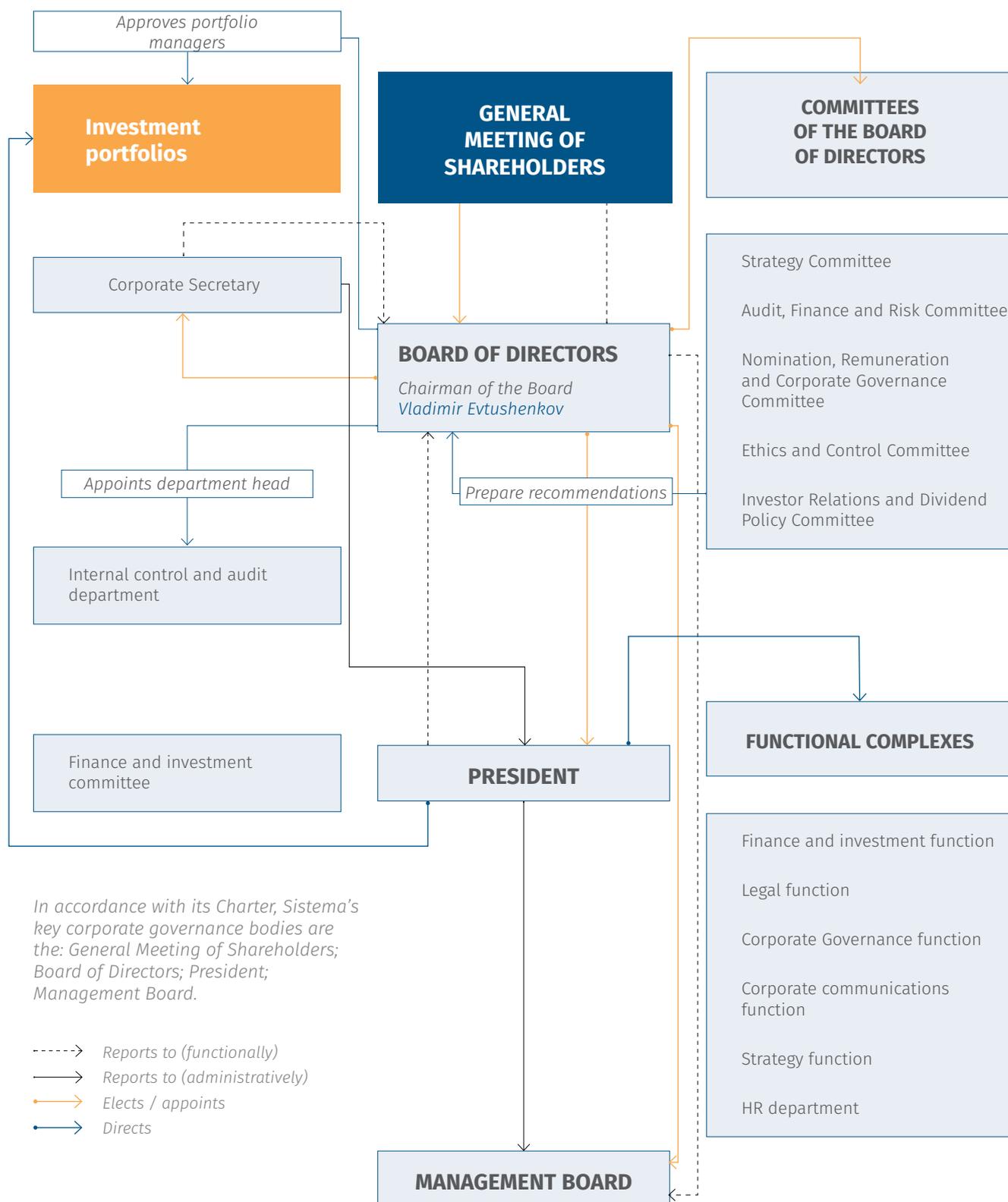
Sistema's Corporate Governance and Ethics Code sets out the additional commitments of the Corporation, its senior management and employees regarding social responsibility, transparency and ethical business principles.

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

⁽¹⁾ Available here: http://www.cbr.ru/sbrfr_new/files/legislation/letters/2014/Inf_apr_1014.pdf

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

Sistema JSFC's Corporate Governance Structure⁽¹⁾



In accordance with its Charter, Sistema's key corporate governance bodies are the: General Meeting of Shareholders; Board of Directors; President; Management Board.

⁽¹⁾ As of December 31, 2016

GENERAL MEETING OF SHAREHOLDERS

Principles of operation

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



All materials for general meetings of shareholders are made available to shareholders in Russian and in English and are published on Sistema's website www.sistema.ru and www.sistema.com

Shareholders are notified of forthcoming meetings and are sent ballot papers for voting. Over the past four years (2013-2016) general meetings of shareholders have been held at Sistema's head office.

Observance of shareholders' rights

Participation in general meetings of shareholders and voting on agenda items

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

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

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

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

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

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

Shareholders' access to the Corporation's documentation

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

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

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

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

Owners of significant stakes (at least 2% of Sistema's authorised capital) have the right to make proposals for the agenda of the general meeting of shareholders and to nominate candidates to the Corporation's governance and control bodies⁽¹⁾.

Proposals for the agenda of the Annual General Meeting of shareholders (AGM), including any notes attached thereto in accordance with the Terms of Reference of the General Meeting of Shareholders of Sistema PJSC and other internal regulations of the Corporation, are accepted in writing within 100 days after the end of the financial year⁽²⁾. Candidates nominated by shareholders to governance and control bodies are provisionally reviewed by the Board's Nomination, Remuneration and Corporate Governance Committee.

Dividend policy

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

To determine the recommended amount of dividends payable for 2015⁽¹⁾, the Board of Directors followed the dividend policy approved in October 2011.

Under the policy, the amount of dividends payable was to be at least 10% of Sistema Group's net income generated during the previous financial year to International Financial Reporting Standards and at least 10% of net cash income generated by the Corporation's investment transactions over the same period (special dividend).

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

Results of general meetings of shareholders held on 25 June 2016:

- 1 Approved the annual report and financial statements for 2015;
- 2 Distributed dividends for the full year 2015 of RUB 6,465,500,000.00, or RUB 0.67 per ordinary share;
- 3 Elected the Board of Directors and Audit Review Commission;
- 4 Approved the Corporation's external auditors;
- 5 Approved the revised Charter and Terms of Reference of the Board of Directors.

RUB **3.7** bn

interim dividends
for the first half of 2016

79%

of votes were held together
by attended shareholders
on AGM

⁽¹⁾Dividends for 2015 was paid in June 2016.

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

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

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

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



A more detailed report on the amount of allocated and paid dividends for the period from 2010 to 2016 [is provided in Section Dividends of this annual report.](#)

BOARD OF DIRECTORS

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

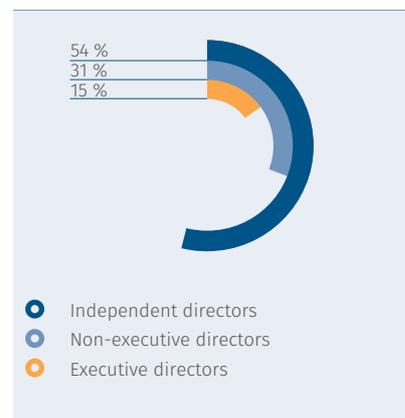
Under Sistema's Charter the Board's responsibilities include:

- 1 supervising the operations of the Corporation in general;
- 2 formulating strategic and financial development plans;
- 3 determining investment principles and criteria;
- 4 assessing the performance of the management team;
- 5 setting the principles of corporate governance;
- 6 approving transactions in accordance with applicable legislation and the Corporation's internal regulations.

Composition of the Board of Directors

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

Composition of the Board of Directors from 1 January to 25 June 2016, (elected on 27 June 2015)



Vladimir Evtushenkov
Chairman

Боев Сергей Федотович
Sergey Boev

Brian Dickie⁽¹⁾

Andrey Dubovskov

Felix Evtushenkov

Dmitry Zubov

Patrick Clanwilliam⁽¹⁾

Robert Kocharyan⁽²⁾

Jeannot Krecké⁽¹⁾

Peter Mandelson⁽¹⁾

Roger Munnings⁽¹⁾

Mikhail Shamolin

David Iakobachvili⁽¹⁾

⁽¹⁾ Independent directors meeting the independence criteria of Moscow Exchange's Listing Rules.

Composition of the Board of Directors from 25 June to 31 December 2016, (elected on 25 June 2016) ⁽³⁾



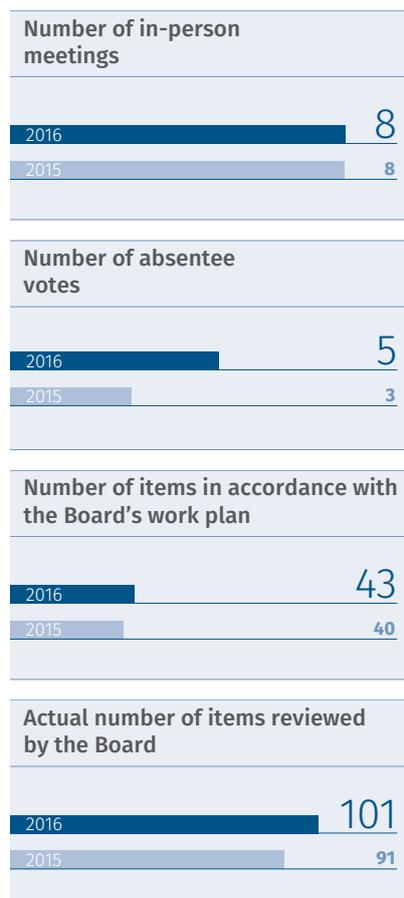
1. Vladimir Evtushenkov
Chairman
2. Sergey Boev
Deputy Chairman
3. Andrey Dubovskov
4. Felix Evtushenkov
5. Patrick Clanwilliam⁽¹⁾
6. Robert Kocharyan⁽²⁾
7. Jeannot Krecké⁽¹⁾
8. Peter Mandelson⁽¹⁾
9. Roger Munnings⁽¹⁾
10. Mikhail Shamolin
11. David Iakobachvili⁽¹⁾

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

Meetings of the Board of Directors

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

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



⁽¹⁾ Independent directors meeting the independence criteria of Moscow Exchange's Listing Rules.

⁽²⁾ In accordance with Moscow Exchange's Listing Rules the Corporation recognised Robert Kocharyan as independent. Information on this decision was disclosed on Sistema's website.

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

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

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

Preparation for Board meetings and attendance rates

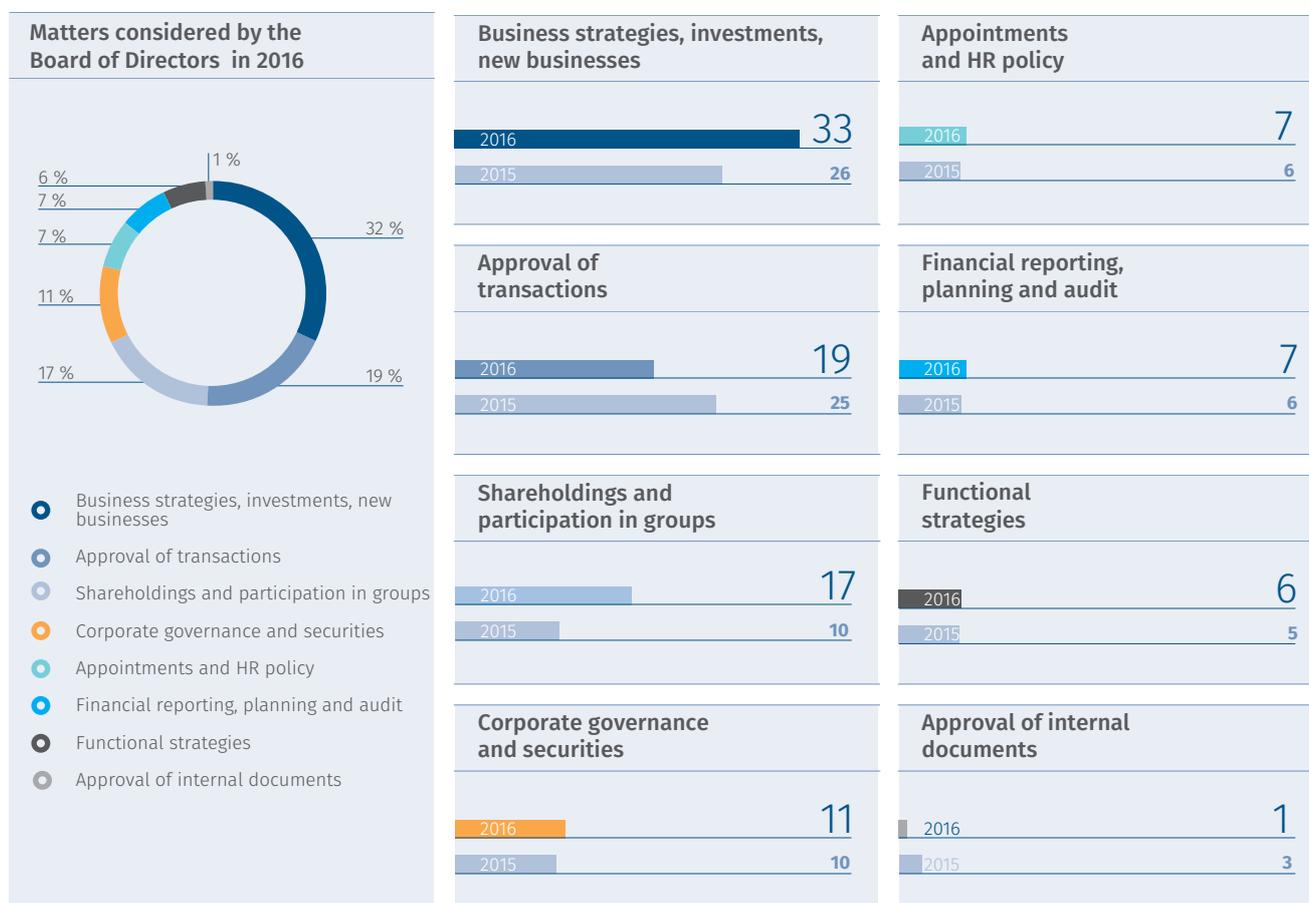
Procedures for Board meetings aim to use the time and experience of Board members efficiently, to enable them to take important decisions affecting the Corporation's strategic development. Agenda materials are made available via the Board's electronic portal at least 10 days before each meeting, to give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

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

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

96%

**the average attendance
in 2016**



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

	Board of Directors	Strategy Committee	Audit, Finance and Risk Committee	Nomination, Remuneration and Corporate Governance	Ethics and Control Committee	Investor Relations and Dividend Policy Committee
V. Evtushenkov	12/13 ⁽¹⁾	12/12	-	-	-	-
S. Boev	13/13	6/12	6/7	3/3	6/7	-
B. Dickie ⁽²⁾	6/6	-	-	3/3	3/4	-
A. Dubovskov	13/13	10/12	-	-	-	-
F. Evtushenkov	12/13	2/12	-	-	3/7	-
D. Zubov ⁽²⁾	6/6	-	-	2/3	-	-
P. Clanwilliam	13/13	-	6/6	-	-	7/7
R. Kocharyan	13/13	6/12	-	6/6	7/7	-
J. Krecké	13/13	-	12/13	-	-	7/7
P. Mandelson	11/13	-	4/7	2/3	1/3	-
R. Munnings	13/13	-	13/13	6/6	7/7	7/7
M. Shamolin	13/13	12/12	-	-	-	0/7
D. Iakobachvili	12/13	5/12	12/13	5/6	-	7/7

⁽¹⁾ The first number denotes the number of meetings attended by the Board member, the second number stands for the total number of meetings the member could have participated in.

⁽²⁾ Member of Sistema's Board of Directors until 25 June 2016.

COMMITTEES OF THE BOARD OF DIRECTORS

Sistema PJSC has five committees of the Board of Directors:

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

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

The Committees of the Board of Directors have broad procedural powers,

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

Functions of the Board Committees

	<ul style="list-style-type: none"> • analysis of strategic issues related to Sistema Group management ; • review of strategic planning methodology; • consideration of M&A transactions and large investment projects.
	<ul style="list-style-type: none"> • preparation and audit of the Corporation's financial statements; • interaction with the Corporation's external auditors; • assessment of the risk management system and compliance with the applicable legal requirements for financial reporting, audit and planning; • preliminary appraisal of transactions submitted to the Board of Directors.
	<ul style="list-style-type: none"> • preliminary review of candidates: (a) for the Board of Directors of Sistema PJSC; (b) for the Boards of Directors of portfolio companies; (c) for top management positions at the Corporation and its portfolio companies; (d) for the position of the Corporation's Corporate Secretary; • development of the Corporation's incentive and remuneration policies; • improving the corporate governance systems of the Corporation and its portfolio companies, safeguarding shareholders' interests and rights.
	<ul style="list-style-type: none"> • corporate security; • monitoring compliance with the requirements of the Corporation's Code of Ethics; • corruption prevention system at the companies that make up Sistema PJSC.
	<ul style="list-style-type: none"> • maintaining effective relations with the financial community and government agencies, strengthening Sistema's investment case; • developing Sistema's dividend policy, including the development of recommendations for the Corporation's Board of Directors with respect to the amount of dividends to be paid; • protection of the rights and interests of Sistema's shareholders.

Strategy Committee

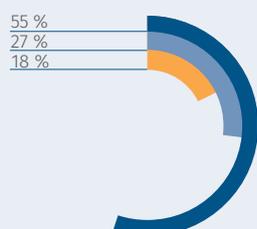
The Strategy Committee is an advisory body of the Board of Directors and is responsible for the mandatory preliminary review of: all Sistema Group merger and acquisition projects with a value exceeding \$100m; all Sistema Group projects related to entering new

regions or industries, all Sistema Group projects with significant government participation.

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

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

Share of independent directors in Committee



- Management (including executive directors)
- Non-executive director
- Independent director

12

meetings

Strategy Committee held in 2016 and reviewed matters related to the development of Sistema's portfolio companies and considered one item concerning the Corporation's strategy

Membership of the Strategy Committee

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

Audit, Finance and Risk Committee

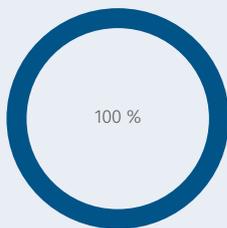
The Audit, Finance and Risk Committee of Sistema's Board of Directors conducts an appraisal of the quality of audit services based on the audit of Sistema's financial statements and gives preliminary recommendations with respect to selecting RAS and IFRS auditors for the company. Based on the opinion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

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

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

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

Share of independent directors in Committee



● Independent director

Composition of the Audit, Finance and Risk Committee

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

13

meetings

Audit, Finance and Risk Committee held in 2016

In 2016, an internal assessment of the Committee's performance was conducted for the first time. Based on the assessment results, potential areas for improvement were identified: the risk management system and tax administration. The Committee members also highly approved of the effectiveness of the internal

and external audit systems of the Corporation. The total score of the Committee's performance on a three-point scale was 2.27.

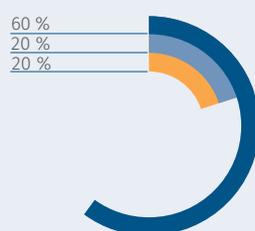
Nomination, Remuneration and Corporate Governance Committee

The purpose of the Committee is to facilitate the preparation and implementation of the Corporation's

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

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

Share of independent directors in Committee



- Independent director
- Management
- Non-executive director

Composition of the Nomination, Remuneration and Corporate Governance Committee

Name of Committee Member	Position held
R. Kocharyan (Committee Chairman)	Member of the Board of Directors of Sistema PJSC, independent director
S. Boev	Member of the Board of Directors of Sistema PJSC
P. Mandelson	Member of the Board of Directors of Sistema PJSC, independent director
R. Munnings	Member of the Board of Directors of Sistema PJSC, independent director
D. Iakobachvili	Member of the Board of Directors of Sistema PJSC, independent director

6

meetings

Nomination, Remuneration and Corporate Governance Committee held in 2016

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

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

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

The Nomination, Remuneration and Corporate Governance Committee of Sistema PJSC also organises the self-assessment procedure of the Board of Directors. The assessment looks at ten key criteria in order to identify those areas in the work of the

Board of Directors that are in need of improvement. The Committee uses the results of self-assessment to make an annual plan aimed at developing Sistema's corporate governance systems, which is then submitted to the Board of Directors for approval.

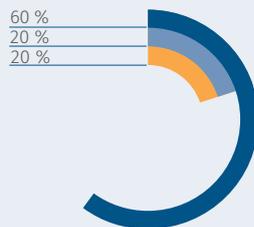
Ethics and Control Committee

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

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

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

Share of independent directors in Committee



- Independent director
- Management
- Non-executive director

Composition of the Ethics and Control Committee

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

7

meetings

Ethics and Internal Control Committee held in 2016

Investor Relations and Dividend Policy Committee

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

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

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

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

Share of independent directors in Committee



- Independent director
- Management

Composition of the Investor Relations and Dividend Policy Committee

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

7

meetings

Investor Relations and Dividend Policy Committee held in 2016

PRESIDENT

The President of Sistema PJSC is a permanent chief executive officer whose main tasks include managing the current operations of the Corporation and dealing with matters outside the remit of the General Meeting of Shareholders, the Board of Directors, and the Management Board with the aim of ensuring the Corporation's profitability and safeguarding the rights and legitimate interests of its shareholders. The President reports to the Board of Directors and the General Meeting of Shareholders of Sistema PJSC.

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



Mikhail Shamolin

President of Sistema PJSC, Chairman of the Management Board.

Was born in Moscow in **1970**.

Graduated from the Moscow Automobile and Road Technical Institute in **1992**, and from the Russian Presidential Academy of Public Administration in **1993**.

In 1996–1997, completed a finance and management course for senior executives at the Wharton School of Business.

In 1998–2004, worked for McKinsey&Co, an international consultancy firm.

In 2004–2005, Managing Director for Ferroalloys at Interpipe Corp (Ukraine).

in 2005–2011, Vice President for Sales and Customer Service, then Vice President, Head of MTS Russia and President of MTS.

On 10 March 2011, appointed President of Sistema PJSC. Sistema's Board of Directors reappointed Mr Shamolin as President and Management Board Chairman for a new three-year term twice: **on 15 March 2014 and on 10 March 2017**.

Member of the Board of Trustees of Sistema Charitable Foundation.

MANAGEMENT BOARD

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

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

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

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

Changes to Sistema's Management Board in 2016

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

N. Vasilkov

12 March 2016

Membership terminated.

A. Zassoursky

21 May 2016

Elected to the Management Board, appointed Vice President, Head of the Strategy Function of Sistema PJFSC.

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

Members of the Management Board of Sistema PJSC as of 31 December 2016

1. Mikhail Shamolin
Chairman
2. Elena Vitshak⁽¹⁾
3. Alexander Gorbunov
4. Felix Evtushenkov
5. Artyom Zassoursky
6. Valentin Korchunov⁽¹⁾
7. Leonid Monosov
8. Oleg Mubarakshin
9. Vsevolod Rozanov
10. Ali Uzdenov
11. Mikhail Cherny
12. Evgeny Chuikov
13. Sergey Shishkin
14. Vladimir Shukshin



⁽¹⁾ Upon completion of the reporting period in 2017 Elena Vitshak and Valentin Korchunov left the Management Board.

THE PRESIDENT'S COMMITTEES

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

-  **Finance and Investment Committee;**
-  **Tender Committee;**
-  **HR Committee;**
-  **Security Committee;**
-  **Internal Control Committee;**
-  **Disciplinary Committee.**

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

Finance and Investment Committee

The responsibilities of the Finance and Investment Committee include:

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

- 4 analysing the terms of external financing for the Corporation and portfolio companies.

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

In 2016, the Committee met 60 times.

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

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

In 2016, the Expert Council met 15 times.

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

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

In 2016, the Risk Subcommittee met 10 times.

Tender Committee

The responsibilities of the Tender Committee include:

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

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

In 2016, the Tender Committee met 36 times.

HR Committee

The responsibilities of the HR Committee include:

- 1 reviewing and making proposals with regards to the HR policies and internal regulations at the Corporation and its portfolio companies;
- 2 coordinating the activities of HR units of the Corporation and portfolio companies;

- 3 assessing candidates for senior executive positions;
- 4 assessing the efficiency and performance of the Corporation's employees.

The Committee consists of nine members. The Chairman of the Committee is the President of Sistema PJSC M. Shamolin.

In 2016, the Committee met 15 times.

Security Committee

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

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

In 2016, the Committee met four times.

Disciplinary Committee

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

The Committee consists of six members. The Chairman of the Committee is the President of Sistema PJSC M. Shamolin.

In 2016, the Committee met six times.

SPECIFIC CHARACTERISTICS OF RISK MANAGEMENT, INTERNAL CONTROL AND INTERNAL AUDIT SYSTEMS

Risk management

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

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

- 1 identification of risks at all levels of management (from top to line management), which includes identifying risk owners and creating risk passports;
- 2 primary assessment of the materiality of identified risks and their analysis (VaR methodology);
- 3 ranging risks by management levels;
- 4 assessment of the aggregate influence of material risks on the Corporation's key financial indicators (Monte Carlo modelling);
- 5 development of plans to mitigate identified risks at all management levels;
- 6 regular monitoring of performance against mitigation plans and assessment of their effectiveness;
- 7 risk monitoring, quarterly reports on risks facing the Corporation.

The risk management procedures of Sistema PJSC are carried out by a dedicated risk management unit.

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

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

Internal control system

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

The key objectives of the internal control system are:

- 1 creating control mechanisms that will ensure the efficiency of business processes and the implementation of investment projects of the Corporation;
- 2 ensuring safety of the Corporation's assets and efficient use of its resources;
- 3 protecting the interests of the Corporation's shareholders and preventing and resolving conflicts of interest;
- 4 creating conditions for timely preparation and submission of reliable reports and other information that is legally required to be publicly disclosed;
- 5 ensuring the Corporation's compliance with applicable laws and regulatory requirements.

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

Level 1. Heads of subdivisions and employees of the Corporation are responsible for assessing and managing risks and building an efficient internal control system within their remit;

Level 2. At this level the function is performed by several subdivisions and Committees of the Corporation. For example:

- 1 the risk management function and the risk committee are responsible for developing and monitoring the implementation of an effective risk management practice;
- 2 the Finance and Investment Committee of the Corporation approves and monitors the implementation of investment projects;
- 3 the Discipline Committee reviews matters related to breaches of the Ethics Code and disciplinary offences;
- 4 the Security and IT Department is responsible, among other things, for economic security, corruption prevention and information security.

Level 3. The Internal Control and Audit Department conducts an independent assessments of the efficiency of the internal control system, the risk management procedures, and the corporate governance system.

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

Internal audit

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

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

- 1 helping shareholders and the management improve the internal control system by performing regular audits of efficiency of the Corporation’s internal control, risk management, and corporate governance systems;
- 2 facilitating the attainment of the Corporation’s strategic goals;
- 3 supplying the Corporation’s management and shareholders with objective information on the existing internal risks and their probability;
- 4 enhancing the awareness of the Corporation’s management about the performance of Sistema Group companies;

- 5 monitoring achievement of the goals of shareholders of the Corporation and Sistema Group companies.

To meet these objectives, the Internal Control and Audit Department carries out the following functions:

- 1 performing independent audits of individual operations, processes, and units;
- 2 assessing the efficiency of the internal control system;
- 3 assessing the efficiency of the risk management system;
- 4 assessing the efficiency of the corporate governance system, preventing violations of the law and the Corporation’s regulations, ensuring observance of professional and ethical standards, and preparing recommendations for improvement thereof;
- 5 developing recommendations to remedy deficiencies identified and monitoring remediation thereof;
- 6 examining and evaluating documents provided with regards to specific investment projects for compliance with current regulations; performing scheduled and unscheduled monitoring of performance against project targets;
- 7 ensuring uninterrupted functioning of the whistleblowing hotline;
- 8 administering investigations, including internal ones;

- 9 monitoring compliance with the Corporation's internal regulations;
- 10 monitoring and investigating instances potentially qualifying as disciplinary offence and/or violation of discipline and/or conflict of interest in the Corporation or Sistema Group companies.

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

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

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

Resolution of conflicts of interest

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

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

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

Ethics assessments make it possible to identify and manage conflicts of interests in a timely manner, thus preventing shareholders' interests from being compromised.

External audit

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

DEVELOPMENT OF THE CORPORATE GOVERNANCE SYSTEM IN 2016

Independent directors on the Corporation's Board

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

The current Board includes the following independent directors:

1. Patrick Clanwilliam;
2. Robert Kocharyan;
3. Jeannot Krecké;
4. Peter Mandelson;
5. Roger Munnings;
6. David Iakobachvili.



1



2



3



4



5



6

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

Dividend policy

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

Top management co-investment programme

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

Assessment of the work of the Board of Directors

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

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

As part of the assessment the Board members completed questionnaires containing the following sections:

1. membership and structure of the Board of Directors;
2. procedures and organization of the Board of Directors' work;
3. organisation of the work of the Board's Committees;
4. decisions of the Board of Directors in the area of strategic planning;
5. decisions of the Board of Directors in the area of finance, financial reporting and risk management;
6. decisions of the Board of Directors in the area of oversight over executive management and corporate governance

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

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

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

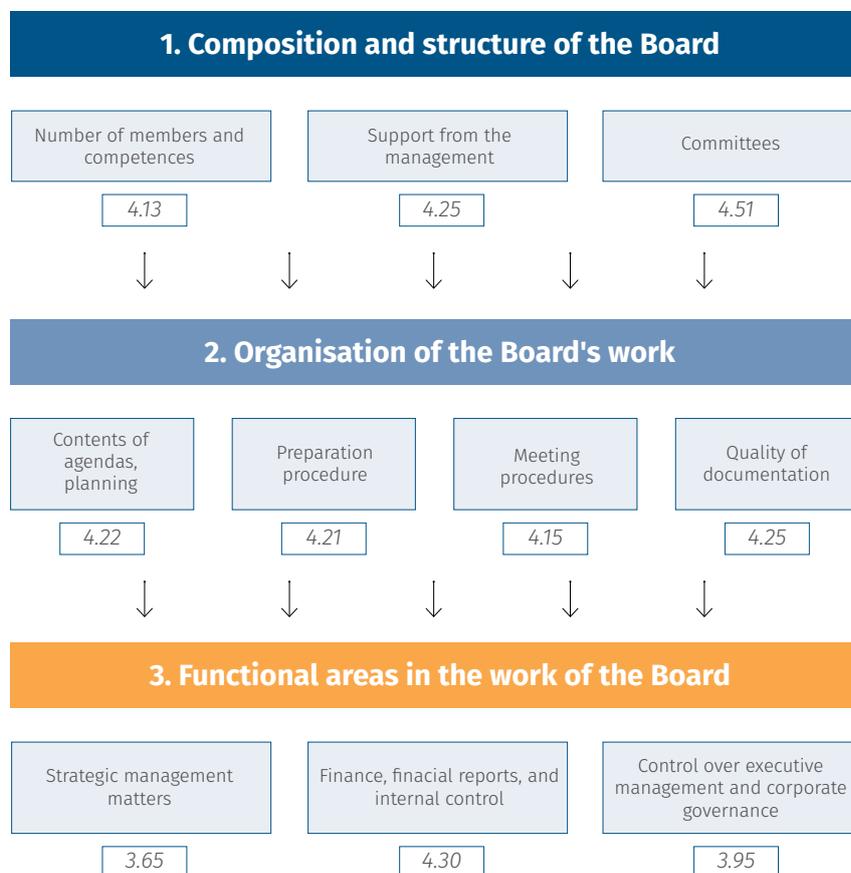
Corporate governance ratings

In 2016, the Russian Institute of Directors (RID) conducted a repeated assessment of the corporate governance practices of Sistema PJSC in accordance with the updated methodology of the National Corporate Governance Rating (NCGR). Sistema scored 8 on the NCGR scale, denoting "Advanced corporate governance practice."

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

- 1 shareholders' rights,
- 2 activities of the governance and control bodies,
- 3 disclosure of information,
- 4 corporate social responsibility and sustainable development.

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



The ISS assessment is based on four components:

- 1 composition of the Board of Directors
- 2 top management remuneration,
- 3 shareholders' rights,
- 4 audit system.

4.16
Total score
(on a 5-point scale)

REMUNERATION POLICY FOR BOARD MEMBERS AND SENIOR MANAGEMENT

Remuneration policy for Sistema Board members

Remuneration for members of the Board of Directors is calculated and paid in accordance with the Policy on Remuneration and Compensation Payable to Members of the Board of Directors of Sistema PJSC⁽¹⁾.

Basic remuneration of Board members

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

Supplementary remuneration of Board members

Board members are awarded supplementary remuneration in the form of ordinary shares of Sistema, subject to investment targets for the reporting year being achieved: (i) the arithmetic mean of total shareholder return (TSR) and internal total shareholder return (iTSR) exceeds or equals cost of equity (CoE)⁽²⁾; or (ii) TSR exceeds or equals the change of the MSCI index (Δ MSCI), provided that iTSR exceeds or equals CoE. The number of ordinary shares awarded to Board members is calculated as follows:

Remuneration in monetary terms

Weighted average price of one share

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

Remuneration for performance of additional duties

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

Board members are reimbursed for expenses accrued in connection with their duties, including participation in meetings of the Board of Directors and Board Committees.

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

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

Remuneration policy for senior management

Short-term incentive system

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

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

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

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

Long-term incentive system

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

Participants total annual income

Weighted average price of one share during the year

⁽¹⁾ Approved by the General Meeting of Shareholders on 27 June 2015.

⁽²⁾ This investment target was achieved in 2016, since the arithmetic mean of TSR and iTSR was 41.2% and CoE was 14.6%. CoE represents the minimum level of return that a company must provide to its shareholders for the expectation of profit and risk. CoE is calculated as the sum of risk-free returns (such as government bonds) and the risk premium associated with investing in the stock market, taking into account the capital structure of the asset in question and country risk.

Co-investment programme

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

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

- 1 shares/stakes in Sistema's subsidiaries;
- 2 ordinary shares of Sistema PJSC.

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

Remuneration is paid if:

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

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

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

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

The Corporation does not grant loans to senior executives.

Remuneration paid to Board members and senior management in 2016⁽¹⁾

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

Cash remuneration	RUB 498,400,342	Remuneration for work in the Board of Directors and additional duties, as well as salaries and bonuses for 2016 paid to Board members who were also employees of the Corporation in 2016 ⁽²⁾ .
Remuneration in the form of ordinary shares of Sistema	RUB 422,928,991	Shares paid to Board members for corporate year 2015-2016 ⁽³⁾ and remuneration under the long-term incentive programme.
Reimbursement of expenses incurred by Board members in connection with their duties	RUB 3,713,752	

Members of Sistema's Management Board⁽⁴⁾ received the following remuneration in 2016:

Cash remuneration	RUB 3,148,937,048	Including fixed salaries and bonuses. ⁽⁵⁾
Remuneration in the form of ordinary shares of Sistema	RUB 1,155,134,028	Shares paid under the long-term incentive programme.

⁽¹⁾ All figures in this section are given before the applicable income tax.

⁽²⁾ Excluding members of Sistema's Board of Directors who were members of its Management Board.

⁽³⁾ The rouble equivalent of fixed amounts in US dollars, calculated at the Russian Central Bank's exchange rate on the date of payment (see above in this section).

⁽⁴⁾ Including the President of Sistema PJSC.

⁽⁵⁾ Bonuses for 2016 were paid to Sistema's employees in January 2017.

Corporate Social Responsibility

PRINCIPLES FOR RESPONSIBLE INVESTMENT

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



Responsible investment is an approach to investing that aims to incorporate environmental, social and governance (ESG) factors into investment decisions, in order to better manage risk and generate sustainable long-term returns.

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

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

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

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

⁽¹⁾ Code of Ethics, Corporate Governance Code, HR Management Code, Corporate Social Responsibility Policy and Charity Policy.



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

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

Sistema

was named best in class for corporate transparency

among Russia's largest private companies, and Segezha Group won the Debut of the Year category in the annual study of public reporting conducted by the Russian Regional Network on Integrated Reporting to identify best practices for information disclosure, including the application of national and international standards and guidelines.

Sistema

was also among the leaders in two sustainable development indices

(Responsibility and Transparency and Sustainable Development) prepared by the Russian Union of Industrialists and Entrepreneurs based on public corporate reporting by Russia's 100 largest companies.

CONTRIBUTION TO SUSTAINABLE DEVELOPMENT

With innovative, infrastructural and systemically important companies in a number of strategic sectors and an intensive social policy in its regions of operation, Sistema makes a significant contribution towards achieving priority goals in Russia's economic, social and environmental development, and also towards achieving most of the global Sustainable Development Goals (SDGs) of the UN's 2030 Agenda for Sustainable Development. Many of the Corporation's projects operate at the intersection of various SDGs, while simultaneously addressing urgent domestic objectives including growth of labour productivity; technological development; import substitution; food security; educational, healthcare, social and environmental improvements, and raising overall living standards.

SDGs	Sistema's contribution	Key programmes
 <p>End poverty in all its forms everywhere</p>	<p>Social and charitable projects of Sistema Charitable Foundation ("SCF") and the Group's companies to support the underprivileged and create equal opportunities for all: children, the elderly and people with special needs.</p>	<p>Taking Care of Veterans, a joint programme of Sistema, the Moscow City Government and the Moscow City Council of Veterans.</p> <p>Generation M, one of Russia's largest charitable projects, which was launched by MTS and combines ideas of developing children's creativity and supporting critically ill children.</p>
 <p>Reduce income inequality within and among countries</p>		<p>Participate!, a charity campaign that collects goods for children in orphanages and social boarding schools, disabled children and children from large families across Russia and Kazakhstan.</p>
 <p>End hunger, achieve food security and improved nutrition and promote sustainable agriculture</p>	<p>Investments in agriculture: renewal of agricultural machinery, introduction of advanced agricultural technologies, and growth of crop yields and livestock productivity.</p>	<p>Upgrading Yuzhny Agricultural Complex, Russia's biggest greenhouse farm, located in Karachay-Cherkessia.</p> <p>Planting new intensive apple orchards in the Rostov region.</p> <p>Introducing a modern comprehensive herd management system – the technological core of a modern dairy farm.</p>
 <p>Ensure healthy lives and promote well-being for all at all ages</p>	<p>Investments in healthcare, pharmaceuticals, and promotion of healthy lifestyles and social inclusion.</p>	<p>Taking Care of Veterans, a programme to provide medical insurance and free spa treatment for World War II veterans and others (Sistema Charitable Foundation and Medsi Group).</p> <p>Be Healthy With Medsi, a programme designed to raise public awareness of healthy lifestyles.</p> <p>Setting up an R&D centre and launching a programme for training medical personnel (Binnopharm).</p>



Promote sustained, inclusive and sustainable economic growth, full and productive employment and decent work for all

In 2016, Sistema Group companies provided employment for around 0.2% of Russia's total workforce.

The Group paid a total of approximately RUB 98bn in taxes to federal and regional budgets in 2016, of which about a quarter goes to pension, medical and social insurance. This is roughly 0.68% of all tax payments made to Russia's consolidated budget and approximately 0.4% of total social security contributions.

Sistema Academy, a corporate-wide project that combines the best coaches and educational programmes of all of the Group's subsidiaries.

Subsidiaries' programmes for training, development, financial and non-financial incentives, and benefits for personnel.



Ensure access to affordable, reliable, sustainable and modern energy for all

Investments in power grid infrastructure, energy efficiency in industrial processes and wider use of alternative energy sources.

A large-scale project to upgrade power grids in Bashkortostan using Smart Grid technologies, and implementation of an automatic power control and metering system.

Production and use of biofuel from woodworking waste at Segezha Group enterprises.

Introduction of solar power supply systems for base stations of the MTS network.



Ensure inclusive and equitable quality education and promote lifelong learning opportunities for all

Supplementary education programmes for schoolchildren, college students, working professionals and senior citizens.

Lift to the Future, a nationwide programme of Sistema Charitable Foundation to improve engineering and technology education.

The Higher School of Management and Innovation, a faculty co-run by Sistema and Moscow State University.

Sistema and MTS support a regional network of special information and education centres called The Russian Museum: A Virtual Branch.

MTS Group's projects Children and the Internet, All Ages Are Online and Mobile Academy are designed to teach younger schoolchildren and senior citizens useful skills for using the Internet and mobile services.

Safe Childhood, BPGC's project for teaching power safety to schoolchildren.

 <p>Build resilient infrastructure, promote inclusive and sustainable industrialisation and foster innovation</p>	<p>Sistema includes a number of high-tech companies investing in modern communications infrastructure, the electricity industry, and innovative solutions for roads and transport.</p>	<p>MTS deploying next-generation telecommunication networks (4G) throughout the country and BPGC building Smart Grids in Ufa.</p> <p>Development and introduction of innovative technologies for railway transport safety at Sarov Technopark.</p>
 <p>Make cities and human settlements inclusive, safe, resilient and sustainable</p>	<p>Investments in redevelopment of the urban environment and complex property development projects, wooden prefab houses, and innovative solutions for smart and safe cities.</p>	<p>Developing more than 20 in-fill residential properties in Moscow, Leader Invest also works on large-scale development projects with a strong emphasis on infrastructure. The company's projects fall into the energy efficiency classes A and B.</p> <p>The high-tech projects Intelligent Transport System and Safe City from the Corporation's portfolio can improve road traffic situation and increase public safety in cities.</p>
 <p>Take urgent action to combat climate change and its impacts</p>	<p>Conservation of forests; introduction of energy-saving and other technologies that help reduce greenhouse gas emissions.</p>	<p>Segezha Group reforests approximately 21,000 ha annually.</p>
 <p>Protect, restore and promote sustainable use of terrestrial ecosystems, sustainably manage forests, combat desertification, and halt and reverse land degradation and halt biodiversity loss</p>	<p>Interaction with environmental non-profits, and responsible forest and land use.</p>	<p>95% of Segezha Group's leased forest is FSC-certified⁽²⁾. Sistema supports the non-profit organisation Far Eastern Leopards, which aims to preserve and restore the population of this rare species in the Russian Far East, as well as projects of the Russian Geographical Society.</p>
 <p>Ensure sustainable consumption and production patterns</p>	<p>Introducing lean production and promoting sustainable consumption among customers</p>	<p>Projects for recycling used batteries (MTS) and switching subscribers to electronic bills (MGTS); use of Segezha Group's paper packaging in the largest retail chains, including Detsky Mir.</p>

⁽²⁾ Forest Stewardship council (FSC)



Strengthen the means of implementation and revitalise the global partnership for sustainable development

Agreements on social and economic cooperation with Russian regions, and projects based on cross-industry social partnerships with the state and non-profits.

In 2016, Sistema signed a cooperation agreement with the Kirov region government, envisaging joint initiatives to create favourable economic, investment and social environments in the region.

MTS signed an agreement to develop telecom infrastructure with the Yamal-Nenets regional government, while Segezha Group signed agreements with Karelia and the Kirov region.

The government of Altay and Sistema Charitable Foundation signed a cooperation agreement envisaging joint projects in culture, education and social welfare to develop volunteering, promote patriotism among young people and encourage social activity.

SOCIAL INVESTMENTS AND PARTNERSHIPS

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

- 1 Improvement of engineering education;
- 2 Social projects and volunteering;
- 3 Use of advanced technologies to promote culture and the arts.

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

Supporting talent and innovation

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

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

Sistema

ranked third in a list of leading Russian corporate charity donors in 2016

compiled by Vedomosti newspaper, the Donors Forum and PwC. The list includes 60 large Russian and international companies with revenue of more than RUB 100m and charitable activities in Russia.

Social projects and volunteering

Sistema's social projects aim to increase quality of life of underprivileged groups by spreading cutting-edge social technologies and developing volunteering.

Since 2015, SCF and Medsi Group have successfully run the Taking Care of Veterans programme under an agreement signed between Sistema, the Moscow City Government and the Moscow City Council of Veterans. About 700 programme participants, including war veterans, have been treated at Medsi clinics in Moscow, while aggregate investment in the programme has exceeded RUB 70m.

A special role in supporting war veterans, children and other target groups of CSR programmes is played by the corporate volunteer movement,

Sistema

received the Russian Business Leaders: Dynamics and Responsibility 2016 award

from the Russian Union of Industrialists and Entrepreneurs in the category Development of Cross-Industry Partnerships in Tackling Social Issues of Russian Regions.

64

projects
in eight regions

Key results of by Sistema Charitable Foundation's Volunteer Centre*

	2015	2016	Growth
Number of subsidiaries involved	13	21	62%
Number of events	55	64	16%
Number of social partners	16	16	-

*Source: Sistema Charitable Foundation

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

Employees and senior managers of Sistema and its subsidiaries began providing regular support to specific social projects in 2016. The New Year's charitable auction (organised for the first time) and several fundraisers as part of the annual Wishing Tree campaign raised over RUB 11m from Sistema employees that went to recipients including the Volgograd regional hospice and the Pavlovsky assisted-living facility in St Petersburg.

174

playrooms
in hospitals and rehabilitation centres in Russia

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

New technologies for promotion of culture and education

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



The multimedia centre was almost fully equipped by sponsors, and primarily Sistema. A multimedia cinema opened here first in 2011 and then became a platform for online lectures in 2013.

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

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

An important place in Sistema Group's social and educational efforts belongs to projects aimed at making web and mobile technologies safer and more accessible for all users, from children to the elderly.

MTS has teamed up with employees of Moscow State University's Psychology Department to develop the Children and the Internet programme, which includes lessons in online safety for younger schoolchildren, and an interactive exhibition, workshops and webinars for teachers and parents. Over 340,000 people in 30 regions completed the programme in the last five years. In 2016, exhibitions and lessons on safe and productive web surfing were organised in libraries, museums and children's art centres in eight cities: Krasnoyarsk, Saratov, Kemerovo, Omsk, Orenburg, Orsk, Kurgan and Izhevsk.

ENVIRONMENTAL RESPONSIBILITY

Given the scale of its business and the environmental impact of its portfolio companies, Sistema considers reduction of its overall environmental footprint, including greenhouse gas emissions and resource consumption, as a priority, and is striving to achieve positive change by introducing environmentally friendly technologies and promoting green lifestyles.

The Corporation's key environmental initiatives focus on responsible use, preservation and restoration of forests.



Segezha Group, the biggest forest user in the European part of Russia, promotes sustainable forest use, which envisages sustainability of resources, forest protection, reforestation, and prevention of forest fires and illegal felling to ensure that the forest brings maximum value to people as well as to the economy. Segezha Group works actively with the government on projects to implement new models of intensive and responsible forest management aimed at facilitating sustainable forest development. Its experience was used to develop the required legal framework, first of all, for the pilot project of intensive forest use and reforestation in Karelia.

Segezha Group is actively engaged in forest management on leased forest areas in four regions of Russia. In 2016 alone, it restored about 22,000 ha of forests. Segezha Group's Russian companies invested some RUB 85m in environmental projects in 2016, while its foreign subsidiaries contributed EUR 150,000. The holding has an environmental management system

HA **22^{th.}**
*forests
were restored in 2016*

based on ISO 14000, performs internal audits of the environmental activities of all of its subsidiaries, and undergoes voluntary Forest Stewardship Council (FSC) certification of its forest resources and supply chains. In 2015, the Group's largest enterprise, Segezha Pulp & Paper Mill, confirmed the compliance of its supply chain and controlled timber with FSC standards until December 2021.

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

RUB **85^m**
*total investments
in environmental projects
in 2016*

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

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



Sistema companies (RTI, MTS, MTS Bank, MGTS and Segezha) participated in an environmental campaign organised by FSC Russia to mark International Day of Forests and collected about 2.4 tons of waste paper for recycling, which saved more than 40 trees, 17,000 litres of water, 9,600 kWh of energy and prevented the emission of more than 4 tonnes of CO₂.

Two of **Segezha Group's** enterprises – Segezha PPM and Lendery Timber Company – were named among the most environmentally responsible forest operators,

in a ranking compiled by the regional environmental organisation SPOK, which rates forest users based on their stance on preservation and use of Specially Protected Natural Areas.

2.4 tons

waste paper

were collected and restored, which saved more than 40 trees

Information about fuel and energy consumption

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

A TEAM OF PROFESSIONALS

As one of Russia's biggest employers, Sistema creates jobs with competitive salaries and additional social guarantees, and offers employees unique opportunities for career growth and to develop new skills. In 2016, the Group employed about 158,000 people in all regions of Russia⁽¹⁾. The Group's companies strictly adhere to generally accepted norms and principles of labour relations, including those set out in World Labour Organisation guidelines and Russian legislation to prevent discrimination, protect employees' personal data and observe human rights⁽²⁾.

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

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

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

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

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

⁽¹⁾ Including Targin.

⁽²⁾ The Corporation is n Rights.



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

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

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

Sistema Group's top managers

are regularly named as some of Russia's best managers in the annual rating compiled by the Managers' Association and Kommersant Publishing House. In 2016, the number of the Corporation's representatives in the list of the Top 1,000 Russian Managers doubled compared to the previous year. A total of 72 senior executives made it to the list, including 65 senior managers of Sistema's portfolio companies – the highest result among the ranking's participants.



Mikhail
Shamolin



Vsevolod
Rozanov

Sistema's President Mikhail Shamolin was ranked #1 among CEOs of diversified holding companies, and Vsevolod Rozanov, Senior Vice President and head of the Finance and Investment Function, was declared the best CFO.

Disclaimer

Certain statements in this report may contain assumptions or forecasts in respect to forthcoming events within Sistema. The words “expect”, “estimate”, “intend”, “will”, “could” and similar expressions identify forward-looking statements. We wish to caution you that these statements are only predictions and that actual events or results may differ materially. We do not intend to update these statements to reflect events and circumstances occurring after the above-mentioned date or to reflect the occurrence of unanticipated events.

Many factors could cause Sistema’s actual results to differ materially from those contained in our projections or forwardlooking statements, including, among others, deteriorating economic and credit conditions, our competitive environment, risks associated with operating in Russia, rapid technological and market change in our industries, as well as many other risks specifically related to Sistema and its operations.

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