SISTEMA JSFC

Annual Report
2014

To whom it may concern

April 24, 2015

Responsibility Statement

To the best of my knowledge (a) the financial statements, prepared in accordance with US GAAP, give a true and fair view of the assets, liabilities, financial position and profit or loss of Sistema JSFC and the undertakings included in the consolidation taken as a whole; and (b) the management report includes a fair review of the development and performance of the business and the financial position of Sistema JSFC and the undertakings included in the consolidation taken as a whole, together with a description of the principal risks and uncertainties that they face.

Yours sincerely,

Mikhail Shamolin
President and Chief Executive Officer

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1. MAIN EVENTS

Sistema

Investments and M&A

Increased stake in NVision Group
In January 2014, Sistema Telecom Assets LLC, wholly owned Sistema's subsidiary, signed legally binding agreements to acquire a 38.75% stake in CJSC NVision Group with CJSC RegionKapital (part of Marshall group, one of Russia's private investment groups) and several other individual shareholders.
The total value of the deal amounted to US$ 82.5 million, US$ 37.5 mln of which paid in cash, and US$ 45 mln in Sistema shares. Sistema Group's ownership in CJSC NVision Group amounted to 88.75%. In December 2014, Sistema Group acquired additional 11.25% shares and increase its stake in NVision to 100%.

Increased stake in Business Nedvizhimost to 100%
In April 2014, Sistema acquired 49% of the ordinary shares of CJSC Business Nedvizhimost from CJSC MGTS-Nedvizhimost, for RUB 3.1 bln. As a result, Sistema now owns 100% of the company.
Business Nedvizhimost owns 76 real estate sites located across Moscow which cover a total area of approximately 178,000 square metres and were used by MGTS as automatic telephone stations (ATS) prior to the implementation of GPON (Gigabit-capable Passive Optical Network) technology.

Partnership in pharmacy
In April 2014, Sistema signed binding agreements with Fresenius Kabi, a German pharmaceutical company, and Zenitco Finance Management, another shareholder of Binnopharm CJSC, to establish a pharmaceuticals joint venture ("JV") for operations in Russia and the CIS. The JV was to combine 100% of Binnopharm and 100% of Fresenius Kabi's Russian and CIS business. However, in autumn of 2014, Sistema and Fresenius announced that the deal will not be closed, however companies will continue to cooperate on commercial projects.

Investment in OZON
In April 2014, Sistema acquired a 10.8% stake for US$ 75 mln in OZON. MTS, Sistema's telecoms subsidiary, also acquired a 10.8% stake at the same valuation. As a result, two representatives from Sistema and MTS joined OZON's Board of Directors.
OZON owns five e-commerce companies in Russia: OZON.ru, the largest multi-category online shop in Russia with more than 750,000 unique visitors per day; Sapato.ru, one of the leading e-commerce store of shoes, accessories and apparel; OZON.travel, the leading Russian online travel agency; O-Courier, OZON's dedicated delivery service operating a network of companies and agents across Russia and Kazakhstan with over 2,200 pick-up points; and OZON Solutions, a B2B consultancy, which helps businesses to succeed in the e-commerce universe.

Investment in forestry and pulp and paper
In September 2014, LLC LesInvest, Sistema's subsidiary, acquired from the Bank of Moscow 100% of OJSC Segezha Pulp and Paper Mill and 100% of LLC Derevoobrabotka-Proekt (the "Group") together with all debt obligations to the Bank of Moscow on debt free cash free basis.
The Group is the largest manufacturer of sxack paper and paper sacks in Russia and the second largest producer of paper sacks in Europe. It is also one of the largest manufacturers and exporters of timber products and ply wood in Russia. In 2013, the Group's estimated revenue and EBITDA amounted to approximately RUB 20.9 bln and RUB 2.4 bln respectively, according to the management accounts. Export accounted for 54% of the Group's total revenue.

Sistema invests in Concept Group
In October 2014, Sistema acquired a 40% stake for a total consideration of approximately RUB 1 billion in a holding company that owns Concept Group, one of Russia's leading fashion clothing retailers by revenue growth.
In accordance with the terms of the signed documentation Sistema has an option to increase its shareholding in Concept Group to a controlling stake within three years.
Founded in 2004, Concept Group creates collections and sells women's clothing, accessories, lingerie as well as children's wear through its own stores, franchises, online and wholesale channels. It operates under the Concept Club, Bestia, Infinity Lingerie and Acoola brands. As of the end of 2013, Concept Group's retail chain comprised 287 stores in 103 cities across Russia with an average store area of 100-250 sq.m. In 2013, Concept Group's revenue exceeded RUB 5 bln, demonstrating increase of nearly 40% in comparison with its revenues in 2012.

Sistema participate in additional share issue of MTS Bank

In October 2014, Sistema signed a binding agreement with its subsidiary MTS Bank to acquire 2,474,818 ordinary shares of the Bank's additional share issue for RUB 9,460,684,754.

Corporate events
In July 2014, Sistema paid out record dividends in the amount of RUB 19.9 bln, corresponding to dividend yield of 5%.
In the second quarter of 2014, Sistema's ordinary shares were included in the First Tier (top) quotation list of the Moscow Exchange.
In September 2014, Sistema terminated the contract for the acquisition of a 98% stake in OJSC United Petrochemical Company from Bashneft (deal announced in autumn of 2013).
In October 2014, Sistema terminated the contract for the acquisition of 162,837,500 Sistema ordinary shares for RUB 7.6 billion as announced on July 18, 2014.
In February 2015, Sistema completed the placement of RUB 10 billion Series BO-01 unconvertible interest-bearing bonds with a par value of RUB 1,000 at the rate of 17% per annum. Coupon payments will be made on a semi-annual basis. The bonds mature in 15 years. In addition, bondholders have the right to redeem their bonds at the point of expiration, 18 months from the date the bonds were placed.

Events related to the deconsolidation of Bashneft

The civil proceedings brought against Sistema and Sistema-Invest
On September 24, 2014, a civil claim was filed with the Arbitrazh (Commercial) Court of the City of Moscow ("Arbitrazh Court") by the First Deputy General Prosecutor of Russia seeking to return shares of JSOC "Bashneft" (Bashneft") held by Sistema and its wholly owned subsidiary Sistema-Invest ("Bashneft Shares") to the Russian Federation (the "Civil Claim"). The Civil Claim asserted that the privatization of Bashneft was unlawful as Bashneft was originally the property of the Russian Federation and, as a result, the authorities of the Republic of Bashkortostan were not legally entitled to privatize Bashneft without obtaining the requisite consents from the Russian Federal authorities.
On November 7, 2014, the Arbitrazh Court issued a written decision, ruling in favour of the Civil Claim.
On November 12, 2014, Sistema's Board of Directors considered and decided not to appeal the decision of the Arbitrazh Court, but rather focus on filing claims for the recovery of damages from the counterparties and/or their legal successors (LLC Ural-Invest) which sold the Bashneft Shares to Sistema and Sistema-Invest.
In December 2014, Bashneft Shares were transferred to the Russian Federation.
In December 2014, Sistema as a good faith buyer filed a claim with the Arbitrazh Court for the recovery of damages from LLC Ural-Invest ("Ural-Invest"), suffered by Sistema as a result of loss of the Bashneft Shares.
In February 2015, the Arbitrazh Court ruled in favour of Sistema's claim for the recovery of RUB 70.7 billion damage from Ural-Invest.
In March 2015, Sistema and Ural-Invest signed a settlement agreement. In accordance with the terms of the settlement agreement, all the property owned by Ural-Invest, i.e. cash assets of approximately RUB 46.5 billion, will be transferred to Sistema.
Given the social importance of the projects of the URAL charitable fund ("Fund"), which is affiliated with Ural-Invest, and in accordance with the terms of the settlement agreement Sistema will invest RUB 4.6 billion of the funds receivable from Ural-Invest to the Fund's socially important charitable projects.
On March 30, the Arbitrazh Court approved the settlement agreement signed by Sistema and Ural-Invest.
In April 2015, Sistema signed an agreement with Ural-Invest to receive an additional RUB 12.9 billion in cash assets and financial instruments for the recovery of damages from Ural-Invest LLS, suffered by Sistema as a result of loss of the Bashneft shares.

Criminal proceedings relating to the privatization of Bashneft
In April 2014, a criminal investigation was commenced in respect of Mr. Ural Rakhimov (the son of Mr. Murtaza Rakhimov, who was the President of the Republic of Bashkortostan during the period when the BashTEK companies were privatized) and Mr. Levon Airapetyan. These persons have been accused of misappropriating Bashneft via an illegal privatization process and have also been accused of legalization with respect to Bashneft.
On September 16, 2014, the majority shareholder and Chairman of the Board of Directors of Sistema, Mr. Vladimir Evtushenkov was charged with legalization of assets that were wrongfully acquired by other persons, and placed under house arrest.
In December 2014, Mr. Vladimir Evtushenkov was released from house arrest and is now participating as normal in business of Sistema Group, as the Chairman of Sistema's Board of Directors.

Key events of subsidiaries

MTS

In September 2014, MTS obtained a controlling stake in the Russian-Uzbek joint venture Universal Mobile Systems LLC ("UMS"). In accordance with the terms of a Settlement Agreement between MTS and the Republic of Uzbekistan, a 50.01% stake in the charter capital of UMS was transferred to MTS, while a state-owned unitary enterprise established and managed by the State Committee for Communications, Development of Information Systems and Telecommunications Technologies of the Republic of Uzbekistan will retain the remaining 49.99% stake. The assets, equipment and infrastructure, which were previously owned by Uzdunrobita FE LLC, a former subsidiary of MTS in Uzbekistan, were transferred to UMS. Operations across Uzbekistan are due to be commercially launched on December 1, 2014.

In October 2014, MTS opened a non-revolving line of credit with Sberbank of Russia worth RUB 50 billion, which will mature in September 2021. The funds will be used for general corporate needs. The operator has also amended the terms of the credit agreement originally signed with Sberbank of Russia in April 2014 by extending the final maturity of the facility from July 2015 to September 2017.
In November 2014, MTS completed its dividend payments based on the first half 2014 financial results, which amounted to RUB 6.2 per MTS ordinary share (RUB 12.4 per ADR), or a total of RUB 12.8 billion. In July 2014, MTS paid out annual dividends of RUB 18.6 per MTS ordinary share (RUB 37.2 per ADR), or a total of RUB 38.4 billion, based on the full-year 2013 financial results.

In December 2014, MTS participated in MTS Banks rights issue and acquired 952,000 ordinary shares of MTS Bank for RUB 3.64 billion.

In February 2015, MTS' subsidiary MTS Ukraine won a tender for a nationwide licence for providing of 3G telecommunications services in the 1950-1965 MHz/2140-2155 MHz ranges as a result of the open tender held by the National Commission for the State Regulation of Communications and Informatization (NCSRCI). Granted for a term of 15 years, the licence cost UAH 2.715 billion. In accordance with the conditions stipulated in the tender documentation, MTS is required to launch 3G services in all of the regional centres across Ukraine within 18 months upon allocation of the licence.

In January 2015, MTS' majority-owned subsidiary MGTS divested its 49.95% stake in Intellect Telecom OJSC to Sistema for RUB 344 million. MGTS also acquired a 89.53% stake in NIS PJSC from Sistema for RUB 44 million.

BPGC
In 2014, BPGC's subsidiary, Bashkirenergo LLC, became the first power company in Russia to switch to a 10-year tariff regulation and to determine its rates based on return on invested capital (RAB), while rates of other power companies are set for no more than 5 years. Regulation of tariffs by return on invested capital has a number of advantages for power grid companies, consumers and the country as a whole. These include incentives to reduce costs, solid investments with favourable rates, an opportunity for distribution grid companies to plan development programmes over the long-term, as well as to improve their service quality and offer predictable tariffs. The 10-year regulation period will allow both energy consumers and energy providers to effectively implement long-term business development planning with the aim of enhancing their investment attractiveness. Investments into the Republic of Bashkortostan's electricity sector will total more than RUB 29 billion for the 10-year period.

In September 2014, Sistema-Invest received a notice from OJSC REESTR about restrictions on transactions with the shares of JSC Bashkirian Power Grid Company owned by Sistema-Invest.

RTI
In May 2014, as a result of converting RUSNANO's 37.67% stake in Sitronics-Nano LLC into additional shares in Mikron, RUSNANO obtained a 25.1% stake in Mikron.

In December 2014, Mikron released its first "Elbrus-2GM" processors using 90 nm technology, based on which JSC MCST plans to launch its production of compact mother cards.

In February 2014, Mikron completed the technological development process behind the creation of its 65 nm integral circuits. The company also is conducting exploratory research to develop its own 45 nm technology.

MTS Bank
In December 2014, MTS Bank successfully completed its additional share issue and raised RUB 13.1 billion. Its capital adequacy ratio (N1) increased from 19% in 2013 to 25% at the end of 2014. Sistema acquired 2,474,818 ordinary shares of MTS Bank's additional share issue for RUB 9.5 billion.

In February 2015, MTS Bank was included in a government approved list of banks for receiving capitalisation support on preferential terms from the Deposit Insurance Agency.

Detsky mir

In December 2014, Vladimir Chirakhov, CEO of Detsky mir, became its minority shareholder, owning a 1.08% stake, as part of a long-term incentive programme for the top management.
In August and December 2014, Detsky mir paid RUB 2.5 billion in dividends to its shareholders.

2. STRATEGY

Mission:
Long-term growth of shareholder value through efficient management of the asset portfolio and achievement of high returns on investment.

Value creation model
The model of Sistema as an investment company envisages creation of shareholder value through constant reinvestment of capital - accumulation of cash from incoming dividends and monetisation of assets, distribution of the received profit in form of dividends among Sistema's shareholders, reinvestment in existing assets and new investment projects in order to receive further income.

Investment strategy

Medium-term goals of Sistema as an investment company

- Generating substantial cash at Hold Co through exits and dividends from subsidiaries, as well as from finding and carrying out unique investment opportunities in Russia that arise from market volatility
- Balancing investment portfolio with export-oriented industrial companies in Russia that may become a source of foreign currency liquidity
- Building industry leaders in private healthcare, high technology and microelectronics, pulp and paper industry, in order to maximise shareholders returns
- Restructuring and supporting portfolio companies operating in segments that are most sensitive to changes in the economic situation

Investment criteria

Sectors and industries:

- sectors complementary to current investment, which allow using Sistema's competences and finding synergies with the existing portfolio
- the consumer sector - affordable private healthcare, children's goods, clothing and footwear, e-commerce
- core industries with an export potential where Russia has permanent structural advantages - low production costs, availability of resources and stable demand

Asset size:

- focus on medium assets, which will ensure a leading position on the market by means of synergy, industry consolidation opportunities and successful implementation of Sistema’s investment and operational strategy
- preference to deals structured as LBO (leveraged buyout)

Geography:

- Russia and the CIS as key regions of competence

3. SHAREHOLDER CAPITAL

Sistema has 9,650,000,000 ordinary shares outstanding, with a par value of RUB 0.09 each. The company's shareholder capital amounts to RUB 868,500,000.

In February 2005, Sistema held the initial public offering. The listing of shares was held in the form of Global Depositary Receipts on the London Stock Exchange under the symbol SSA. One GDR represents 20 ordinary shares. The company's ordinary shares are traded under the symbol AFKS on the Moscow Exchange. Sistema's free float on the London Stock Exchange is approximately 19% and 16.8% of shares are traded on the Moscow Exchange (including positions of insiders, shares owned by management and members of the Board of Directors, and ordinary shares on Sistema's Group balance sheet).

Sistema's shares are included in several key indices of the Moscow Exchange (index MICEX and RTS). These indices include 50 most liquid shares of companies, representing key industries of the russian economy.

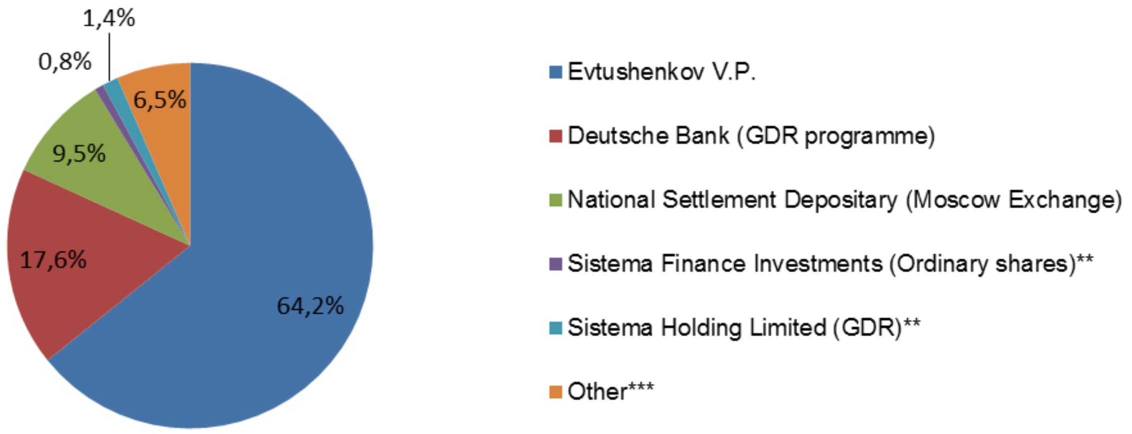
Sistema's shares also included to MICEX Financial services index. The sector Indices are capitalization-weighted indices calculated based on prices of the most liquid shares of Russian issuers admitted to trading on the Moscow Exchange.

The Moscow Exchange's multi-asset indices are composite indices comprised of stocks and bonds admitted to trading on the Moscow Exchange and that can be used as investment vehicles by Russian Retirement Funds according with the Russian legislation. Sistema's shares are included to equity sub-index, bond sub-index.

Sistema's GDRs also included to MSCI Russia index, that confirms international recognition and supports reputation of the company among the largest institutional investors with index strategies.

Sistema owns one public company: MTS's shares are traded on the New York Stock Exchange in the form of ADRs (ticker: MBT) and MTS's common shares are traded on the Moscow Exchange (ticker: MTSS). Chairman of the Board of Directors of Sistema Vladimir Evtushenkov, with 64.19% of shares, is the principal Sistema shareholder.

*Sistema's shareholders**



** As of January 23, 2015*
**Shares and GDRs owned by Sistema Group*
**** Position of insiders management, member of the Board of Directors and other)*

Sistema's GDR price performance on the London Stock Exchange

Sistema's GDRs and ordinary shares significantly decreased in the second half of 2014 due to situation around Bashneft and changes in macroeconomic conditions. Rouble depreciated against US dollar by 75.3% in 2014, Brent oil price fell by 44.5% in 2014.

Sistema's GDR dropped by 83.8% since January 1, 2014 till December 31, 2014. The closing price of Sistema's GDR on the London Stock Exchange on the first trading day of 2014 was US$ 31.25 with a market capitalisation of US$ 15,078 million, while on the last trading day it was US$ 5.21 with a market capitalisation of US$ 2,514 million. Sistema's ordinary shares decreased by 74.5% in 2014, RTS index lost 45.2% in 2014.

Sistema's GDRs reached a high of US$ 32.08 on January 10, 2014 and a low of US$ 1.88 on December 16, 2014. Average daily volume on the London Stock Exchange in 2014 amounted to 997,240 GDRs.

Dividends

Sistema's dividend policy aims to provide a regular and sizeable dividend flow, while allowing the company to maintain the financial flexibility to take advantage of attractive investment opportunities in the future.

Dividends are declared on the basis of results from the previous financial period, and the company's dividend policy is for annual dividends to be a minimum of 10% of the corporation's consolidated net income under US GAAP (net of any special dividends paid). In addition, in the event of a large asset sale for cash, special dividends will be declared in an amount of at least 10% of the net gain from such a transaction, as determined by the Board of Directors. Under Russian law, the total amount of dividends with respect to any year may not exceed the company's annual unconsolidated net income determined in accordance with Russian Accounting Standards (RAS).

In June 2014, the Annual General Meeting of Shareholders approved the total amount of dividend payment on Sistema's shares for 2013 at RUB 19.9 billion, representing a payment of RUB 2.06 per ordinary share (RUB 41.2 per GDR). The total proposed dividend payment has been determined on the basis of Sistema's full year 2013 US GAAP net income and the corporate centre's net gain from the sale of stake in RussNeft in July 2013. In July 2014, Sistema paid out record dividends, corresponding to dividend yield of 5%.

4. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is a discussion of our financial position and results of operations as of and for the years ended 31 December 2014 and 2013 and of the material factors that we believe are likely to affect our consolidated financial position. You should read this section together with our audited consolidated financial statements as of 31 December 2014 and 2013 and for the years then ended (further – the "Financial Statements"). References to "the Group", "we" or "us" are references to Sistema JSFC and its subsidiaries. Our reporting currency is the U.S. dollar, and our Financial Statements have been prepared in accordance with U.S. GAAP.

In addition, this discussion contains forward-looking statements that involve risks and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements as a result of various factors.

We are one of the largest publicly-traded diversified investment companies in the Russian Federation and the CIS, managing companies serving over 100 million customers. We are focused on delivering long-term growth to our shareholders through returns on our diversified portfolio of investments and identifying new and profitable investment opportunities. Our investment portfolio is currently largely composed of stakes in Russian businesses in a variety of sectors, including telecommunications, transportation, consumer, high technology and others.

We were founded in 1993 by Vladimir Evtushenkov and his close associates and developed through the 1990s and early 2000s through participation in privatisations and the creation of several successful strategic partnerships. We completed an initial public offering in February 2005, when we listed our GDRs on the London Stock Exchange. Our ordinary shares are listed on the Moscow Exchange.

In September 2012, in line with our strategy to become an investment company and to better allow us to identify and evaluate new investment opportunities and to manage our existing investments, we announced a new organisational and management structure which combines our investments into five investment portfolios (as of the end of March, 2015).

The following table illustrates our ownership interests in our principal consolidated subsidiaries and equity holdings as of 31 December 2014.

Significant entities	Short name	Principal activity	Beneficial ownership as of December 31, 2014	2013
Sistema Joint Stock Financial Corporation	Sistema	Investing and financing		
Mobile TeleSystems	MTS	Telecommunications	53%	53%
Sistema Shyam TeleServices Limited	SSTL	Telecommunications	57%	57%
MTS Bank	MTS Bank	Banking	87%	87%
RTI	RTI	Technology	85%	85%
Detsky mir-Center	Detsky mir	Retail trading	99%	100%
Medsi	Medsi	Healthcare services	75%	75%
Targin	Targin	Oilfield services	100%	100%
Bashkirian Power Grid Company (Note 5)	BPGC	Energy transmission	91%(1)	79%(1)
LesInvest	LesInvest	Timber	100%	-
Leader-Invest	Leader-Invest	Real estate	100%	100%

(1) Voting interests as of December 31, 2014 and 2013 – 93%.

Segment Reporting

We currently have five reportable segments: MTS, SSTL, MTS Bank, RTI and Corporate. The Other category includes other operating segments including Targin, BPGC, LesInvest, Sistema Mass-media, Detsky mir, Intourist, Medsi, Binnopharm, Sitronics-N, Leader-Invest, SG-Trans and others, none of which meets the quantitative thresholds for determining reportable segments.

To measure the performance of these segments, we examine certain segment financial information, including net sales to external customers, intersegment sales and operating income.

Recent Developments

Acquisition of 3G license in Ukraine – In February 2015, MTS-Ukraine won a tender to acquire a nationwide license for the provision of 3G telecommunications services. The license with the cost of UAH 2,715 million ($156.9 million at the acquisition date) has been granted for 15 years.
In accordance with the terms of the license MTS-Ukraine is required to launch provision of 3G services in all of the regional centers across Ukraine within 18 months upon allocation of the license.

Bond placement – In February 2015, the Company completed the placement of Series BO-01 unconvertible interest-bearing RUB-denominated bonds for the total amount of RUB 10 billion ($160.3 million at the date of the placement) at the coupon rate of 17% per annum.

Insolvency of Kyivska Rus Bank – In March 2015, the National Bank of Ukraine adopted a resolution declaring Kyivska Rus Bank (Ukraine) to be insolvent. As of December 31, 2014, the Group held $25.1 million in deposits in the bank. Management determined that insolvency of the bank did not provide evidence related to conditions existing as of December 31, 2014, and therefore considered to be a nonrecognized subsequent event.

Operating environment

Starting from March 2014, sanctions have been imposed in several tranches by the U.S. and the E.U. on certain Russian officials, businessmen and companies. Following the decline in oil prices in 2014 and early 2015, Russia, which is the main market of the Group's operations, has experienced significant economic instability, characterized by the substantial depreciation of the Russian rouble, growth of interest rates caused by the decision of the Central Bank of the Russian Federation to significantly increase its key interest rate, a forecasted decline in gross domestic product and a significant decline in the value of shares traded on the Russian stock exchanges. International credit agencies downgraded Russia's long-term foreign currency sovereign rating with a negative outlook. Neither the Company, nor any of its subsidiaries are subject to the current sanctions, and the Group does not appear on the U.S. or E.U. lists of sanctioned parties. However, there is significant uncertainty regarding the extent or timing of any potential further economic or trade sanctions. Any continuing economic and political instability could have a negative impact on the Group's operating results.

Although the Group's reporting currency is the U.S. dollar, it generates most of its revenues in Russian roubles, which is also the functional currency of its principal operating subsidiaries. Therefore, the Group's reported results of operations are significantly impacted by the fluctuations in the exchange rate between the U.S. dollar and the Russian rouble, which depreciated against the U.S. dollar by 42% in 2014, and was on average 17% lower than the average value of the Russian rouble compared to the U.S. dollar during 2013. Also, given that most of the Group's revenues are generated in Russian roubles, the Group faces exchange rate risk relating to payments that the Group must make in currencies other than the Russian rouble.

During 2014, a deterioration in the political environment in Ukraine, the second largest market of the Group's operations, has led to general instability, economic deterioration and armed conflict in the eastern portion of Ukraine. The deterioration has further exacerbated the country's already weak macroeconomic trends, which have led to reduced credit ratings, significant depreciation of its national currency and increased inflation. In 2014, the Ukrainian Parliament adopted a law allowing for the imposition of sanctions against countries, persons and companies deemed by the Ukrainian government to threaten Ukrainian national interests, national security, sovereignty or the territorial integrity of Ukraine. The National Bank of Ukraine passed a decree prohibiting Ukrainian companies from paying dividends to foreign investors. These circumstances, combined with continued political and economic instability in Ukraine, could result in a negative impact on our business, including the Group's financial position and results of operations. For example, such risks apply to the Group's funds deposited in Ukrainian banks, the liquidity of which is negatively affected by the economic downturn. As of December 31, 2014, the Group held $376.9 million in current accounts and deposits in Ukrainian banks, including $90.2 million in Delta Bank (fully provided as of December 31, 2014) and $25.1 million in Kyivska Rus Bank.

Key Factors Affecting Our Results of Operations

General Factors

Russian Macroeconomic Conditions and Trends

The following table sets out key economic indicators of the Russian Federation and for the periods indicated:

Macroeconomic indicator	Year Ended 31 December 2013	2014
Real GDP growth (%, period-on-period)	1.3	0.6
Inflation		
Consumer price inflation (%)	6.5	11.4
Producer price inflation (%)	3.7	5.9
Exchange rates		
Period-end exchange rate (RUB/USD)	32.73	56.26
Average exchange rate (RUB/USD)	31.85	38.42
Nominal rouble appreciation (depreciation) against U.S. dollar (based on period-end rates)	(7.6)	(72.2)

Source: The Federal State Statistics Service (Rosstat).

The macroeconomic condition of the Russian economy substantially affects our results of operations. A fall in GDP, for example, would likely lead to a decline in demand for the products our subsidiaries offer, including telecommunications products and services and refined oil products. A fall in GDP may also lead to a decline in the prices of the products our subsidiaries sell. In addition, a decline in real disposable income may negatively impact our results of operations, should it cause a decline in demand for the key retail products our subsidiaries sell.

Inflation and exchange rate movements have a particular impact on our results of operations.

Inflation

While a significant part of our purchases are denominated in U.S. dollars or are closely tied to the U.S. dollar, a significant share of our costs, including salaries and utility costs, are sensitive to rises in the general price level in Russia. An increase in inflation, therefore, would increase our costs and thereby exert downward pressure on our profit margin and may also negatively impact domestic demand for the products of our subsidiaries. To the extent the increase in costs from higher inflation is not offset by an increase in sales, our results of operations would be negatively affected.

MTS' financial position and results of operations have been influenced by inflation in the various countries in which it conducts business, particularly Russia with an inflation rate of 11.4% for 2014. The Ukrainian economy has been characterized by high rates of inflation of 12.1% Inflation rates in Armenia, Turkmenistan and Uzbekistan in 2014 were estimated at 4.6%, 4.4% and 6.1% respectively. We expect inflation-driven increases in costs to put pressure on our margins. While we could seek to raise our tariffs to compensate for such increase in costs, competitive pressures may not permit increases that are sufficient to preserve operating margins.

Exchange rate movements

The depreciation of the rouble against the U.S. dollar would likely have an overall negative effect on our financial position and results of operations. With respect to our financial position, rouble depreciation would lead to an increase in the rouble equivalent of our borrowings and other liabilities that are denominated in U.S dollars, and would subject our investments in rouble-denominated monetary assets to the risk of loss in U.S. dollar terms. As of 31 December 2014, our borrowings denominated in foreign currencies equaled $3,363.6 million. Rouble depreciation may also make it more difficult to fund timely cash payments on debt denominated in foreign currencies. The negative impact of rouble depreciation on our financial position would be partially offset, however, by an increase in the rouble equivalent of our monetary assets denominated in foreign currencies, such as the U.S. dollar or euro. With respect to our results of operations, rouble depreciation would have an adverse effect on our costs denominated in U.S. dollars. Depreciation of the rouble against the U.S. dollar would also increase our costs denominated in roubles, both in absolute terms and relative to rouble-denominated revenues.

While we could seek to raise our prices and tariffs to compensate for the increase in costs resulting from depreciation of the rouble, competitive pressures may not permit increases that are sufficient to preserve our operating margins. In addition, because the U.S. dollar is our reporting currency and the rouble is our predominant functional currency, a decline in the rouble against the U.S. dollar resulted in a decrease in revenues in U.S. dollar terms in our consolidated financial statements.

We carry out a variety of measures to hedge against currency fluctuations, and, in particular, the depreciation of the rouble against the U.S dollar.

Capital expenditures and the implementation of large-scale investment projects

We require substantial funds to support our operations and implement large-scale investment projects at our subsidiaries. Our portfolio companies require capital expenditures for various reasons. MTS, for example, needs to make significant capital expenditures, particularly in connection with the development and the purchasing of software for our mobile and fixed line networks. Our results of operations, therefore, are impacted by our ability to raise adequate levels of debt financing and successfully complete capital investment projects in a timely manner and within budget.

In 2013 and 2014, our cash outlays for capital expenditures were $2,994.4 million and $2,902.6 million, respectively. In 2013 and 2014, we financed our cash requirements through a combination of operating cash flows, proceeds from disposal of investments and borrowings. In particular, we have used cash flows received through dividends from MTS to finance capital expenditures in our other subsidiaries as well as to repay our debt.

The table below sets forth capital expenditures at each of our reportable segments for the periods indicated:

	Year Ended 31 December	
Subsidiary	**2013**	**2014**
	($ in millions)	
MTS	2,561.3	2,315.0
RTI	95.0	105.1
MTS Bank	21.4	27.6
SSTL	45.8	43.3
Corporation	73.2	28.1
Other	197.7	383.6

Certain of our subsidiaries, such as MTS, operate in capital-intensive industries, and their results of operations depend significantly on their ability to successfully carry out large-scale investment projects. This includes the ability to select and prioritise those large-scale investment projects which are most likely to increase margins and the ability to plan and implement such projects, including attracting the significant funding necessary to ensure their completion.

MTS spent in total $2,315.0 million (or 21.3% of its total revenues) in 2014 for network development in Russia and the other countries where MTS operates.

Acquisitions strategy

Our investment approach is based on seeking opportunities to create value for our portfolio, including through acquisitions. During 2013 and 2014, several of our acquisitions have had an impact on our results of operations and financial position. The ability to carry out large-scale acquisitions successfully and on a timely basis is largely dependent on choosing the appropriate companies to acquire, securing the necessary financing and properly integrating the acquired companies into our portfolio.

Our ability to create value is dependent on our ability to choose the appropriate acquisitions to make. For this, we rely on various financial metrics including total shareholder return, or TSR, which is compared against internal hurdle rates for specific industries and investment types when making an acquisition.

Having selected a potential value-enhancing acquisition, we often require substantial funding sources to complete the transaction. In 2013 and 2014, we spent $34.7 million and $392.4 million, respectively, on purchases of businesses, net of cash acquired. Historically, we have relied on the combination of operating cash flows, dividends from subsidiaries and external funding to finance our acquisitions. We expect to continue relying on these sources for future acquisitions, and, in particular, expect to seek external funding sources only for large-scale acquisitions. Therefore, our ability to make acquisitions depends on factors that affect the overall performance of our subsidiaries and conditions on the lending market, including the condition of the global and Russian economies and market interest rates. See "—Market Risks—Interest Rate Risk."

Our results of operations are also dependent on properly integrating a newly acquired company into our portfolio. We seek to influence our portfolio companies primarily through board representation, with operational decisions taken by the management teams of each portfolio company. In certain circumstances, we may also assist our portfolio companies in relation to overall strategy, partnerships, risk management, corporate governance and internal controls, third party financing, management selection and identifying and implementing synergies with other portfolio companies.

Because of the number of significant transactions completed between 1 January 2013 and 31 December 2014, period-to-period comparisons of our results of operations need to be considered in light of the impact of such transactions. See "—Acquisitions, Divestitures and Key Corporate Restructurings—Acquisitions."

Factors Affecting MTS Results of Operations

In addition to general economic conditions, inflationary trends and currency fluctuations discussed above, factors significantly affecting the results of operations of MTS are set forth below.

Competition and Market Penetration

The wireless telecommunications services markets in which MTS operates are highly competitive, particularly in Russia and Ukraine, where mobile penetration exceeds 150%. MTS also face increased competition in our cable TV and fixed line business, where the market for alternative fixed line communications services in Russia is rapidly evolving and becoming increasingly competitive. Competition is generally based on price, product functionality, range of service offerings and customer service.

The primary mobile competitors in Russia include MegaFon,Vimpelcom and us,, each of which has effective national coverage in Russia. Competition today is based largely on local tariff prices and secondarily on network coverage and quality, the level of customer service provided, roaming and international tariffs and the range of services offered. In certain areas of Russia, MTS competes with T2 RTK Holding, which had more than 38 million subscribers as of December 31, 2014 according to AC&M-Consulting.

Tariff regulation

The Federal Tariff Service regulates certain tariffs in the sphere of telecommunications, including the tariffs on the local and DLD calls by subscribers of public switched telephone networks and installation and subscription fees. The Federal Service for the Oversight of Consumer Protection and Welfare is responsible for the enforcement of sanitary regulations, including some authority over the location of telecommunications equipment, and supervises the compliance of companies with the regulations relating to the protection of consumer rights. The Federal Service for State Regisrtration, Cadastre and Cartography is responsible for registering certain telecommunications infrastructure that is considered real property in accordance with Government Decree No. 68 dated February 11, 2005. The Federal Service for Financial Monitoring (Rosfinmonitoring) is a federal executive body responsible for countering money laundering and terrorism financing. Mobile operators are to comply with Federal Law No. 115-FZ dated August 7, 2001 "On combating money laundering and terrorist financing."

If MTS or any of MTS' subsidiaries were to be classified by FAS (or the AMC with respect to our operations in Ukraine) as a dominant market force or as having a dominant position in the market, FAS and the Federal Tariff Service (or the AMC, as the case may be) would have the power to impose certain restrictions on our or their businesses. In particular, the authorities may impose on us tariffs at levels that could be competitively disadvantageous and/or set interconnect rates between operators that may adversely affect our revenues. Moreover, MTS refusal to adjust it tariffs according to such government-determined rates could result in the imposition of fines. Additionally, geographic restrictions on MTS expansion could reduce MTS subscriber base and prevent it from fully implementing MTS business strategy, which may materially adversely affect MTS's business, financial position, results of operations and prospects.

Acquisitions, Divestitures and Key Corporate Restructurings

Between 1 January 2013 and 31 December 2014, we completed a number of acquisitions and divestitures, several of which have had a significant impact on our results of operations and financial position, as well as a number of corporate restructurings. Due to the number of transactions completed between 1 January 2013 and 31 December 2014, period-to-period comparisons of our results of operations need to be considered in light of the impact of such transactions.

Acquisitions

Acquisitions of businesses from third parties are accounted for using the purchase method. Upon acquisition, the assets and liabilities of an acquired entity are measured at their fair value as at the date of acquisition.

In the years ended 31 December 2013 and 2014, we spent $34.7 million and $392.4 million, respectively, on acquisitions of controlling stakes in businesses from third parties, net of cash acquired.

In addition, in the years ended 31 December 2013 and 2014, we spent $299.2 million and $67.4 million, respectively, on acquisitions of non-controlling stakes in existing subsidiaries.

See Notes 3 and 5 of the Financial Statements for further description of these acquisitions and those which are less significant to our business.

Divestitures & Key Corporate Restructurings

DECONSOLIDATION OF BASHNEFT

In September 2014, a civil claim was filed with the Moscow Court of Arbitration by the Prosecutor General's Office of the Russian Federation seeking the transfer to the Russian Federation of all shares in Bashneft held by the Group. The civil claim asserted that the transfer of Bashneft from the property of the Russian Federation into the property of Bashkortostan in 1992-1993 had been unlawful, as no requisite consent had been obtained from the federal authorities, and therefore all subsequent transactions with Bashneft shares should be considered null and void. In November 2014, the court ruled in favour of the plaintiff and ordered the transfer of the Bashneft shares held by the Group to the Russian Federation. The transfer of the shares took place in December 2014.

The Group deconsolidated Bashneft in December 2014 and recognized a loss upon loss of control, measured as the difference between the carrying amount of noncontrolling interests in the former subsidiary (including accumulated other comprehensive income attributable to the noncontrolling interests) at the date Bashneft was deconsolidated and the carrying amount of its assets and liabilities. The Group also removed the amount previously accumulated in the translation adjustment component of equity and attributable to Bashneft and reported it as part of the loss on transfer of Bashneft shares to the Russian Federation.

The loss on deconsolidation of Bashneft recognized in the consolidated statement of operations and comprehensive income for the year ended December 31, 2014 is measured as follows:

Net assets as at deconsolidation date	$ 4,061,927
Noncontrolling interests	(1,384,789)
Accumulated currency translation adjustment	2,291,873
Loss on deconsolidation of Bashneft	4,969,011
Tax effect	-
Loss on deconsolidation of Bashneft, net of tax	$ **4,969,011**

Bashneft results were separately presented in the consolidated statements of operations and comprehensive income for the years ended December 31, 2014 and 2013 as follows:

	2014	**2013**
Revenues	$ 16,224,383	$ 17,783,111
Income from Bashneft, before income taxes	1,944,770	1,996,126
Income tax expense	(427,716)	(455,637)
Income from Bashneft, net of tax effect	1,517,054	1,540,489

Additionally, the assets and liabilities pertaining to Bashneft have been presented separately within the consolidated statement of financial position as of December 31, 2013 as follows:

Cash and cash equivalents	$	625,417
Accounts receivable		593,016
Inventories and spare parts		716,847
Other current assets		2,659,069
Intragroup balances		(1,539,621)
Current assets of Bashneft		**3,054,728**
Property, plant and equipment		8,794,360
Other non-current assets		941,695
Intragroup balances		(116,276)
Non-current assets of Bashneft		**9,619,779**
Accounts payable		(1,351,326)
Debt, current portion		(367,147)
Other current liabilities		(1,096,320)
Intragroup balances		151,361
Current liabilities of Bashneft		**(2,663,432)**
Debt, long-term portion		(2,419,639)
Other long-term liabilities		(1,344,437)
Intragroup balances		30,052
Long-term liabilities of Bashneft	$	**(3,734,024)**

The Group retains no continuing involvement with Bashneft after it has been deconsolidated, other than routine transactions in the normal course of business.

In December 2014, the Group filed a claim with the Moscow Court of Arbitration for the recovery of RUB 70.7 billion losses from Ural-Invest, a legal successor of the seller of the Bashneft shares to the Group. In February 2015, the court upheld the Group's claim. In March 2015, the Group and Ural-Invest signed a settlement agreement. In accordance with its terms, all assets owned by Ural-Invest of RUB 46.5 billion, will be transferred to the Group, which will invest RUB 4.6 billion of this amount into the projects of Ural charitable fund. In March 2015 the Moscow Court of Arbitration approved the settlement agreement between the Group and Ural-Invest. The transfer of assets did not occur as of the date of the issuance of the Financial Statements and therefore the Group did not recognize the gain in the consolidated statement of operations and comprehensive income.

Disposal of interests in subsidiaries between January 1, 2013 and December 31, 2014

Disposals in 2014

NIIDAR-Nedvizhimost – In 2014, the Group sold its 100% interest in NIIDAR-Nedvizhimost, a subsidiary of RTI which managed rental property, for a total cash consideration of $150.0 million.
As a result of this transaction, the Group recognized gain on disposal of subsidiaries of $139.1 million, included in other operating expenses in the consolidated statement of operations and comprehensive income.

Disposals in 2013

SG-trans – During 2013, the Group completed a reorganisation of its transportation assets. As a result of the reorganization, SG-trans, which was acquired in 2012 was split into two legal entities: SG-trading which comprised the non-core non-transportation assets and SG-trans which retained all the core transport assets. In April 2013 the Group sold a 70% stake in SG-trans to Financial Alliance, an affiliate of the Group, for cash consideration of RUB 12 billion ($380.2 million at the disposal date), thereby reducing its direct ownership in SG-trans from 100% to 30%.

Upon disposal, the Group deconsolidated SG-trans and accounted for its remaining interest using the equity method. As a result of the transaction, the Group recognized a gain of $4.0 million in the consolidated statement of operations and comprehensive income.

In July 2013, the Group further sold additional 15% of SG-trans to Unirail, a shareholder of Financial Alliance, for a cash consideration of RUB 2.5 billion ($76.4 million) with no gain or loss recognized as a result of this transaction.

RussNeft – In July 2013, the Group sold its 49% stake in RussNeft, the Group's affiliate, for cash consideration of $1,200 million. Prior to the disposal, the Group has been accounting for this investment using the equity method. As of the disposal date, the carrying value of the Group's investment in RussNeft was nil. Accordingly, the Group recognized a $1,200 million gain on this disposal being the difference between the consideration received and the carrying value of investment disposed.

Capital transactions in the year ended December 31, 2014

MTS Bank – In December 2014, the Group participated in additional share issue of MTS Bank for $309.0 million. The transaction resulted in no change in noncontrolling interests and additional paid-in capital.

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

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

NVision – In January 2014, the Group acquired an additional 38.75% stake in NVision from minority shareholders for $82.5 million, $37.5 million of which was paid in cash and $45.0 million in the Company's treasury shares. Upon completion of this transaction, the Group's ownership in NVision was 88.75%. The transaction was accounted for directly in equity and resulted in an increase of noncontrolling interests by $42.0 million and a decrease of additional paid-in capital by $121.8 million. In December 2014, the Group acquired the remaining 11.25% stake in NVision for approximately $10.0 million. The transaction was accounted for directly in equity and resulted in a decrease of noncontrolling interests by $13.8 million and a decrease of additional paid-in capital by $24.0 million.

Capital transactions in the year ended December 31, 2014

Business-Nedvizhimost – In December 2013, MTS sold a 51% stake in Business-Nedvizhimost to the Company for RUB 3.2 billion ($98.5 million as of the transaction date). This transfer of ownership interest within the Group resulted in an increase of noncontrolling interests and a decrease of additional paid-in capital by $42.7 million.

RTI – In December 2013, RTI issued 4,687,500,000 common shares with par value of 1 Russan ruble which were acquired by existing shareholders, the Company and the Bank of Moscow, for cash consideration of RUB 6.0 billion ($183.9 million as of the purchase date) in proportion to their existing ownership interests. The Bank of Moscow received a put option to sell its 703,125,000 shares acquired upon their issuance to the Group at a price of $27.5 million plus 8.25% p.a. not earlier than December 26, 2016 and not later than December 26, 2018. As a result of this put option, the Group classified the underlying noncontrolling interests as redeemable.

Targin – In September 2013, the Company acquired a 100% stake in Bashneft Services Assets, (renamed to Targin in July 2014) from Bashneft for RUB 4.1 billion ($126.8 million as at transaction date). This transfer of ownership interest within the Group resulted in a decrease of noncontrolling interests and an increase of additional paid-in capital by $24.4 million.

MTS – In September-December 2013, the Group acquired 0.6% of MTS ordinary shares on the open market for $120.0 million. The transaction was accounted for directly in equity and resulted in a decrease of noncontrolling interests by $23.0 million and a decrease of additional paid-in capital by $97.0 million.

Detsky mir – In September 2013, Detsky mir purchased 25%+1 of its own shares from Sberbank for cash consideration of $140.0 million. The transaction was accounted for directly in equity and resulted in a decrease of noncontrolling interests by $5.4 million and a decrease of additional paid-in capital by $134.6

million. The Group took a long-term loan from Sberbank to fund the purchase. Simultaneously the Group has pledged these shares to Sberbank as security against the loan.

SITRONICS-N – In September 2013, the Group undertook restructuring of certain RTI assets. Upon completion of a series of transactions, SITRONICS, a subsidiary of RTI, spun off two companies, SITRONICS-N and RTI Microelectronics, with allocation of all its major assets and liabilities to these companies. To complete the restructuring process a 100% stake in SITRONICS was sold to SITRONICS-N for 1 RUB. In October 2013, the Company acquired a 100% stake in SITRONICS-N from RTI for RUB 1.0 billion ($31.0 million as at transaction date). This transaction resulted in an increase of noncontrolling interests and a decrease of additional paid-in capital by $11.0 million.

Mikron – In August 2013, Mikron issued 691,962 ordinary shares which were purchased by the RF for cash consideration of RUB 465 million ($14.1 million). This transaction was accounted for directly in equity and resulted in an increase of noncontrolling interests by $5.2 million and an increase of additional paid-in capital by $8.9 million.

MTS Bank – In April 2013, MTS acquired a 25.0945% stake in MTS Bank through the purchase of its additional share issuance for RUB 5 billion ($123 million). Upon completion of the transaction, the Group's effective ownership in MTS Bank decreased from 99% to 87%. This transfer of ownership interest within the Group resulted in an increase of noncontrolling interests and a decrease of additional paid-in capital by $105 million.

Consolidated Financial Results Overview

The following table sets forth a summary of our financial results for the years ended 31 December 2013 and 2014. This financial information should be read in conjunction with our Financial Statements.

	Years ended December 31,			
	2013	**% of revenues**	**2014**	**% of revenues**
	(Amounts in thousands of USD, except percentages)			
Sales	17,623,153	95.3%	15,886,775	95.8%
Revenue from banking activities	878,832	4.7%	698,182	4.2%
TOTAL REVENUES	18,501,985	100.0%	16,584,957	100.0%
Cost of sales, exclusive of depreciation and amortization shown separately below	(7,907,148)	(42.7)%	(7,460,524)	(45.0)%
Cost related to banking activities, exclusive of depreciation and amortization shown separately below	(523,960)	(2.8)%	(760,084)	(4.6)%
Selling, general and administrative expenses	(3,896,207)	(21.1)%	(3,431,075)	(20.7)%
Depreciation and amortization	(2,633,548)	(14.2)%	(2,292,118)	(13.8)%
Taxes other than income tax	(239,814)	(1.3)%	(193,122)	(1.2)%
Equity in results of affiliates	29,866	0.2%	73,124	0.4%
Impairment of goodwill	(258,048)	(1.4)%	-	-
Impairment of other assets	(804,545)	(4.3)%	(864,629)	(5.2)%
Gain on disposal of investment in RussNeft	1,200,000	6.5%	-	-
Gain from reentry into Uzbekistan	-	-	181,305	1.1%
Gain on Bitel case resolution	371,100	2.0%	-	-
Other operating expenses	(273,109)	(1.5)%	(99,385)	(0.6)%

OPERATING INCOME	3,566,572	19.3%	1,738,449	10.5%
Interest income	182,447	1.0%	212,774	1.3%
Interest expense	(960,136)	(5.2)%	(811,346)	(4.9)%
Change in fair value of derivative instruments	30,199	0.2%	-	-
Foreign currency transaction loss	(298,264)	(1.6)%	(548,596)	(3.3)%
Income before income tax	2,520,818	13.6%	591,281	3.6%
Income tax expense	(842,107)	(4.6)%	(453,417)	(2.7)%
Net income excluding Bashneft	1,678,711	9.1%	137,864	0.8%
Income of Bashneft operations, net of tax effect of $427,716 and $455,637	1,540,489	8.3%	1,517,054	9.1%
Loss on deconsolidation of Bashneft, net of tax effect of nil	-	-	(4,969,011)	(30.0)%
NET (LOSS) / INCOME	3,219,200	17.4%	(3,314,093)	(20.0%)
Noncontrolling interests	(961,672)	(5.2)%	(773,539)	(4.7)%
NET (LOSS) / INCOME ATTRIBUTABLE TO SISTEMA JSFC	2,257,528	12.2%	(4,087,632)	(24.6%)
OIBDA (1)	6,200,120	33.5%	4,030,567	24.3%

(1) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and services debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended	
	2013	**2014**
	($ in thousands)	
Operating income	3,566,572	1,738,449
Depreciation and amortization	2,633,548	2,292,118
OIBDA	6,200,120	4,030,567

In our comparison of period-to-period results of operations, to analyse changes, developments and trends in revenues by reference to individual segment revenues, we present our revenues on an aggregated basis, which are revenues after elimination of intra-segment (between entities in the same segment) transactions, but before intersegment (between entities in different segments) eliminations. Amounts attributable to individual companies, where appropriate, are shown prior to both intra-segment and inter-segment eliminations.

The following tables set forth a summary of revenues and operating income by reportable segment for the years ended 31 December 2013 and 2014.

Revenues by segment:

	Year ended 31 December			
	2013	**% of total revenues**	**2014**	**% of total revenues**
	($ in thousands, except percentages)			
MTS	12,510,761	67.6%	10,865,647	65.5%
RTI	2,195,509	11.9%	1,845,107	11.1%
MTS Bank	903,133	4.9%	715,445	4.3%
SSTL	209,432	1.1%	220,717	1.3%
Corporate	82,979	0.4%	75,358	0.5%
Other	3,211,176	17.4%	3,287,920	19.8%
Aggregated revenue	19,112,990	103.3%	17,010,194	102.6%
Intersegment eliminations	(611,005)	(3.3%)	(425,237)	(2.6%)
Total	**18,501,985**	**100.0%**	**16,584,957**	**100.0%**

Operating income/(loss) by segments:

	Year ended 31 December			
	2013	**% of total operating income**	**2014**	**% of total operating income**
	($ in thousands, except percentages)			
MTS	3,662,740	102.7%	2,765,484	159.1%
RTI	(776,878)	(21.8%)	172,070	9.9%
MTS Bank	18,954	0.5%	(396,963)	(22.8%)
SSTL	(210,185)	(5.9%)	(431,828)	(24.8%)
Corporate	834,945	23.4%	(546,842)	(31.5%)
Other	84,721	2.4%	286,744	16.5%
Aggregated operating income	3,614,297	101.3%	1,848,665	106.3%
Intersegment eliminations	(47,725)	(1.3%)	(110,216)	(6.3%)
Total	**3,566,572**	**100.0%**	**1,738,449**	**100.0%**

Explanation of Key Items in Statements of Operations

Sales

Our sales are derived mainly from the revenues generated by MTS and RTI. In 2013 and 2014, before intersegment eliminations, revenues of MTS accounted for 67.6% and 65.5%, and RTI 11.9% and 11.1%, respectively, of our consolidated sales. See "—Critical accounting policies," for a discussion of our revenue recognition policies.

Revenues from banking activities

Revenues from banking activities consist of revenues of MTS Bank.

Cost of sales, exclusive of depreciation and amortization

Our cost of sales is primarily incurred at MTS and RTI. In 2013 and 2014, cost of sales at MTS and RTI accounted for 75.2% and 70.2%, respectively, of our cost of sales, exclusive of depreciation and amortization.

Cost of sales at MTS and RTI are those costs that are incurred directly in the sale and production of MTS' and RTI's principal products and services. For MTS, they mainly consist of cost of services, such as interconnect and line rental charges and roaming expenses, and the cost of handsets and accessories. For RTI, they mainly consist of the cost of subcontract works, goods, raw materials, equipment and certain other operating expenses.

Cost of sales also includes a share of rental expenses under operating leases. See Note 30 of the Financial Statements.

Selling, general and administrative expenses

Selling, general and administrative expenses are primarily incurred at MTS, RTI and Corporate. In 2013 and 2014, selling, general and administrative expenses at MTS accounted for 57.6% and 57.1%, respectively, of our overall selling, general and administrative expenses. RTI accounted for 9.6% and 9.7% of our overall selling, general and administrative expenses in 2013 and 2014, respectively. Selling, general and administrative expenses at Corporate level accounted for 9.0% and 8,8% of the Group's selling, general and administrative expenses in 2013 and 2014, respectively.

Our selling, general and administrative expenses consist of marketing, advertising costs, employee salaries and bonuses, social contributions payable to state funds and sundry office expenses.

Selling, general and administrative expenses also include a share of rental expenses under operating leases. See Note 30 of the Financial Statements.

Depreciation and amortization

Most of our depreciation and amortization expenses are incurred at MTS. In 2013 and 2014, depreciation and amortization at MTS accounted for 85.2% and 84.4%, respectively, of our overall depreciation and amortization expenses.

Depreciation and amortization expenses primarily consist of expenses related to the depreciation of property, plant and equipment and the amortization of intangible assets.

Operating income

Operating income is revenues less operating costs, plus equity in the results of affiliates, , gain on disposal of Russneft, gain from reentry in Uzbekistan and gain on Bitel case resolution.

Interest expense

Interest expenses consist primarily of interest expense on loans and borrowings net of amounts capitalized.

Foreign currency transaction gains/losses

Management has determined that the functional currency of most of our subsidiaries are the currencies of the countries of their domicile.

Foreign currency transaction gains/losses result from a change in exchange rates between the functional currency and the currency in which foreign currency transactions are denominated.

Income tax expense

Income tax expense comprises current and deferred income tax. During the periods under discussion, the corporate income tax rate in the Russian Federation was 20% and the income tax rate on dividends paid within Russia was 9% or 0% subject to meeting certain conditions. Our foreign subsidiaries pay income tax in their respective jurisdictions. The income tax rate in Ukraine was 18% during the reporting period.

Deferred income tax reflects the tax effect of all significant differences between the tax bases of assets and liabilities and their amounts reported in the Financial Statements. Deferred tax assets and liabilities are measured using the enacted tax rates applicable in the periods when the differences are expected to affect taxable income. See A1 of our Financial Statements for a summary of our income tax policies.

Year Ended 31 December 2014 Compared to the Year Ended 31 December 2013

Total revenues

Our sales in USD decreased by $1,917.0 million, or 10.4%, from $18,502.0 million in the year ended 31 December 2013 to $16,585.0 million in the year ended 31 December 2014 mainly due to the rouble depreciation against US dollar which resulted in a raise of the average annual exchange rate by 20.8% for the reporting year.

Our consolidated revenues in rouble terms increased by 7.2% year-on-year in 2014 despite the challenging economic environment, and reflect a strong contribution from all our companies, particularly from MTS, Detsky mir, as well as Targin (Sistema acquired control from Bashneft in the third quarter of 2013) and the pulp and paper business (acquired in the third quarter of 2014). Ten of our 13 major assets demonstrated revenue growth in 2014 in rouble terms.

As of the fourth quarter of 2014, we began consolidating LesInvest into our financial results. In the fourth quarter of 2014, LesInvest already contributed $151.2 million to our consolidated revenue. The consolidation of Targin contributed approximately $612.9 million to our revenue growth for the full year of 2014.

MTS is our largest revenue contributor. In the years ended 31 December 2013 and 2014, MTS share of our consolidated revenues was 67.6% and 65.5%, respectively. MTS revenue in rouble terms increased by 3.1% year-on-year in 2014 as a result of the continued development of its data services and subscriber base growth. The total subscriber base increased by 4.1% to 104.1 million customers as of December 31, 2014. See "—Segment Financial Results Overview—" below, for further discussion of MTS results of operations.

Revenues from banking activities

Revenues from banking activities in USD decreased by $187.7 million, or 20.8%, from $903.1 million in the year ended 31 December 2013 to $715.4 million in the year ended 31 December 2014. This was largely due to lower revenues reported in the fourth quarter on the back of unfavorable market conditions. Revenues from banking activities accounted for 4.9% of total revenues in 2013 and 4.3% of total revenues in 2014. See "Segment Financial Results Overview – MTS Bank," below, for further discussion of results of operations at MTS Bank.

Cost of sales, exclusive of depreciation and amortization

Cost of sales, exclusive of depreciation and amortization, decreased by $446.6 million, or 5.6%, from $7,907.1 million in the year ended 31 December 2013 to $7,460.5 million in the year ended 31 December 2014. The decrease in the cost of sales followed the decrease in revenues due to rouble depreciation."

Cost related to banking activities, exclusive of depreciation and amortization

Cost related to banking activities, exclusive of depreciation and amortization, increased by $236.1 million, or 45.1%, from $524.0 million in the year ended 31 December 2013 to $760.1 million in the year ended 31 December 2014 mainly as a result of accrued provisions needed for the loan portfolio to individuals.

Selling, general and administrative expenses

Selling, general and administrative expenses decreased by $465.1 million, or 11.9%, from $3,896.2 million in the year ended 31 December 2013 to $3,431.1 million in the year ended 31 December 2014 but grew in rouble terms by 6.2% year-on-year, which is lower than the rate of inflation.

Depreciationand amortization

Depreciation,and amortization decreased by $341.4 million, or 13.0%, from $2,633.5 million in the year ended 31 December 2013 to $2,292.1 million in the year ended 31 December 2014 mainly as a result of rouble depreciation and increased by 3.5% as a result of a growth in depreciable assets base as well as acquisitions made in the second half of 2014.

Impairment of other assets

Impairment of other assets increased by $60.1 million, or 7.5%, from $804.5 million in the year ended 31 December 2013 to $864.6 million in the year ended 31 December 2014. In the year ended 31 December 2014, we recorded an impairment loss of $864.6 million mainly in connection with an impairment of long-lived assets in SSTL as well as impairment of available-for-sale securities and provision for cash and deposits in Delta bank in Ukraine. See also Note 15 of the Financial Statements.

Equity in results of affiliates

In the year ended 31 December 2014, we recorded a gain of $73.1 million in our equity in the results of affiliates. MTS-Belarus was the main contributor to the total equity income in results of affiliates.

Gain on disposal of investment in RussNeft

In the year ended 31 December 2013, we sold our 49% stake in RussNeft for cash consideration of $1,200 million. Prior to the disposal, the Group has been accounting for this investment using the equity method. As of the disposal date, the carrying value of the Group's investment in RussNeft was nil. Accordingly, the Group recognized a $1,200 million gain on this disposal being the difference between the consideration received and the carrying value of investment disposed.

Gain on Bitel case resolution

In the year ended 31 December 2013, we recorded a gain of $371.1 million upon settlement all disputes that have arisen from MTS' investments in Bitel in 2005.

Gain from reentry into Uzbekistan

In the year ended 31 December 2014, we recorded a gain of $181.3 million upon receiving the 50.01% ownership interest in Universal Mobile Systems LLC ("UMS"), which was attributable to financial incentive to encourage the Group reentry into the Republic of Uzbekistan.

Operating income

For the reasons set forth above, our operating income decreased by $1,828.1 million, or 51.3%, from $3,566.6 million in the year ended 31 December 2013 to $1,738.4 million in the year ended 31 December 2014.

Our consolidated operating income margin equaled 19.3% for the year ended 31 December 2013 and 10.5% for the year ended 31 December 2014. In both years, MTS was the main contributor to our operating income.

Interest income

Interest income increased by $30.3 million, or 16.6%, from $182.4 million in the year ended 31 December 2013 to $212.8 million in the year ended 31 December 2014 mainly due to the increase of interest rates in the end of 2014.

Change in fair value of derivative instruments

In the years ended 31 December 2013, we recorded a gain of $30.2 million reflecting a decrease in the fair value of RUSNANO's put option to sell its shares in the SITRONICS-Nano to Sistema. See «Divestitures & Key Corporate Restructurings», above for a detailed explanation.

Interest expense

Interest expense decreased by $148.8 million, or 15.5%, from $960.1 million in the year ended 31 December 2013 to $811.3 million in the year ended 31 December 2014. This decrease in interest expense related to the loans denominated in roubles and was mainly due to the rouble depreciation against US dollar.

Foreign currency transaction gains/losses

In the year ended 31 December 2014, we recorded a foreign currency transaction loss of $548.6 million, which was mainly due to the depreciation of the rouble against the U.S. dollar in 2014. The loss is mostly attributable to indebtedness denominated in foreign currencies.

See "Key Factors Affecting Our Results of Operations - General Factors – Russian and CIS Macroeconomic Conditions and Trends."

Income before income tax excluding Bashneft

For the reasons set forth above, income before income tax excluding Bashneft decreased by $1,929.5 million, or 76.5%, from $2,520.8 million in the year ended 31 December 2013 to $591.3 million in the year ended 31 December 2014.

Income tax expense

Income tax expense decreased by $388.7 million, or 46.2%, from $842.1 million in the year ended 31 December 2013 to $453.4 million in the year ended 31 December 2014, following a decrease in operating income.

The following table sets forth our income tax expense for the years ended 31 December 2013 and 2014:

	For the year ended 31 December			
	2013	**% of total income tax expense**	**2014**	**% of total income tax expense**
	($ in thousands, except percentages)			
Current provision	619,643	73.6%	417,079	92.0%
Deferred income tax expense /(benefit)	222,464	26.4%	36,338	8.0%
Total income tax expense	842,107	100.0%	453,417	100.0%

Our effective tax rate was 33.4% in 2013 and 76.7% in 2014. See also Note 21 of the Financial Statements for a detailed explanation differences between nominal and actual rates.

Net income excluding Bashneft

For the reasons set forth above, our net income excluding Bashneft decreased by $1,540.8 million, or 91.8%, from $1,678.7 million in the year ended 31 December 2013 to $137.9 million in the year ended 31 December 2014.

Income of Bashneft operations

In the years ended 31 December 2013 and 2014, we recorded a gain of $1,540.5 and 1,517.1 million, respectively which reflected net income of Bashneft for the periods presented.

Loss on deconsolidation of Bashneft

In the year ended 31 December 2014, we recorded a loss of $4,969.0 million in connection with the deconsolidation of Bashneft. See Note 2 of the Financial Statements.

Net income

For the reasons set forth above, net income decreased by $6,533.3 million, from income of $3,219.2 million in the year ended 31 December 2013 to loss $3,314.1 million in the year ended 31 December 2014.

Non-controlling interest and net income attributable to JSFC Sistema

Non-controlling interests equaled $961.7 million in the year ended 31 December 2013 and $773.5 million in the year ended 31 December 2014. The decrease of income attributable to non-controlling shareholders of our subsidiaries was driven by subsidiaries' operating results.

For the reasons set forth above, net income attributable to JSFC Sistema decreased by $6,345.2 million from net income of $2,257.5 million in the year ended 31 December 2013 to net loss of $4,087.6 million in the year ended 31 December 2014.

Segment Financial Results Overview

The following analysis concentrates on our four reportable operating segments – MTS, RTI, MTS Bank, Corporate and SSTL – and other operating segments which comprise BPGC, Targin, Lesinvest, Detsky Mir, Intourist, Sistema Mass Media, , Medsi, Binnopharm, Sitronics-N, Leader-Invest and SG-trans. Segment results are presented after elimination of intra-segment transactions, but prior to elimination of transactions between segments.

MTS

MTS is a leading telecommunications provider in Russia and the CIS, providing a wide range of mobile and fixed line voice and data telecommunications services, including transmission, broadband, pay-TV and various value added services, as well as selling equipment and accessories.

Capital expenditures at MTS totaled $2,561.3 million and $2,315.0 million, respectively, in 2013 and 2014 and were spent on network development in Russia and other countries where MTS operates.

For the years ended 31 December 2013 and 2014, MTS revenues accounted for 67.6% and 65.5%, respectively, of Sistema's consolidated revenues.

Certain Operating Data

Below we provide certain operating data useful for evaluating MTS business and results. The data focuses primarily on MTS mobile operations, particularly in Russia and Ukraine, which comprise the most significant share of MTS revenue in the periods presented, and is among the information routinely reviewed by MTS management as part of their evaluation of MTS performance.

Mobile Subscriber Data

The following table shows MTS' mobile subscribers by country as of the dates indicated:

	At December 31,	
	2013	**2014**
	(in millions)	
Subscribers[(1)]		
Russia	69.4	74.3
Ukraine[(2)]	21.5	20.2
Turkmenistan	1.7	1.7
Armenia	2.0	2.1
Uzbekistan[(3)]	n/a	0.2
Total consolidated	94.7	98.5
MTS Belarus (unconsolidated)	5.2	5.3

(1) We define a subscriber as an individual or organization whose account shows chargeable activity within 61 days (or 183 days in the case of MTS Prepaid tariffs) or whose account does not have a negative balance for more than this period.
(2) Including CDMA subscribers starting 2011.
(3) We resumed operations in Uzbekistan since December 1, 2014. We expect our subscriber base and revenues to increase and MTS market to enhance in 2015.

Mobile churn rate

We define mobile churn as the total number of subscribers who cease to be a subscriber during the period (whether involuntarily due to non-payment or voluntarily, at such subscriber's request), expressed as a percentage of the average number of MTS subscribers during that period. We view the subscriber churn as a measure of market competition and customer dynamics. The following table shows MTS Russian and Ukrainian subscriber churn for the periods indicated.

	Year Ended December 31,	
	2013	2014
Subscriber Churn		
Russia	38,1%	41,0%
Ukraine	27.2%	34.2%

The churn rate is highly dependent on competition in MTS license areas and those subscribers who migrate as a result of such competition.

A vast majority of MTS subscribers are prepaid subscribers with no contractual commitment to us. As a result, these subscribers have unfettered freedom to migrate between operators at their convenience. This freedom, combined with the relative ease with which subscribers can obtain SIM cards, contributes to churn and increasing penetration levels in the markets where we operate.

The churn rate is highly dependent on competition in MTS license areas and those subscribers who migrate as a result of such competition. MTS churn rate in Russia slightly increased to 41.0% during the year ended December 31, 2014, as compared to 38.1% for the year ended December 31, 2013, due to growth in the number of new connections. We continued to offer MTS popular tariff plan “Super MTS” (free calls to all subscribers of MTS Russia), updated options for unlimited mobile Internet, further improved network quality and enhanced data rate by expanding MTS 3G and LTE capabilities. We expect that the extension of the MTS-Bonus loyalty program and further development of MTS mono-brand retail network will allow us to keep churn rate under control in 2015, stimulate value-added services usage and promote subscriber loyalty through superior customer service.

The churn rate in Ukraine increased to 34.2% for the year ended December 31, 2014, from 27.2% for the year ended December 31, 2013 due to the fact that MTS Ukraine terminated operations in Crimea in October 2014.

Mobile ARPU

We calculate mobile average monthly service revenue per subscriber by dividing MTS service revenues for a given period, including interconnect, guest roaming fees and connection fees, by the average number of MTS subscribers during that period and dividing by the number of months in that period. The following table shows MTS average monthly service revenue per Russian and Ukrainian subscriber based on MTS current calculation methodology and average monthly minutes of use per Russian and Ukrainian subscriber for the periods indicated.

	Year Ended December 31,		
	2012	2013	2014
Average monthly service revenue per subscriber, RUB			
Russia	297.1	338.6	339.1
Ukraine	152.7	157.5	129.1
Average monthly minutes of use per subscriber			
Russia	304	359	372
Ukraine	597	608	554

Average monthly service revenue per subscriber in Russia slightly increased to RUB 339.1 for the year ended December 31, 2014, from RUB 338.6 for the year ended December 31, 2013. This increase was coupled with an increase in subscriber base in 2014 to 74.3 million from 69.4 million, and was caused by inflation and an increase in the disposable income of the general population. Average monthly minutes of use per subscriber in Russia increased to 372 minutes in 2014 from 359 minutes in 2013 mainly due to decrease in tariffs for on- net traffic and various roaming-related offers.

In Ukraine, average monthly service revenue per subscriber decreased to RUB 129.1 for the year ended December 31, 2014, from RUB 157.5 for the year ended December 31, 2013. The average monthly minutes of use per subscriber decreased to 554 minutes in 2014 from 608 minutes in 2013 due to the negative impact of macroeconomic factors on overall voice traffic and difficulty in provision of services in eastern Ukraine.

Results of Operations

The following table presents the results of operations for MTS for the periods under discussion:

	Year ended 31 December			
	2013	% of revenues	2014	% of revenues
	($ in thousands, except percentages)			
Revenues[(1)]	12,510,761	100.0%	10,865,647	100.0%
Cost of sales, exclusive of depreciation and amortization shown separately below	(4,278,360)	(34.2%)	(3,867,666)	(35.6%)
Selling, general and administrative expenses	(2,243,182)	(17.9%)	(1,960,441)	(18.0%)
Equity in results of affiliates	77,615	0.6%	(37,940)	(0.3)%
Interest income	87,704	0.7%	120,926	1.1%
Interest expense	(486,636)	(3.9%)	(435,117)	(4.0%)
Depreciation and amortization	(2,244,014)	(17.9%)	(1,934,339)	(17.8%)
Operating income	3,662,740	29.3%	2,765,484	26.0%
OIBDA[(2)]	5,906,756	47.2%	4,699,823	43.8%

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(1) Includes net sales to external customers and intersegment sales. Intersegment sales accounted for $21,884 thousand and $28,521 thousand in the years ended 31 December 2013 and 2014, respectively.

(2) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and services debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended	
	2013	2014
	($ in thousands)	
Operating income	3,662,740	2,765,484
Depreciation and amortization	2,244,014	1,934,339
OIBDA	5,906,756	4,699,823

Revenues

Revenues decreased by $1,645.1 million, or 13.1%, from $12,510.8.1 million in the year ended 31 December 2013 to $10,865.6 million in the year ended 31 December 2014 due to the rouble depreciation but increased by 3.1% year-on-year in 2014 from RUB 398,443 million in 2013 to 410,758 million in 2014 as a result of the continued development of its data services and subscriber base growth. The total subscriber base increased by 4.1% to 104.1 million customers as of December 31, 2014. MTS is outperforming the market in terms of revenue growth from mobile data services with a 37% market share[1] at the end of 2014. The principal reason for the growth of MTS consolidated revenues for the year ended December 31, 2014, was the large increase in the usage of value-added services by MTS subscribers (by RUB 14,432 million), which was mainly attributable to the increase of data traffic driven by MTS active promotion of value-added services, an increase in mobile Internet penetration, an increase in usage of smartphones by MTS subscribers and active 3G and LTE network expansion and the consequent improvement of the quality and uptake of value-added services. The increase of MTS consolidated revenues for the year ended December 31, 2014 was also supported by the growth of interconnect revenues by RUB 5,619 million and increase in revenues from sales of handsets and accessories by RUB

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[1] MTS data

2,443 million. The growth of MTS interconnect revenues was due to increases in the volume of traffic from MTS competitors and the appreciation of U.S. dollar and EUR against Russian rouble by approximately 21% based on average exchange rates for the year ended December 31, 2014 and 2013 which affected MTS interconnect revenue in rouble terms. The increase in sales of handsets and accessories by RUB 2,443 million was stimulated by the continued expansion of MTS retail operations. In the year ended December 31, 2014, we experienced a decline in MTS revenues from voice services by RUB 7,260 million due to continued refocusing of MTS strategy to promote data services. The decrease in subscription fees by RUB 3,316 million in the year ended December 31, 2014 as compared to the year ended December 31, 2013 is attributable to the reallocation of MTS subscriber base to more affordable contract tariff plans. MTS consolidated mobile subscriber base increased and amounted to 98.5 million as of December 31, 2014 as compared to 94.7 million as of December 31, 2013. The increase in the mobile churn rate in Russia to 41.0% from 38.1% in 2013 had an immaterial impact on MTS consolidated revenues.

In Russia MTS revenues increased by 5.6% in rouble terms to RUB 374,895 million for the year ended December 31, 2014 from RUB 354,894 million for the year ended December 31, 2013 mainly as a result of the growth of revenues from value-added services by RUB 17,103 million. In the year ended December 31, 2014, we experienced a decline in Russia convergent revenues from voice services due to continued refocusing of MTS strategy to promote data services. The decrease in subscription fees in the year ended December 31, 2014 as compared to the year ended December 31, 2013 is attributable to the reallocation of MTS subscriber base to more affordable contract tariff plans.

Ukraine revenues decreased by 31.6% to $853.3 million in the year ended December 31, 2014, from $1,247.6 million in the year ended December 31, 2013, primarily due to the depreciation of Ukrainian hryvnia against US dollar. The decline was partly offset by the growth in interconnect revenues for the year ended December 31, 2014 due to the increase in the volume of traffic from MTS competitors.

Other countries and business activities revenues for the year ended December 31, 2014, slightly decreased by 1.7% to $291.4 million from $286.6 million for the year ended December 31, 2013. The effect of MTS reentry into Uzbekistan was not significant.

Cost of sales, exclusive of depreciation and amortization

Overall cost of sales, which includes cost of services and cost of handsets and accessories, exclusive of depreciation and amortization, decreased by $410.7 million, or 9.6%, from $4,278.4 million in the year ended 31 December 2013 to $3,867.7 million in the year ended 31 December 2014.

The cost of services and cost of handsets and accessories in Russia decreased by $267.0 million, or 8.6%, from $3,088.4 million in the year ended 31 December 2013 to $2,821.5 million in the year ended 31 December 2014 and increased in rouble terms by 10.2% or RUB 10,047 million. The increase was mainly attributable to the growth of interconnect expenses by RUB 6,442 million, roaming expenses by RUB 3,978 million and cost of handsets and accessories by RUB 2,715 million.

The cost of services and cost of handsets and accessories in the Ukraine segment of MTS decreased in the year ended 31 December 2014 and amounted to $241.4 million compared to $316.1 in the year ended 31 December 2013. Ukraine cost of services and cost of handsets and accessories as a percentage of Ukraine revenues for the year ended December 31, 2014 increased and amounted to 28.3% as compared to 25.3% for the year ended December 31, 2013. The decrease was primarily attributable to the depreciation of Ukrainian hryvnia against US dollar which resulted in decline of Ukraine cost of services and cost of handsets and accessories in dollar terms. The decrease was partly offset by the growth in interconnect expenses due to the increase in outgoing traffic volumes. The increase in other direct cost is attributable to the growth of fees for radio frequencies.

Selling, general and administrative expenses

Selling, general and administrative expenses at MTS decreased by $282.7 million, or 12.6%, from $2,243.2 million in the year ended 31 December 2013 to $1,960.4 million in the year ended 31 December 2013. This decrease was mainly attributable to the depreciation of rouble.

Depreciation and amortization

Depreciation and amortization of property, network equipment, numbering capacity, licence costs and other intangible assets decreased by $309.7 million, or 13.8%, from $2,244.0 million in the year ended 31 December 2013 to $1,934.3 million in the year ended 31 December 2014 mainly due to rouble depreciation.

Segment operating income

We recognized a gain of $371.1 million with respect to the resolution of Bitel case in the consolidated statement of operations and comprehensive income for the year ended December 31, 2013 - See Note 30 to our consolidated financial statements for a detailed discussion.

In the year ended 31 December 2014, we recorded a gain of $181.3 million upon receiving the 50.01% ownership interest in Universal Mobile Systems LLC ("UMS"),which was attributable to financial incentive to encourage the Group reentry into the Republic of Uzbekistan.

For the reasons stated above, operating income at MTS decreased by $832.9 million, or 22.7%, from $3,662.7 million in the year ended 31 December 2013 to $2,829.8 million in the year ended 31 December 2014.

Foreign currency transaction gains/losses

Foreign currency translation losses increased by $311.2 million, or 181.0%, from $171.9 million in the year ended 31 December 2013 to $483.1 million in the year ended 31 December 2014. The increase was mainly due to a significant depreciation of the rouble in the year ended 31 December 2014.

RTI

RTI is a leading Russian technology holding company in the fields of defence, microelectronics and high-tech R&D. Its principal assets include a 97% stake in RTI Systems Concern, a large military-industrial holding and 50% + 0.5 share in NVision Group, which was acquired in 2012.

RTI comprises four principal business units (BU): Defense Solutions, Complex SecuritySystems, Information and Communication Systems and Microelectronic Solutions. For the years ended 31 December 2013 and 2014, RTI's sales accounted for 11.1% and 11.9%, respectively, of consolidated revenues. Capital expenditures at RTI totaled $95.0 million and $105.1 million, respectively, in 2013 and 2014.

The following table presents the results of operations for RTI for the periods under discussion:

	Year ended 31 December			
	2013	**% of revenues**	**2014**	**% of revenues**
	($ in thousands, except percentages)			
Revenues[(1)]	2,195,510	100.0	1,845,107	100.0
Cost of sales, exclusive of depreciation and amortization shown separately below	(1,667,977)	(76.0)	(1,368,880)	(74.2)
Selling, general and administrative expenses	(373,539)	(17.0)	(332,433)	(18.0)
Equity in net income of investees	(1,696)	(0.1)	-	-
Impairment of goodwill	(258,048)	(11.8)	-	-
Impairment of other assets	(545,176)	(24.8)	-	-
Interest income	45,045	2.1	42,160	2.3
Interest expense	(138,020)	(6.3)	(143,175)	(7.8)
Depreciation and amortization	(96,374)	(4.4)	(85,797)	(4.6)
Operating income	(776,878)	(35.4)	172,071	9.3
OIBDA[(2)]	(680,504)	(31.0)	257,868	14.0

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(1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to $509,963 thousand and $316,820 thousand in the years ended 31 December 2013 and 2014, respectively.

(2) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to

investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and services debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended	
	2013	2014
	($ in thousands)	
Operating income	(776,878)	172,071)
Depreciation and amortization	96,374	85,797
OIBDA	(680,504)	257,868

Revenues

Revenues at RTI decreased in the year ended 31 December 2014 by 16.0% and amounted to $1,845.1 million compared to $2,195.5 million in the year ended 31 December 2013 mainly due to rouble depreciation (RTI's rouble revenues increased by 1.4% year-on-year as a result of revenue growth at the Defence Solutions BU and the Microelectronics Solutions BU)..

Cost of sales, exclusive of depreciation and amortizationamortization

Cost of sales, exclusive of depreciation and amortization, decreased by $299.1 million, or 17.9%, from $1,668.0 million in the year ended 31 December 2013 to $1,368.9 million in the year ended 31 December 2014.

Segment operating income

RTI recorded operating income of $172.1 million in the year ended 31 December 2014 and an operating loss of $776.9 million in the year ended 31 December 2013. In 2014, the RTI sold its 100% interest in NIIDAR-Nedvizhimost, a subsidiary which managed rental property, for a total cash consideration of $150.0 million.As a result of this transaction, RTI recognized gain on disposal of subsidiaries of $139.1 million.

MTS Bank

MTS Bank provides a broad range of banking services, maintaining a diversified corporate loan portfolio and playing an active role in the Russian banking market. For the years ended 31 December 2013 and 2014, MTS Bank's revenues accounted for 4.2% and 4.9%, respectively, of our consolidated revenues

The following table presents the results of operations for MTS Bank for the periods under discussion:

	Year ended 31 December			
	2013	% of revenues	2014	% of revenues
	($ in thousands, except percentages)			
Revenues[(1)]	903,133	100.0	715,445	100.0
Cost related to banking activities	(610,201)	(67.6)	(838,448)	(117.2)
Selling, general and administrative expenses	(252,115)	(27.9)	(230,437)	(32.2)
Net interest income/(expenses)[(2)]	40,678	4.5	(377,575)	(52.8)
Depreciation and amortization	(19,152)	(2.1)	(17,735)	(2.5)
Operating income/(loss)	18,954	2.1	(396,963)	(55.5)
OIBDA[(3)]	38,106	4.2	(379,228)	(53.0)

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(1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to $24,301 thousand and $17,263 thousand in the years ended 31 December 2013 and 2014, respectively.

(2) MTS Bank derives a majority of its revenue from interest. In addition, management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing MTS Bank. Therefore, only the net amount is disclosed.

(3) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and services debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended	
	2013	**2014**
	($ in thousands)	
Operating income	18,954	(396,963)
Depreciation and amortization	19,152	17,735
OIBDA	38,106	(379,228)

Revenues

MTS Bank derives a majority of its revenue from interest income.

Revenues decreased by $187.7 million, or 20.8%, from $903.1 million (RUB 28,763 million) in the year ended 31 December 2013 to $715.4 million (RUB 26,565 million) in the year ended 31 December 2014 due mainly to lower revenues reported in 2014 on the back of unfavourable market conditions and decrease of loan portfolio.

Interest income decreased by $78.3 million, or 10.7%, from $731.8 million in the year ended 31 December 2013 to $653.4 million in the year ended 31 December 2014.

Loans to customers and banks (gross), including leases, decreased by $2,403.8 million, or 41.7%, from $5,771.3 million in the year ended 31 December 2013 to $3,367.6 million in the year ended 31 December 2014.

Non-interest income decreased by $133.4 million, or 77.9%, from $171.4 million in the year ended 31 December 2013 to $37.9 million in the year ended 31 December 2014.

Cost related to banking activities

Cost related to banking activities increased by $228.2 million, or 27.2%, from $610.3 million in the year ended 31 December 2013 to $838.4 million in the year ended 31 December 2014 as a result of accrued provisions needed for the loan portfolio to individuals.

Selling, general and administrative expenses

Selling, general and administrative expenses slightly decreased by $21.7 million, or 8.6%, from $252.1 million in the year ended 31 December 2013 to $230.4 million in the year ended 31 December 2014.

Segment operating income/(loss)

For the reasons set forth above, MTS Bank reported operating loss of $397.0 in the year ended 31 December 2014 whereas there was the operating income of $19.0 in the year ended 31 December 2013.

SSTL

For the years ended 31 December 2013 and 2014, SSTL's revenues accounted for 1.1% and 1.3%, respectively, of our consolidated revenues. Capital expenditures at SSTL totaled $45.8 million and US$43.3 million, respectively, in 2013 and 2014.

The following table presents the results of operations for SSTL for the periods under review:

	Year ended 31 December			
	2013	% of revenues	2014	% of revenues
	($ in thousands, except percentages)			
Revenues[1]	209,432	100.0%	220,717	100.0%
Cost of sales, exclusive of depreciation and amortization shown separately below	(185,211)	(88.4%)	(157,053)	(71.2%)
Selling, general and administrative expenses	(152,235)	(72.7%)	(115,846)	(52.5%)
Impairment of long-lived assets other than goodwill and provisions for other assets	-	1.9%	(293,518)	(133.0%)
Interest income	9,522	4.5%	7,477	3.4%
Interest expense	(121,513)	(58.0%)	(90,277)	(40.9%)
Depreciation and amortization	(63,666)	(30.4%)	(60,374)	(27.4%)
Operating loss	(210,185)	(100.4%)	(431,828)	(195.6%)
OIBDA (negative) [2]	(146,519)	(70.0%)	(371,454)	(168.3%)

(1) Consists of net sales to external customers. SSTL recorded no intersegment sales in the years ended 31 December 2013 and 2014.

(2) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and services debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended	
	2013	2014
	($ in thousands)	
Operating loss	(210,185)	(431,828)
Depreciation and amortization	63,666	60,374
OIBDA (negative)	(146,519)	(371,454)

Revenues

Revenues at SSTL increased by $11.3 million, or 5.4%, from $209.4 million in the year ended 31 December 2013 to $220.7 million in the year ended 31 December 2014 mainly due to increase in data transmission services.

Cost of sales, exclusive of depreciation and amortization

Cost of sales, exclusive of depreciation and amortization, decreased by $28.2 million, or 15.2%, from $185.2 million in the year ended 31 December 2013 to $157.1 million in the year ended 31 December 2014 mainly due to implemented cost-cutting program.

Selling, general and administrative expenses

Selling, general and administrative expenses decreased by $36.4 million, or 23.9%, from $152.2 million in the year ended 31 December 2013 to $115.8 million in the year ended 31 December 2014 due mainly to implemented cost-cutting program.

Interest expense

Interest expense decreased by $31.2 million, or 25.7%, from $121.5 million in the year ended 31 December 2013 to $90.3 million in the year ended 31 December 2014 due to a decrease in SSTL's average indebtedness in 2014 as compared to 2013.

Impairment of long-lived assets

In the year ended 31 December 2014 we concluded that the SSTL fixed assets with a carrying value of US$290.4 million were impaired and recognized a loss in the consolidated statement of operations.

Depreciation and amortization

Depreciation and amortization decreased by $3.3 million, or 5.2%, from $63.7 million in the year ended 31 December 2013 to $60.4 million in the year ended 31 December 2014.

Segment operating income

For the reasons set forth above, SSTL operating losses increased by $221.6 million, or 105.5%, from a loss of $210.2 million in the year ended 31 December 2013 to a loss of $431.8 million in the year ended 31 December 2014.

Corporate

Operating income in our corporate segment decreased from income of $834.9 million to a loss of $546.8 million mainly as a result of gain on disposal of investment in Russneft in the year ended December 31, 2013 in the amount of $1,200 million.

Other

Our other operating segments include the following assets: BPGC, Targin, LesInvest, Detsky Mir, Intourist, Medsi, Sistema Mass-media, Sitronics-N, Leader-Invest, Binnopharm and SG-trans.

For the years ended 31 December 2013 and 2014, revenues from other operating segments accounted for 17.4% and 19.8%, respectively, of our consolidated revenues. Capital expenditures in other operating segments totaled $197.7 million and $383.6 million in 2013 and 2014, respectively.

The following table presents the results of operations for other operating for the periods under discussion:

	Year ended 31 December			
	2013	**% of revenues**	**2014**	**% of revenues**
	($ in thousands, except percentages)			
Revenues[1]	3,211,176	100.0	3,287,920	100.0
Cost of sales, exclusive of depreciation and amortization shown separately below	(2,142,459)	(66.7)	(2,261,814)	(68.8)
Selling, general and administrative expenses	(586,741)	(18.3)	(546,984)	(16.6)
Equity in net income of investees	(40,165)	(1.3)	(24,477)	(0.7)
Interest income	45,791	1.4	50,609	1.5
Interest expense	(129,802)	(4.0)	(73,809)	(2.2)
Depreciation and amortization	(195,964)	(6.1)	(179,600)	(5.5)
Operating income	84,721	2.6	286,744	8.7
OIBDA[2]	280,685	8.7	466,344	14.2

(1) Includes net sales to external customers and intersegment sales. Intersegment sales amounted to $18,115 thousand and $37,242 thousand in the years ended 31 December 2013 and 2014, respectively.

(2) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and services debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents a reconciliation of OIBDA to operating income for the periods indicated:

	For the year ended	
	2013	**2014**
	($ in thousands)	
Operating income/(loss)	84,721	286,744
Depreciation and amortization	195,964	179,600
OIBDA	280,685	466,344

Revenues

Revenues of our other operating segments slightly increased by $76.7 million, or 2.4%, from $3,211.2 million in the year ended 31 December 2013 to $3,287.9 million in the year ended 31 December 2014 mainly due to the consolidation of Targin and Lesinvest and growth of revenues in Detsky mir by $52.4 million partly offset by a decrease in revenues in other operating segments due to the rouble depreciation against US dollar.

Bashkirian Power Grid Company (BPGC) is a large regional company providing electricity transmission services between central Russia and the Urals, and power transmission and distribution services to consumers in the Republic of Bashkortostan. BPGC's revenue decreased by 13.9% year-on-year in 2014 from $416.7 million to $358.6 million mainly due to rouble depreciation (BPGC's rouble revenue grew by 3.8% year-on-year in 2014 reflecting organic growth in electricity consumption and an increase in technological connections to the power grids).

Detsky Mir is a leading Russian operator in children's goods retail, maintaining a chain of over 150 stores. Sales at Detsky Mir increased by $52.4 million, or 4.6%, from $1,130.4 million in the year ended 31 December 2013 to $1,182.8 million in the year ended 31 December 2014 as a result of double-digit growth in like-for-like sales and high revenue growth dynamics in stores opened in 2012 and 2013.

Medsi is one of Russia's leading national networks of private clinics, providing healthcare services in Moscow and other Russian regions. Sales at Medsi decreased by $39.8 million, or 13.5%, from $294.0 million in the year ended 31 December 2013 to $254.2 million in the year ended 31 December 2014 mainly due to rouble depreciation. Medsi's rouble revenues grew by 4.3% year-on-year in 2014, reflecting an 0.7% rise in the number of patient visits, and a 4.0% increase in the average bill in rouble terms.

Sistema Mass Media is a holding company which manages assets in pay TV, premium movie and TV content production and advertising. Sales of Sistema Mass-Media decreased by $22.2 million, or 20.2%, from $109.8 million in the year ended 31 December 2013 to $87.6 million in the year ended 31 December 2014. This reduction mainly reflects the deteriorating market situation, which translated into lower advertising budgets and a consequent drop in demand for TV series, as well as the loss of the Ukrainian market for re-selling and distributing TV shows.

Binnopharm is a pharmaceuticals company managing one of the largest full-cycle facilities in Russia for the manufacturing of bio-technology drugs in line with GMP (Good Manufacturing Practice) international quality standards. Sales at Binnopharm decreased by $39.6 million, or 37.9%, from $104.3 million in the year ended 31 December 2013 to $64.7 million in the year ended 31 December 2014. The results were impacted by an entry into legal force of a Federal law "On contract system in the area of state procurement" and government's adoption of Federal contract system which practically put freeze on regional procurement of medicines and subsequently resulted in a temporary decrease of revenues from Binnopharm's distribution business by more than 45% in the first half of 2014. The effects from this reorganisation are expected to normalize in 2015 with Government procurement of drugs generally expected to increase this year.

Targin is an oil services company focused on onshore drilling and work over operations, equipment servicing and manufacturing, transportation and construction. Sistema acquired control over Targin (formerly known as Bashneft-Service Assets) from Bashneft in October 2013. During 2014, Targin contributed $612.9 million to the Group's consolidated revenue compared to $223.0 million in 2013.

Our newly acquired pulp and paper assets consolidated under Lesinvest already contributed $151.2 million to our consolidated revenue.

Intourist sales slightly decreased by 14.3% the year ended 31 December 2014 and amounted to $75.7 million

Cost of sales, exclusive of depreciation and amortization

Cost of sales, exclusive of depreciation and amortization, increased by $119.4 million, or 5.6%, from $2,142.5 million in the year ended 31 December 2013 to $2,261.8 million in the year ended 31 December 2014 following the reasons discussed in revenue section above.

Selling, general and administrative expenses

Selling, general and administrative expenses decreased by $39.8 million, or 6.8%, from $586.7 million in the year ended 31 December 2013 to $547.0 million in the year ended 31 December 2014.

Depreciation and amortization

Depreciation and amortization decreased by $16.4 million, or 8.4%, from $196.0 million in the year ended 31 December 2013 to $179.6 million in the year ended 31 December 2014.

Segment operating income/(loss)

For the reasons discussed above, our other operating segments, in aggregate, recorded an operating income of $286.7 million in 2014 as compared to $84.7 million in 2013.

Liquidity and Capital Resources

Sistema JSFC and its subsidiaries use a variety of sources to finance operations, both external and internal. In addition to net cash provided by operations, short- and long-term borrowings to fund capital expenditures and strategic investments are used. Short- and long-term funding sources may change with time, but currently include notes issued in the international and Russian capital markets and credit facilities with international and Russian banks, denominated both in roubles and foreign currencies.

We expect to repay all long-term debts as they become due from our operating cash flows, including distributions received from subsidiaries, or through re-financings. See Note 20 to our Financial Statements for a description of our indebtedness.

Dividend policy

Our parent company, Sistema JSFC, is a holding company, and its ability to repay its debts depends in large part on the receipt of dividends, distributions and other payments from our subsidiaries, proceeds from the sale of our subsidiaries and from additional borrowings.

Because most of our operating subsidiaries are incorporated in Russia, their ability to pay dividends to Sistema JSFC is limited by the provisions of the Russian law. For example, the Russian law requires that, among other things, dividends can only be paid in an amount not exceeding net profits as determined under Russian accounting standards. In addition, dividends may only be paid if the value of the company's net assets is not less than the sum of the company's charter capital, the company's reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred stock of the company, if any, as determined under Russian accounting standards. Our subsidiaries located in other jurisdictions are likely to be subject to similar or other limitations on their ability to declare and pay dividends as a result of regulatory, fiscal and other restrictions.

In June 2014, Sistema declared and paid dividends for the year ended 31 December 2013 of RUB 19.9 billion ($574.3 million), or RUB 2.06 per share.

Stock-Option Plans

During the years ended December 31, 2014 and 2013 the Company's Board of Directors established two-year motivational programs for senior and mid-level management. Participants of the programs upon fulfillment of certain performance conditions and subject to continuing employment with the Group will be granted the Company's ordinary shares. As a result, the Group recognized an expense of $79.4 million and $54.2 million for the years ended December 31, 2014 and 2013, respectively, which were recognized in consolidated statement of operations and comprehensive income. The fair value of awards granted was measured based on the fair value of the Company's ordinary shares.

Cash Flows

A summary of our cash flows is presented in the table below for the periods indicated:

	Year ended 31 December	
	2013	**2014**
	($ in thousands)	
Cash flows		
Net cash provided by operating activities excluding Bashneft	4,198,847	4,292,429
Net cash provided by operating activities of Bashneft	2,629,988	2,755,291
Net cash provided by operating activities	6,828,835	7,047,720
Net cash used in investing activities excluding Bashneft	(1,731,667)	(2,632,825)
Net cash used in investing activities of Bashneft (net of cash disposed of US$961,733)	(1,158,995)	(3,256,540)
Net cash used in investing activities	(2,890,662)	(5,889,365)
Net cash used in financing activities excluding Bashneft	(2,502,846)	(1,164,280)
Net cash (used in)/provided by financing activities of Bashneft	(580,164)	885,338
Net cash used in financing activities	(3,083,010)	(278,942)
Effect of foreign currency translation on cash and cash equivalents	(293,247)	(1,938,436)
Net increase/ (decrease) in cash and cash equivalents	561,916	(1,059,023)

Net cash provided by operating activities excluding Bashneft

Net cash provided by operating activities excluding Bashneft in the reporting year slightly increased by $93.6 million, or 2.2% from $4,198.8 million in the year ended December 31, 2013 to $ 4,292.4 million in year ended December 31, 2014. This increase was caused by changes in working capital.

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Net cash used in investing activities excluding Bashneft

Net cash used in investing activities excluding Bashneft decreased from $1,731.7 million in the year ended 31 December 2013 to $2,632.8 million in the year ended 31 December 2014. This decrease was largely due to Group's active acquisition policy. In the reporting year, the Group spent $594.0 million on purchasing of subsidiaries and affiliates, net of cash acquired whereas it was spend $ 98.4 million for the same purposes. In addition, in the reporting year, net decrease in loans to customers and banks was $664.1 million (there was the net increase in loans to customers and banks of $ 70.4 million in 2013).

The Group's capital expenditure in 2014 amounted to $2,902.6 million compared to $2,994.4 million in 2013.

Net cash used in financing activities excluding Bashneft

In the reporting year, net cash used by the Group in financing activities compared to the previous year, decreased by 53.5% to $1,164.3 million, as a result of $761.7 million net proceeds from long-term and short-term borrowings and a $231.5 million decline in the payments for additional stock in the existing subsidiaries. The decrease also resulted from a $308.7 million reduction in the dividends paid by the Group to the shareholders of subsidiary companies. This was partly compensated by the $281.3 million growth in dividend payments to the Group's shareholders in 2014.

Working Capital

Working capital is defined as current assets less current liabilities. As of the date hereof, we believe our working capital is sufficient for our present requirements. As of 31 December 2014, we had a positive working capital of $114.5 million, compared to a working capital of $766.7 million as of 31 December 2013 excluding Bashneft working capital.

Capital Requirements

Sistema JSFC and each of its subsidiaries require funding to finance the following:

- Capital expenditures, which consist of purchases of property, plant and equipment and intangible assets;
- Acquisitions;
- Repayment of debt;
- Changes in working capital;
- General corporate activities, including dividends;
- Potential payments of obligations under judgments; and
- Potential payments of obligations under other contractual obligations.

We anticipate that capital expenditures, acquisitions and repayment of long-term debt will represent the most significant uses of funds for several years to come.

Our capital expenditures in the years ended 31 December 2014 and 2013 were $2,902.6 million and $2,994.4 million, respectively. We expect to continue to finance most of our capital expenditure needs through our operating cash flows, and to the extent required, additional indebtedness, such as borrowings or additional capital raising activities.

In addition to our capital expenditures, we spent $661.4 million and $397.6 million in the years ended 31 December 2014 and 2013, respectively, on acquisitions, including $67.4 million and $299.2 million respectively on acquisitions of non-controlling interests in existing subsidiaries. See "—Acquisitions, Divestitures and Key Corporate Restructurings—Acquisitions," above, and Notes 3 and 5 of the Financial Statements for further description of our acquisitions. We may continue to expand our business through acquisitions. Our cash requirements relating to potential acquisitions can vary significantly based on market opportunities.

As of 31 December 2014, short-term debt equaled $1,728.7 million, of which $1,598.7 million represented the current portion of long-term debt. As of 31 December 2013, short-term debt equaled $2,143.7 million, of which $2,102.9 million represented the current portion of long-term debt. As of 31 December 2013 and 2014, short-term debt (including the current portion of long-term debt) accounted for 20.4% and 20.9%, respectively, of our overall debt.

Capital Resources

We plan to finance our capital requirements through operating cash flows and financing activities, as described above.

Cash

As of 31 December 2013 and 2014, excluding our assets from banking activities, we had cash and cash equivalents of $1,537.5 million and $1,288.7 million, respectively.

As of 31 December 2013 and 2014, the current portion of our assets from banking activities amounted to $3,898.7 million and $2,180.2 million, respectively.

Loans and Borrowings

As of 31 December 2014, our indebtedness consisted mainly of notes and corporate bonds and loans from banks and financial institutions. Total indebtedness as of 31 December 2014 was $8,262.8 million, consisting of $6,534.1 million in long-term debt, $1,598.8 million in long-term debt maturing within one year and $129.9 million in short-term loans payable. The table below sets forth our notes and corporate bonds outstanding as of 31 December 2014. See Note 20 to our Financial Statements for further description of our material debt obligations.

	Maturity	Interest rate (as at December 31, 2014)	2014	2013
USD-denominated:				
Calyon, ING Bank, Nordea Bank, Raiffeisen Zentralbank Osterreich	2015-2020	LIBOR+1.15% (1.51%)	$ 673,698	$ 798,440
China Development Bank	2015-2018	LIBOR+1.5% (1.86%)	179,421	187,497
Bank of China	2015-2021	LIBOR+1.5%-3.5% (1.86%-3.86%)	170,552	170,615
Skandinavska Enskilda Banken	2015-2017	LIBOR+0.23%-1.8% (0.59%-2.16%)	91,987	129,494
Bank of Moscow	2015	LIBOR+7.5% (7.76%)	82,552	82,552
HSBC Bank and ING BHF Bank			-	12,022
Other			14,230	27,223
			1,212,440	**1,407,843**
EUR-denominated:				
Credit Agricole Corporate Bank and BNP Paribas	2015-2018	EURIBOR+1.65% (1.82%)	33,649	47,574
Bank of Moscow	2015-2017	EURIBOR+5.0% (5.15%)	27,333	-
LBBW	2015-2017	EURIBOR+1.52% (1.69%)	16,995	25,630
Bank of China			-	74,403
Other			12,187	14,398
			90,164	**162,005**
RUB-denominated:				
Sberbank	2015-2021	8.45%-15.0%	3,007,244	2,922,817
Gazprombank	2015-2018	9.0%-10.6%	253,170	294,439
Raiffeisenbank	2015-2016	Mosprime+1.45%-5.25% (23.42%-29.02%), 9.45%	149,568	71,891
Bank of Moscow	2015-2018	CBR+3.0% (11.25%); Mosprime+4.5%-8.85% (28.27%-31.02%);	128,993	256,258
VTB	2015-2018	9.0%-22.75%	86,461	77,571
Unicredit	2016	Mosprime+5.2% (12.17%); 10.1-10.4%	37,179	73,248
Alfa-Bank	2015	9.75%-14.18%	27,143	92,486
Credit bank of Moscow	2016	19.0%	8,888	30,554
Other			30,928	53,560
			3,729,574	**3,872,824**
Other currencies			17,642	4,399
Total			**$ 5,049,820**	**$ 5,447,071**

The following table presents the aggregate scheduled maturities of debt principal outstanding as of 31 December 2014:

Payments due in the year ended 31 December		
2015[1]	$	1,598,770
2016		1,185,257
2017		1,469,871
2018		1,022,949
2019		1,148,236
Thereafter		1,707,742
Total	**$**	**8,132,825**[1]

(1) Includes only long-term debt and current portion of long-term debt. Does not include $129.9 million in short-term loans payable in 2015.

Commitments and Contingencies

For a detailed discussion of our commitments and contingencies, see Note 30 of our Financial Statements.

Operating leases

We leases land, buildings and office space mainly from municipal organizations through contracts which expire in various years through 2068.

Rental expense under operating leases amounting to $641.0 million and $678.5 million for the years ended December 31, 2014 and 2013, respectively, is included in selling, general and administrative expenses. Rental expense under operating leases amounting to $204.6 million and $238.1 million for the years ended December 31, 2014 and 2013 respectively, is included in cost of sales.

Future minimum rental payments under operating leases in effect as of December 31, 2014, are as follows:

Year ended December 31		
2015	$	282,393
2016		204,009
2017		202,489
2018		204,662
2019		199,758
Thereafter		303,487
Total	**$**	**1,396,798**

Capital commitments

As of December 31, 2014, the Group had executed purchase agreements of approximately $840.0 million to acquire property, plant and equipment and intangible assets.

Guarantees

As of December 31, 2014, MTS Bank and its subsidiaries guaranteed loans for several companies, including related parties, which totaled $217.2 million. These guarantees would require payment by the Group only in the event of default on payment by the respective debtor. As of December 31, 2014, no event of default has occurred under any of the guarantees issued by the Group.

Commitments on loans and unused credit lines

As of December 31, 2014, MTS Bank and its subsidiaries had $126.9 million of commitments on loans and unused credit lines available to its customers.

Taxation

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

Generally, according to Russian tax legislation, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2014, tax declarations of certain companies of the Group in Russia for the preceding three fiscal years were open for further review.

The Group purchases supplemental software from foreign suppliers of telecommunications equipment in the ordinary course of business. The Group's management believes that customs duties are calculated in compliance with applicable legislation. However there is a risk that the customs authorities may take a different view and impose additional customs duties.

Pricing of revenue and expenses between each of the Group's subsidiaries and various discounts and bonuses to the Group's subscribers in the course of performing its marketing activities may be subject to transfer pricing rules. The Group's management believes that taxes payable are calculated in compliance with the applicable tax regulations relating to transfer pricing. However there is a risk that the tax authorities may take a different view and impose additional tax liabilities. As of December 31, 2014 and 2013, no provision was recorded in the Financial Statements in respect of such additional claims.

In November 2014, the Russian legislation was amended to introduce the concept of "controlled foreign companies" and the new tax regime for such entities. It is expected that the adoption of the new rules will generally lead to an increase in the administrative and, in certain cases, tax burden for the Russian entities that have subsidiary structures incorporated outside the Russian Federation. Management does not believe the law can materially impact the Group's tax obligations as of December 31, 2014.

Management believes that it has adequately provided for tax and customs liabilities in the accompanying Financial Statements. As of December 31, 2014 and 2013, the provision accrued amounted to $53.3 million and $69.6 million, respectively. In addition, the accrual for unrecognized income tax benefits, potential penalties and interest recorded in accordance with the authoritative guidance on income taxes totaled $6.1 million and $18.8 million as of December 31, 2014 and 2013, respectively. However, the risk remains that the relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

With regard to matters where practice concerning payment of taxes is unclear, management estimated possible tax exposure to be $21 million and $nil as of December 31, 2014 and 2013, respectively.

Credit Ratings

Our credit ratings impact our ability to obtain short- and long-term financing, and the cost of such financing. In determining our credit ratings, the rating agencies consider a number of factors, including our operating cash flows, total debt outstanding, commitments, interest requirements, liquidity needs and availability of liquidity. Other factors considered may include our business strategy, corporate governance, the condition of our industry and our position within the industry. Although we understand that these and other factors are among those considered by the rating agencies, each agency might calculate and weight each factor differently.

The credit ratings of our parent company, MTS and MTS-Bank as of April 6, 2015 were as follows:

Name of issuer	Rating Agency	Date of Rating	Rating	Outlook
Sistema	S&P	7 November 2014	BB	Negative
Sistema	Moody's	19 February 2015	B1	Negative
Sistema	Fitch	18 March 2015	BB-	Stable
MTS	S&P	04 February 2015	BB+	Negative
MTS	Moody's	25 February 2015	Ba1	Negative watch

MTS	Fitch	18 March 2015	BB+	Stable
MTS-Bank	Fitch	18 March 2015	B+	Stable
MTS-Bank	Moody's	21 November 2014	B2	Negative

Market Risks

We are exposed to a variety of market risks, including foreign currency risk, interest rate risk, credit risk and liquidity risk. We actively seek to minimise the potential adverse effects of these risks on our financial performance, and, in particular, use derivative instruments, including swap, forward and option contracts to manage foreign currency and interest rate risks. We do not use derivatives for trading purposes. See Key Factors Affecting Our Results of Operations—General Factors—Russian Macroeconomic Conditions and Trends," above, for a discussion of our foreign currency and inflation risks.

Interest Rate Risk

Interest rate risk is the risk that changes in variable interest rates will adversely impact our financial results. Our interest rate risk arises from fixed-rate and variable-rate loans and borrowings. Borrowings issued at fixed rates expose us to fair value interest rate risk, while borrowings issued at variable rates, particularly fluctuations in LIBOR, EURIBOR and MosPrime, expose us to cash flow interest rate risk.

As of 31 December 2014, approximately $1,472.8 million, or 17.8% of our total indebtedness was variable interest rate debt, while $6,790.0 million, or 82.2% of our total indebtedness was fixed interest rate debt.

For indebtedness with variable interest rates, the table below presents principal cash flows and related weighted average interest rates by contractual maturity dates as of 31 December 2014.

		December 31,							
	Currency	**2015**	**2016**	**2017**	**2018**	**2019**	**There-after**	**Total**	**Average rate at December 31, 2014**
Calyon, ING Bank N.V, Nordea Bank AB, Raiffeisen Zentralbank Osterreich AG	USD	124,742	124,742	124,742	124,742	99,824	74,906	673,698	1.51%
China Development Bank	USD	39,871	39,871	39,871	59,808	-	-	179,421	1.86%
Bank of China	USD	6,978	56,714	60,129	13,798	13,798	19,135	170,552	2.82%
Skandinaviska Enskilda Banken AB	USD	37,506	35,094	19,387	-	-	-	91,987	0.89%
Bank of Moscow	USD	82,552	-	-	-	-	-	82,552	7.76%
Total USD variable debt		**291,649**	**256,421**	**244,129**	**198,348**	**113,622**	**94,041**	**1,198,210**	-
Weighted average USD interest rate		**3.28%**	**1.77%**	**1.84%**	**1.71%**	**1.67%**	**1.78%**	-	-
Credit Agricole Corporate Bank and BNP Paribas	EUR	8,412	8,412	8,412	8,413	-	-	33,649	1.82%
Bank of Moscow	EUR	10,933	10,933	5,467	-	-	-	27,333	5.15%
LBBW	EUR	5,665	5,665	5,665	-	-	-	16,995	1.69%
Total EUR variable debt		**25,010**	**25,010**	**19,544**	**8,413**	**-**	**-**	**77,977**	
Weighted average EUR interest rate		**3.25%**	**3.25%**	**2.71%**	**1.82%**	**-**	**-**	-	-
Bank of Moscow	RUB	71,639	8,807	32,250	16,297	-	-	128,993	23.65%
Raiffeisenbank	RUB	38,430	9,820	-	-	-	-	48,250	26.89%
Unicredit	RUB	9,702	9,702	-	-	-	-	19,404	27.17%
Total RUB variable debt		**119,771**	**28,329**	**32,250**	**16,297**	**-**	**-**	**196,647**	
Weighted average RUB interest rate		**24.98%**	**25.98%**	**23.65%**	**23.65%**	**-**	**-**	-	-

Credit Risk

Credit risk is the risk of financial loss to us if a customer or counterparty to a financial instrument fails to meet its contractual obligations, and arises principally from cash and cash equivalents, assets from banking activities, short-term investments, net accounts receivable and long-term investments.

Credit risk with regard to assets from banking activities is managed by evaluating the creditworthiness of our customers.

Credit risk with respect to short-term and long-term investments is managed by assessing the creditworthiness of each borrower, taking into account the type of security that can be pledged, as well as the purpose of each investment or loan.

Credit risk connected with other current assets is managed by assessing the creditworthiness of each customer, taking into account its financial position, past experience and other factors.

The carrying amount of our financial assets represents our maximum credit exposure. The following table sets forth the maximum exposure to credit risk as at the periods indicated:

	Year ended 31 December	
	2014	2013
	($ in thousands)	
Cash and cash equivalents	1,288,722	1,537,492
Assets from banking activities	3,554,563	6,452,969
Short term investments	479,341	1,562,547
Accounts receivable, net	1,163,092	1,630,593
Other non-current assets	390,057	56,127
Long-term investments	316,625	249,071
Total	**7,582,457**	**11,488799**

Liquidity Risk

Liquidity risk is the risk that we will not be able to settle all liabilities as they become due. Our approach to managing liquidity is to ensure, as far as possible, that we will always have sufficient liquidity to meet our liabilities when due, under both normal and stressed conditions, without incurring unacceptable losses or risking damage to our reputation. Our liquidity in the future will primarily depend on our ability to maintain adequate cash flows from operations to meet our debt obligations as they become due, on our ability to obtain adequate external financing to meet our committed future capital expenditures and on the extent to which we will be obligated to make payments under certain judgments and other contractual obligations. Our operating cash flows could be adversely affected by numerous factors beyond our control, including but not limited to, fluctuations in exchange rates and inflation, the price of acquisitions, the change in telecommunications tariffs, taxation, or increased competition. Our ability to obtain external financing depends on numerous factors, including but not limited to, our financial performance and creditworthiness as well as our relationships with lenders.

Critical Accounting Policies

Critical accounting policies are those policies that require the application of management's most challenging, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies involve judgments and uncertainties that are sufficiently sensitive to result in materially different results under different assumptions and conditions. We believe that our most critical accounting policies are those described below.

Revenue Recognition

Revenue recognition policies have a significant impact on our results of operations. Generally, revenues are recognized when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collectability of the fee is reasonably assured. Revenue amounts are presented net of value-added taxes.

Revenues under arrangements specific to the respective reportable segments of the Group are recognized as follows:

MTS

Revenues derived from wireless, local telephone, long distance, data and video services are recognized when services are provided. This is based upon either usage (minutes of traffic processed, volume of data transmitted) or period of time (monthly subscription fees).

Content revenue is presented net of related costs when MTS acts as an agent of the content providers while the gross revenue and related costs are recorded when MTS is a primary obligor in the arrangement.

Upfront fees received for connection of new subscribers, installation and activation of wireless, wireline and data transmission services ("connection fees") are deferred and recognized over the estimated average subscriber life, as follows:

Mobile subscribers	1 -12.5 years
Residential wireline voice phone subscribers	15 years
Residential subscribers of broadband internet service	1 year
Other fixed line subscribers	3-5 years

MTS calculates an average life of mobile subscribers for each region in which it operates and amortizes connection fees based on the average life specific to that region.

Incentives provided to customers are usually offered on signing a new contract or as part of a promotional offering. Incentives representing the reduction of the selling price of the service (free minutes and discounts) are recorded in the period to which they relate, when the respective revenue is recognized, as a reduction to both accounts receivable and revenue. However, if the sales incentive is a free product or service delivered at the time of sale, the cost of the free product or service is classified as an expense. In particular, the Group sells handsets at prices below cost to contract subscribers. Such subsidies are recognized in the cost of sales.

RTI

Revenues from the long-term contracts are recognised using the percentage-of-completion method of accounting, measured by the percent of contract costs incurred to-date to estimated total contract costs. The completed-contract method is used for a single contract or a group of contracts for which reasonably dependable estimates cannot be made or for which inherent hazards make estimates doubtful. Provisions for estimated losses on construction contracts in progress are made in their entirety in the period in which such losses are determined. A total expected loss on a contract is recognised immediately in profit or loss.

Contract expenses are recognised as incurred unless they create an asset related to future contract activity.

The sales of software products and system integration services are generally multiple-element arrangements, involving the provision of related services, including customization, implementation and integration services, as well as ongoing support and maintenance provided to customers.

A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met: (a) the delivered items have value to the customer on a standalone basis; and (b) the arrangement includes a general right of return relative to the delivered items, delivery or performance of the undelivered items is considered probable and substantially in the control of the Group.

If evidence of the fair value of the undelivered elements of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value does exist, or until all elements of the arrangement are delivered. Fees allocated to post-contract support are recognized as revenue on a pro rata basis over the support period. Fees allocated to other services are recognized as revenue as services are performed.

In cases where extended payment terms exist, license and related customization fees are recognized when payments are due, unless a history of collection, without providing concessions, has been established under comparable arrangements.

When sale agreements provide price protection to the dealer, the revenue is deferred until the dealer sells the merchandise to a third party due to the frequent sales price reductions and rapid technology obsolescence.

Where certain products of this segment are sold with a product return right, a reserve is established. In addition other post-contract support obligations are accrued at the time of sale.

MTS Bank

Revenues from interest bearing assets are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Property, plant and equipment – Property, plant and equipment are stated at historical cost. Cost includes major expenditures for improvements and replacements, which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance, including preventative maintenance, are charged to the consolidated statement of operations and comprehensive income as incurred.

The cost of major overhauls and replacements, which extend useful lives of the assets or increase their revenue generating capacity, are capitalized to the cost of the assets.

Depreciation for property, plant and equipment is computed under the straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	20-50 years
Leasehold improvements	Lesser of the estimated useful life or the term of the lease
Switches and transmission devices	7-31 years
Network and base station equipment	4-12 years
Power and utilities	3-47 years
Other plant, machinery and equipment	3-25 years

Whilst there are certain assets within the Group that have useful lives longer than those presented above, these assets are quantitatively insignificant in comparison to the overall Group balance for each category. As such, the Group has taken the approach of reporting the useful economic lives which most faithfully represent the majority of assets, in order to provide a more reasonable range that more closely relates to the Group norm.
Assets held under capital leases are initially recognized as assets of the Group at their fair value at the inception of a lease or, if lower, at the present value of minimum lease payments. The discount rate used in determining the present value of the minimum lease payments is the Group's incremental borrowing rate, unless (1) it is practicable to determine the implicit rate computed by the lessor; and (2) the implicit rate is less than the Group's incremental borrowing rate. If both of those conditions are met, the interest rate implicit in the lease is used.

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the consolidated statement of financial position along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is included in the determination of net income.

Construction in progress and equipment for installation are not depreciated until an asset is placed into service.

Impairment of long-lived assets other than goodwill and indefinite lived intangible assets – The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group compares the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets (Note 15).

Income taxes – Income taxes of the Group's Russian entities have been computed in accordance with RF laws. The corporate income tax rate in the RF is 20%. The income tax rate on dividends paid within Russia is 9% or 0% subject to meeting certain conditions. The foreign subsidiaries of the Group are paying income taxes in their respective jurisdictions.

Deferred tax assets and liabilities are recognized for differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the tax bases of assets and liabilities that will result in future taxable or deductible amounts. The deferred tax assets and liabilities are measured using the enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. In making such determination, the Group considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations.

Uncertain tax positions are recognized in the consolidated financial statements for positions which are not considered more likely than not of being sustained based on the technical merits upon examination by the tax authorities. The measurement of the tax benefit recognized in the consolidated financial statements is based upon the largest amount of tax benefit that, in management's judgment, is greater than 50% likely of being realized based on a cumulative probability assessment of the possible outcomes.

The Group recognizes interest and penalties relating to unrecognized tax benefits within income taxes.

Recently adopted accounting pronouncements – Effective January 1, 2014, the Group adopted Accounting Standards Update ("ASU") 2013-05, Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity, ASU 2013-07, Liquidation Basis of Accounting and ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The adoption of these amendments did not have a material impact on the Group's consolidated balance sheet or results of operations.

Transition to International Financial Reporting Standards –To conform with the Russian legislation, the Group will prepare its consolidated financial statements for the year ended December 31, 2015 in accordance with International Financial Reporting Standards ("IFRS").

5. RISKS

Risks

The key risk factors related to Sistema JSFC

The Corporation may face a variety of risks in the course of its business operations. The main risks that the Corporation may encounter are the consequences of the processes and factors that Sistema JSFC has little or no influence on. Hence, efficient assessment and management of risks remain an important component of the strategy of Sistema JSFC.

The risk management system of Sistema JSFC is based on a two-level approach to risk management, namely, detection of risks in subsidiaries and affiliates and in the Corporation and their integration for assessing their influence on the Group in general. The main objective is to provide a reasonable guarantee that the strategic goals will be achieved and to ensure that the level of risk will be kept within the limits that are acceptable for the shareholders and the management of the Corporation. The integrated risk management system (ERM) operating at Sistema JSFC was built in compliance with international standards, recommendations and best practices in risk management.

The integrated risk management system (ERM) implemented in the Corporation envisages the presence of the following components and procedures:

- identification of risks at all levels of the management (from the top to the line management), which includes finding the risk owner and making a risk passport;
- primary assessment of the materiality of identified risks and their analysis (VaR methodology);
- ranging of risks by management levels;
- assessment of the aggregate influence of material risks on the Company's key financial indicators (Monte Carlo modelling);
- development of plans to mitigate identified risks at all management levels;
- regular risk monitoring and control;
- preparation of reports on the company's risks.

As part of quarterly ERM procedures the risk managers of Sistema Group compile 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, conduct an analysis of the impact that material risks have on the financial results of specific subsidiaries and Sistema Group as a whole, using simulation and financial modelling methods.

In order to deal with the risks included in the risk register of Sistema Group the company developed risk management (mitigation) and response plans for specific subsidiaries, which may be extended, adjusted and then approved by the risk committees of the respective companies.

Quarterly monitoring of the Corporation's risks is performed at the level of the Management Board and the Risk Sub-Committee operating under the umbrella of the Finance and Investment Committee of Sistema JSFC by reviewing the effects of the mitigation and response measures taken and by reassessing the already identified and/or new risks, as well as by evaluating their potential impact on the financial results of the Corporation and Sistema Group as a whole.

The top management of Sistema JSFC presents a regular risk management report to the Audit, Finance and Risk Committee of the Board of Directors of Sistema JSFC. Sistema's Board of Directors review risk management reports on a biannual basis.

The Group's risk management system keeps developing and improving. Various risk mitigation mechanisms are being widely applied (including insurance), financial risk control and response procedures are being improved. At the Corporation level particular attention is given to the risks of investment projects starting from the stage of project origination up to the stage of completion. The risk management systems of subsidiaries are currently at different stages of development depending on the time of their introduction. These systems are being gradually improved in accordance with the plans approved earlier. As new assets are added to Sistema's portfolio, individual plans are developed in order to implement risk management systems depending on the specific needs of such assets. The risk management processes of subsidiaries are monitored by the Corporation via Sistema's representation in collective governance and executive bodies of S/As.

External risks

The risks related to changes in the political and economic situation in Russia are material to Sistema JSFC because most of the Corporation's business is conducted in the Russian Federation. Moreover, many of the Corporation's subsidiaries operate in the emerging markets, including Armenia, the Republic of Belarus, Ukraine, Uzbekistan, Turkmenistan and India, which are also characterized by the risks listed below.

Economic risks

- The business of Sistema JSFC is inextricably linked with the state of the global economy and financial markets and heavily depends on the Russian economy in particular, which in its turn relies on the export of oil, gas and other commodities. Further weakening of the rouble against the US dollar and Euro amid a slump in the oil prices, imposed sanctions and increased capital flight from Russia may result in a rise in costs and a drop in revenues or impede the achievement of financial targets and repayment of debt by the Group's subsidiaries.
- Capital flight from Russia and 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 the joint ventures (partnerships) and new investment projects of the Group's companies. Growing inflation may result in higher expenses and, therefore, put pressure on profit margins and also affect the domestic demand for products of Sistema Group's companies.
- If in the medium term sanctions are maintained and the access of Russian banks and businesses to foreign debt remains restricted, this may significantly increase the current liquidity deficit in the market and result in further interest rate rises.
- An unfavourable macroeconomic environment in many countries of Sistema's operations may make it necessary to reevaluate goodwill for some of the assets.
- Foreign currency control and restrictions on capital repatriation may adversely affect the business of Sistema Group and reduce the value of Sistema's investment in Russia.

Political and social risks

- The influence of geopolitical risks has significantly intensified as protectionism and economic sanctions are increasingly being used as a tool for achieving geopolitical goals.
- The risks of inter-state conflicts have significantly risen compared with the beginning of 2014, both in terms of their probability and the effect that they may produce on various areas.

Legal risks and uncertainty

The risks related to weaknesses in the Russian regulatory framework include, to various degrees, the following.

- Possible discrepancies, ambiguity and anomalies in: (1) federal laws; (2) orders, directives and regulations issued by the Russian President, Government and federal ministers; (3) and regional and local laws, rules and requirements.
- Relative unpredictability of legislative and administrative decisions and court rulings and a lack of means that could make the understanding of such legislative decisions and court rulings easier.
- There is no clarity about the influence of the Federal Law "On Strategic Foreign Investment" and the new Customs Treaty of Russia, Belarus and Kazakhstan on Sistema's business and its foreign shareholders. Russia's accession to the World Trade Organisation may result in certain legislative and other changes in the markets of Sistema's operations.
- The shareholder responsibilities provided for by the corporate laws of the Russian Federation may result in Sistema being held financially liable for its subsidiaries.
- If minority shareholders of Sistema's subsidiaries contest past or future related-party transactions or other transactions or vote against related-party transactions or other transactions in the future, this will limit Sistema's operational capacity.
- If the Russian Federal Anti-monopoly Service (FAS) concludes that Sistema JSFC or one of its material subsidiaries has acquired or founded a new company in violation of the anti-monopoly law or has otherwise violated competition laws, this may result in administrative sanctions.
- Failure to formally comply with certain requirements of the Russian law may result in Sistema JSFC or one of its subsidiaries incorporated in Russia being forced to carry out liquidation, their ownership structure may be called into question and early debt repayment claims may be made.

Taxation system of the Russian Federation

- The Russian law on transfer pricing may make it necessary to introduce adjustments to the price setting system of Sistema Group's companies and result in additional tax obligations with regard to controlled transactions.
- On 1 January 2015 new rules were introduced relating to the taxation of undistributed profits of controlled foreign companies, the concept of a beneficiary owner, tax residence of legal entities and indirect sale of properties in Russia. As a result of the need to apply new taxation rules the Group's companies may face new tax liabilities arising due to the uncertainty around interpretation of the tax law and the lack of previous law enforcement practice.

Stock markets

- Deterioration of the geopolitical situation, sanctions imposed on Russian companies, worsening of the macroeconomic environment and capital and investor flight from the Russian market have led to a reduction in the value of Russian companies in 2014. At the same time, external factors and national currency trends had more impact on the decline in the market values of Russian companies than the fundamental indicators of specific enterprises and holdings.
- There is a risk that in 2015 Russian companies' stock will grow more slowly than their peers on other emerging markets.

Risks related to the operations of Sistema JSFC

There is no certainty that the business strategy will be successfully implemented.

- The key components of the business strategy include development of a balanced and diversified asset portfolio in sectors and regions where Sistema JSFC has competitive advantages, and also proactive management of the investment portfolio and involvement of leading international and Russian partners. Despite having a well-formulated strategy, Sistema JSFC cannot guarantee achievement of the established goals, efficient management of the portfolio companies or taking up of new investment opportunities.
- The success of Sistema's strategy depends on numerous factors, including obtaining of the necessary permits from the authorities, sufficient demand from consumers, successful development of technologies, efficient management of spending, timely completion of development and introduction of new products and services by the Group's companies, successful differentiation of the companies' offers from their rivals and perception of the goods by the market.

The company may face difficulties in generating profits from acquisitions, integration, disposal or restructuring of assets.

- Sistema JSFC grows its business via new acquisitions, sale and restructuring of assets. The process of taking investment opportunities in the market entails certain risks, including the risks of not finding relevant targets or their not being available for acquisition, a risk of insufficient or inadequate due diligence of the target company's operations and/or financial situation, risks of the assets being overvalued and overpaid for and, consequently, of occurrence of financial risks exceeding expectations and discovery of financial liabilities not found earlier.
- Acquisition of additional businesses may also put additional pressure on the Corporation's cash flows, especially if the acquisition is paid for in cash. Besides, if an acquisition deal is not closed or closed with delays, it may negatively affect Sistema's achievement of its strategic growth goals and have a substantial negative impact on the current business, operational results, financial situation and prospects.
- Moreover, Sistema JSFC may encounter problems of integrating assets into the existing structure, their optimal management or necessary restructuring. These risks include inability to efficiently assimilate and integrate operating assets and personnel of the acquired company into the business, inability to establish and integrate all the necessary control systems and mechanisms, including with regard to facilities and agreements related to logistics and distribution, conflicts between majority and minority shareholders, hostility and/or unwillingness to cooperate on the part of the acquired asset's management, potential loss of customers of the acquired asset.
- Potential disposals of assets carry certain risks related to potential inability to execute the transaction or undervaluation of the sold asset, liabilities arising from the sale of asset, failure to meet deadlines for transaction closure or loss of synergy between existing assets. Besides, execution of such transactions, including restructuring, merger of businesses or financial resources depends on a combination of necessary conditions, including corporate and government consents. There is no certainty that such deals will be completed on the announced terms or closed at all.

Sistema's ability to maintain its competitiveness and implement its business strategy in many respects depends on the management and key employees.

- The top management team is the key to implementing Sistema's strategy. Moreover, further success of the investment portfolios and their ability to efficiently implement a common strategy, including plans of growth and increase of scale, will to a large degree depend on the efforts of individual management teams working with the specific assets.

Sistema's ability to service its debt largely depends on the cash flows from its subsidiaries.

- Sistema's financial performance largely depends on the ability of its subsidiaries to generate cash flows needed to service its financial liabilities, including repayment of debt and interest and any other borrowing in the future. From time to time, the Group companies' abilities to make such payouts may be limited as a result of regulatory, tax or other restrictions. Disposal of one of the Group’s core assets reduces the Group's materiality and the amount of expected dividend flow from subsidiaries, which along with tightening of bank funding may have a negative impact on servicing current liabilities and hinder access to debt financing in the future.

The success of Sistema in many respects depends on the success of its core asset, MTS.

- Sistema's financial performance *in many respects* depends on the success of its core asset, MTS. If MTS fails to generate the necessary income, it may impinge on Sistema's ability to service its debt liabilities and secure growth and business expansion through restructuring and acquisition of assets. Consequently, the risks and events that may have a material detrimental effect on MTS, its operating results, financial standing and prospects may, in turn, have a material detrimental effect on Sistema, its operating results, financial standing or prospects.

In the event of problems with fund raising or financing, Sistema's operations would be curtailed accordingly.

Future financial receipts and cash flows from Sistema's subsidiaries and affiliates may not be sufficient to cover the planned expenses in the event of contingencies, such as:

- absence of external sources of financing;
- changes in the terms of existing agreements on financing;
- emergence of new business opportunities or investment in existing businesses, in case of sizable investments;
- a slower than planned growth of revenue;
- deterioration of the economic situation in the countries of Sistema's operations.

Covenants might limit the ability to raise debt financing, carry out investment programmes or participate in various businesses.

- Sistema's bank loan agreements and agreements of some of its S/As on bank loans and debt securities contain certain restrictive covenants. These covenants put restrictions on attraction of additional debt financing, encumbrance of property with pledges, sale of assets and transactions with affiliates. Such covenants may result in restriction of Sistema's operations, including financing of capital expenses, or limit the possibilities for timely repayment of debt or payments on liabilities. If operations of subsidiaries are restricted, their revenue may decline, which, in turn, may limit Sistema's opportunities for using such revenue to service the debt or finance its subsidiaries. Moreover, mergers and restructuring of subsidiaries, in certain circumstances, disposal of assets may lead to breach of restricting covenants under such subsidiaries' loan agreements, which may bring about acceleration of such loans or reclassification of long-term loans into short-term loans.

Licences and permits required for Sistema Group companies' business may be deemed invalid, revoked, rescinded or not prolonged, or contain encumbrances that restrict Sistema's operations.

- Operations of Sistema Group companies are regulated by various government bodies and agencies as pertains to obtaining and renewing licences, approvals and permits and also the need to constantly abide by existing legislation, regulations and standards. Regulating authorities to a large extent rely on their own judgment when interpreting and implementing requirements of applicable laws, regulations and standards, issuing and extending licences, approvals, sanctions and permits and monitoring compliance with licence requirements. There is no guarantee that existing licences and permits, including those issued to the Group's companies, will be extended, new licences and permits will be issued or that the companies will be able to comply with the terms of corresponding licences. There is no guarantee either that any of the existing or future licences or permits will not be suspended or revoked on some or other grounds. Any of these circumstances can have material negative consequences for the business of Sistema JSFC.

If ambiguity of privatisation laws is used to challenge Sistema's property rights to its privatised subsidiaries, and the company is unable to defend its position, there is a risk of losing its share in such assets or subsidiaries.

- Sistema's portfolio contains several privatised assets. Since the Russian laws on privatisation are rather ambiguous, inconsistent and conflicting with other laws, for example, there are conflicts between federal and local laws, the privatisation of many companies could be challenged, including the possibility of discriminatory challenges.
- If the legitimacy of privatisation of a company is contested, and Sistema is unable to defend its stand in the dispute, there is a risk of losing a stake in such company or its assets, which may have a material adverse effect on the business, financial situation, performance or development prospects of the Corporation.

The business of Sistema is regulated by the anti-corruption laws under the jurisdictions in which it operates, including the anti-corruption laws of the Russian Federation and the Foreign Corrupt Practices Act of the USA, and may be regulated by the UK Bribery Act 2010, and violations of applicable laws may lead to penalties and reputational risks.

- Any investigation into potential violations of the FCPA, the UK Bribery Act or other anti-corruption laws of the US, the UK or other jurisdictions may affect the reputation, business, financial situation and performance of Sistema JSFC.

All segments where Sistema JSFC operates are open to competition on the part of other companies.

- Operations in the segments of telecommunications, high technology, banking, retail, media, tourism, private healthcare services and pharmaceuticals are exposed to the influence of economic and other factors. Each segment exhibits strong competition between companies in Russia and other countries, including but not limited to competition in terms of price, product and service quality. Inability of Sistema Group companies to compete efficiently may have a material negative impact on the business, performance, financial situation and prospects.

Sistema depends on the ability to maintain its brand quality and reputation.

- Developing and maintaining brand awareness for the Group companies is a crucial component of shaping the public opinion about their existing and future products and services. Sistema JSFC believes that the importance of company brand is growing steadily at the highly competitive markets. Successful development and improvement of brand awareness to a large extent depends on the efficiency of marketing operations and the companies' ability to provide useful and quality products and services at competitive prices. The efforts to develop the brand may be incommensurate with actual revenues which may be insufficient to cover expenses on such activities.

6. Corporate Governance

Principles of Corporate Governance
Ensuring the appropriate level of corporate governance and information transparency in accordance with the highest global standards is an important element of the strategy followed by Sistema as an investment company. The high level of corporate governance and information transparency make it possible to attract and establish trust based relationships with partners and investors and increase return on capital through more effective management decisions. The Corporation's governance system is based on the following key principles:

- transparency and clarity of all processes for investors and partners;
- a transparent dividend policy;
- a proactive and professional Board of Directors;
- investment decisions made in compliance with the established procedures;
- the attention of the Board of Directors to all transactions with related parties;
- an active role of the Board of Directors in the strategic planning process;
- development of corporate governance in portfolio companies.

Sistema is guided by the above principles in all spheres of its activities, including strategic and financial management, HR and social policy, reporting, control and audit, and risk management.

The principles and procedures of corporate governance in Sistema are set forth in its Charter and a number of publicly available by-laws. Together these documents define the structure and competence of the Corporation's governance and control bodies. The Corporate Governance Code and the Code of Ethics of Sistema specify additional commitments of the Corporation relating to transparency, social responsibility and ethical principles of doing business.

Sistema makes every effort to bring the corporate governance practice in line with the recommendations specified by the Bank of Russia in the Corporate Governance Code (Letter of the Bank of Russia No. 06-52/2463 dated April 10, 2014[2]) and the guidelines set out in the UK Corporate Governance Code[3]. An analysis of compliance of Sistema's corporate governance practice with the requirements specified in the Corporate Governance Code and UK Corporate Governance Code is attached hereto as Annexes 9.7 and 9.8. Where corporate governance practices at Sistema deviate from the recommendations set forth in the above documents, the Corporation clarifies how the balance of interests is otherwise maintained in accordance with the applicable standards of corporate governance.

General Meeting of Shareholders

Principles of Operation
The General Meeting of Shareholders (GMS) is the supreme governance body of Sistema. Its operation is regulated by laws of the Russian Federation on joint-stock companies and the provisions of the Corporation's Charter and by-laws. The General Meeting procedure aims to make sure that Sistema respects the rights of shareholders and meets the requirements of applicable legislation and best international practices in corporate governance.

Information and materials for the meeting are submitted to the shareholders in Russian and in English; and are also published on Sistema's official web (www.sistema.ru, www.sistema.com). Shareholders receive notices of upcoming meetings along with voting ballots. The venues of General Meeting of Shareholders are always located close to the Corporation's headquarter.

Observance of Shareholder Rights
Sistema strives to ensure the maximum protection for the shareholders and their rights to participate in the management process and profit sharing. The fundamental rights of the shareholder in this regard are the right to attend the General Meeting of Shareholders, the right to vote on the items of the agenda and the right to receive dividends.

To ensure the right to participate in the General Meeting of Shareholders, information on the next General Meeting of Shareholders of Sistema and voting ballots are sent to all shareholders at least 30 days before the date of the meeting; all materials on the agenda items are published on the Corporation's web site in Russian and in English (www.sistema.ru; www.sistema.com). The shareholder can fill out the ballot in advance and mail it to Sistema at the address specified in the ballot. In this case, the shareholder's vote will be taken into account when counting the voting results.

[2] The Corporate Governance Code is available at: http://www.cbr.ru/sbrfr_new/files/legislation/letters/2014/Inf_apr_1014.pdf
[3] The UK Corporate Governance Code is available at: http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.aspx

Depositary receipt holders may vote on the items of the shareholders' meeting agenda following the established procedure by proxy through bank Deutsche Bank AG, which is used by Sistema as the depositor bank for the GDR programme:

Global Equity Services,
Trust and Securities Services,
Email: adr@db.com

The votes cast by GDR holders whose identity was disclosed to the depository are collected by Deutsche Bank AG via clearing systems and are included in the general voting ballot of the depositary, indicating all votes cast for and against the proposed draft resolution, or any abstentions.

Each shareholder may also attend the General Meetings of Shareholders in person or through a representative and vote on agenda items directly at the meeting.

An important guarantee of the shareholder's right to participate in running the Corporation is the right to access documents that the company is obliged to retain in line with the provisions of the Federal Law on Joint Stock Companies. To exercise this right, the shareholder should send a written request to the Corporate Secretary of Sistema, asking for access to the documents the shareholder wishes to see. When the shareholder is provided with access to confidential documents, the shareholder shall also submit a written undertaking not to disclose the confidential information to guarantee the protection of rights of all the Corporation's shareholders.

Holders of material blocks of shares are entitled to make proposals on the GMS agenda items and nominate candidates to the governance and control bodies of the Corporation[4]. Proposals on the agenda of the General Meeting of Shareholders of Sistema are accepted in writing within 100 days of the end of the financial year[5]. Candidates to control and governance bodies of the Corporation are preliminarily interviewed at a meeting of the Nomination, Remuneration and Corporate Governance Committee of the Sistema's Board of Directors.

To ensure the proper observance of the shareholders' right to participate in profits, the Corporation announces in advance the amount of dividends recommended for distribution by the Board of Directors, along with the dividend record date. Therefore, shareholders always have the opportunity to dispose of their shares, taking into account the expected dividend payments.

Dividend Policy

In making its dividend recommendation to the General Meeting of Shareholders, the Board of Directors is guided by the existing dividend policy, which was approved in October 2011. In accordance with this policy, the amount of dividends shall be at least 10% of the Group's net income for the previous financial year under international accounting standards and at least 10% of the net gain from investment transactions made by the Corporation during that period (special dividends). This approach allows the Corporation to distribute dividends in a predictable amount.

General Meetings of Shareholders held in 2014 and their results

Quorum at General Meetings of Shareholders for three years

EGM dated 14/06/2012	76.6%
AGM dated 30/06/2012	81.6%
EGM dated 01/11/2012	79.2%
AGM dated 29/06/2013	83.7%
AGM dated 28/06/2014	82.4%

The Annual General Meeting of Shareholders of Sistema was held on June 28, 2014. The meeting (1) approved the annual report and annual financial statements of the Corporation, including the profit and loss statement, for 2013; (2) determined the amount, procedure, forms and time for payment of dividends on Sistema's shares; (3) elected members to the Board of Directors; (4) elected members to the Audit Commission; (5) approved the Corporation's auditors.

[4] The shareholders holding 10% or more of the Company's voting shares are also entitled to request the convocation of an extraordinary General Meeting of Shareholders.
[5] If an extraordinary General Meeting of Shareholders is conducted and its agenda contains an item on the election of the Board of Directors, holders of sufficient blocks of shares have the right to nominate candidates to the Board of Directors. Written proposals must be received by the Company at least 30 days before the date of the meeting.

In accordance with the resolution adopted by the Annual General Meeting of Shareholders and following the recommendations of the Corporation's Board of Directors, RUB 19,879 mln, was allocated for distribution in the form of dividends, which is equivalent of RUB 2.06 per ordinary share of Sistema. The amount of dividends was determined in accordance with the current dividend policy. The amount of dividend payments increased by 115% against 2013[6].

The Annual General Meeting of Shareholders approved Deloitte & Touche CIS CJSC as the auditor for the 2014 financial statements of Sistema prepared under Russian Accounting Standards and US GAAP. The auditor was selected through an open competitive process organised by the Audit, Finance and Risks Committee of Sistema's Board of Directors.

In 2014, no extraordinary General Meetings of Shareholders were held at Sistema.

Board of Directors

The Board of Directors, which is responsible for strategic management of the Corporation, plays the key role in creating an effective corporate governance system. The Board of Directors defines the strategy, prepares strategic and financial development plans, determines investment principles, assesses the performance of executive management and risks, approves the principles governing the corporate governance procedures, approves transactions and exercises control over the Corporation's activities in general. The competence of the Board of Directors is set forth in the Charter of Sistema.

The members of the Board of Directors of Sistema acting as of December 31, 2014 were elected at the Annual General Meeting of Shareholders of Sistema held on June 28, 2014; the composition of the Board has remained unchanged from the previous period. The Board of Directors includes 13 members. The majority of the Board of Directors is represented by independent directors.

Members of the Board of Directors of Sistema elected on June 28, 2014[7]		
1.	Vladimir Evtushenkov	Chairman of the Board of Directors
2.	Alexander Goncharuk	Deputy Chairman of the Board of Directors Non-executive member
3.	David Yakobachvili	Deputy Chairman of the Board of Directors Independent Director
4.	Sergey Boev	Non-executive member
5.	Brian Dickie	Independent Director
6.	Dmitry Zubov	Non-executive member
7.	Robert Kocharyan	Independent Director
8.	Jeannot Krecké	Independent Director
9.	Peter Mandelson	Independent Director
10.	Munnings Roger	Independent Director
11.	Mark Holtzman	Independent Director
12.	Serge Tchuruk	Independent Director
13.	Mikhail Shamolin	Executive member, President and CEO

Composition of Board of Directors

Independent Directors	61%
Non-executive Directors	31%
Executive Directors	8%

Meetings of the Board of Directors

Meetings of Sistema's Board of Directors are held on a regular basis in accordance with the approved annual work plan. The work plan of the Board of Directors is prepared in according with the strategic planning logic and reporting cycle at Sistema. Additional matters (e.g., transactions) are included in the agenda of scheduled meeting of the Board of Directors as required in the normal course of business. If urgent matters need to be considered, extraordinary meetings shall be held.

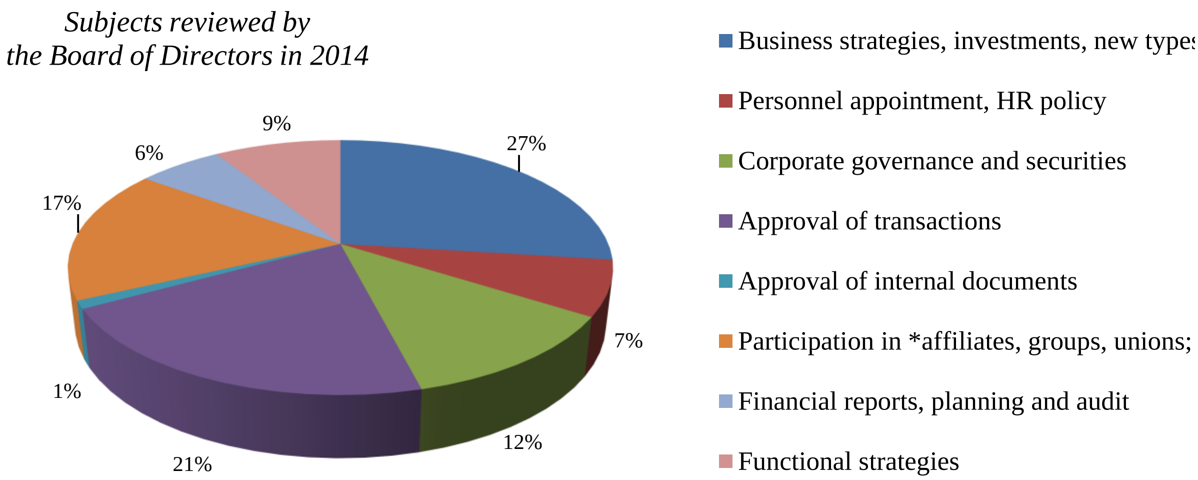
Development of the work plan for the Board of Directors and inclusion of additional matters to this plan falls within the competence of the Chairman of the Board of Directors.

[6] In 2013, RUB 9,264 mln, or RUB 0.96 per share of Sistema, was allocated for payment of dividends

[7] For brief biographical data on the members of the Board of Directors and information about their shareholdings in Sistema, see Annexes.

In 2014, Sistema's Board of Directors held 10 meetings: eight scheduled physical meetings and two unscheduled meetings, one of which was held in the form of absentee voting. In total, the Board of Directors reviewed 100 agenda items in 2014:

	2014	2013
Number of physical meetings held	**9**	8
Number of meeting in the form of absentee voting	**1**	1
Number of matters according to the BoD work plan	**39**	43
Number of matters covered at the BoD meetings	**100**	105



*Subsidiaries

The meeting agenda of Sistema's Board of Directors in 2014 mainly included matters associated with business strategy, approval of transactions (including participation in the capital of portfolio companies) and corporate governance. The focus on these areas by the Board of Directors is due to the nature of the Corporation's activities as an investment company where special attention is required for the strategy and corporate governance of portfolio companies, portfolio strategy, review of new investment opportunities and transactions.

Preparation for the Meetings and Quorum of the Board of Directors

The procedure for preparing and holding meetings of the Board of Directors is aimed at ensuring that the time and expertise of the Board of Directors' members are used with maximum efficiency to make decisions on the Corporation's development. Materials on the agenda items are submitted to the members of Sistema's Board of Directors 10 days before the date of the meeting, which allows them to comfortably determine their position on the voting. The majority of the key agenda items are subject to mandatory preliminary discussion at the meetings of Committees of the Corporation's Board of Directors.

A day before the meeting, members of Sistema's Board of Directors meet with the persons presenting reports and management in informal situation over business dinner where the members of the Board of Directors have the opportunity to clarify the meeting agenda items and obtain information on the preliminary position of voting parties.

Meetings of Sistema's Board of Directors have a high attendance. In 2014, the average quorum at the meetings was 91.5%.

Attendance of the Board of Directors and Committee Meetings by Members of the Board of Directors in 2014[8]

	Board of Directors	Strategy Committee	Audit, Finance and Risks Committee	Nomination, Remuneration and Corporate Governance Committee	Ethics and Control Committee	Investor Relations and Dividend Policy Committee
Attendance of meetings						

[8] The composition of the Board of Directors and its Committees is specified as of December 31, 2014.

V. Evtushenkov	9/10[9]	8/11				
S. Boev	9/10	6/11	10/13		4/7	
A. Goncharuk	7/10	4/11		5/8	3/7	
B. Dickie	10/10	0/3		3/3	7/7	
D. Zubov	10/10			8/8		
P. Kocharyan	10/10	5/8		8/8	6/7	
J. Krecke	10/10			8/8		7/7
P. Mandelson	8/10		11/13			5/7
R. Munnings	10/10		13/13	8/8	7/7	7/7
M. Holtzman	7/10		12/13			5/7
S. Tchuruk	9/10	1/3	2/5		6/7	
M. Shamolin	10/10	10/11		5/5		1/7
D.Yakobachvili	10/10	6/8	13/13			7/7

President and Management Board
The President of Sistema is a permanent sole executive management body, whose main task is to manage the current activities of the Corporation and make resolutions on the matters outside the scope of competence assigned to the General Meeting of Shareholders, the Board of Directors and the Management Board of the Corporation to ensure its profitability and observance of the rights and lawful interests of its shareholders. The President reports to the Corporation's Board of Directors and the General Meeting of Shareholders.

The President of Sistema is Mikhail Shamolin is since March 10, 2011. On March 15, 2014, the Board of Directors passed a resolution on his re-appointment as the Corporation's President for a term of three years.

Mikhail Shamolin President of Sistema, Chairman of the Management Board	Born in 1970 in Moscow. Graduated from Moscow Automobile and Road Construction Institute in 1992. Obtained the second higher education degree at Russian Presidential Academy of State Service in 1993. In 1996-1997 completed a training programme for top managers at Wharton Business School in the field of finance and management. In 1998-2004 worked at international consulting company McKinsey&Co. In 2004-2005 was Managing Director of Ferroalloy Business at Interpipe Corporation (Ukraine). In 2005-2011 occupied the positions of Vice-President for Sales and Customer Service, further, Vice-President – Director of MTS Russia Business Unit and President of MTS OJSC. Was appointed President of Sistema on March 10, 2011, and was re-appointed by the Board of Directors as President, Chairman of the Management Board at JSFC Sistema for three years on March 15, 2014.

The Management Board of Sistema defines the methods for execution of the Corporation's development strategy, prepares development plans, defines and controls the implementation of investment procedures, evaluates staff performance and reviews preliminarily the matters to be submitted for consideration to the Corporation's Board of Directors.

In 2014, the Management Board held 24 meetings where 33 agenda items were reviewed. During the reporting period, the Management Board reviewed the matters in the following main areas:

1) Preliminary review of matters to be included in the agenda of the Board of Directors, in particular:
    - Investment policy of the Corporation and priority investment areas;
    - Development strategy and creation of value for Sistema's key portfolio assets;
    - Internal control and audit;
    - HR policy;
    - Corporate social responsibility.
2) Forecasts and results of implementation of the quarterly, half-year and annual budget.
3) Strategic planning in the Corporation and its subsidiaries, including top level indicators of the strategic planning cycle.
4) Management of debt and borrowings.

[9] The first figure refers to the number of meetings attended by the member of the Board of Directors, the second figure refers to the total number of meetings which could be attended by the member.

5) Risk management and risk map.
6) Monitoring and control of investment projects.

Members of Sistema's Management Board [10]		
1.	Mikhail Shamolin	Chairman of the Management Board President and CEO
2.	Anton Abugov	First Vice-President, Investment portfolio manager
3.	Christopher Alan Baxter	Senior Vice-President, Investment portfolio manager
4.	Elena Vitchak	Vice-President, Head of HR Department
5.	Sergey Drozdov	Senior Vice-President, Head of the Corporate governance division
6.	Felix Evtushenkov	First Vice-President, Investment portfolio manager
7.	Leonid Monosov	Vice-President, Investment portfolio manager
8.	Oleg Mubarakshin	Vice-President, Head of the Legal functional division
9.	Vsevolod Rozanov	Senior Vice-President, Chief Financial Officer
10.	Andrei Terebenin	Senior Vice-President, Investment portfolio manager
11.	Ali Uzdenov	Senior Vice-President, Investment portfolio manager
12.	Michael Hecker	Vice-President, Head of Strategy

After end of the reporting year, Nikolay Vasilkov became a member of the Corporation's Management Board in the position of Vice-President, Head of Strategy Division in February 2015. At the same time, Michael Hecker retired from the Management Board.

Changes in the Top Management in 2014

A number of changes in the top management took place in 2014:

A Buyanov	June 25, 2014	Was relieved of his duties as First Vice-President.
A. Terebenin	May 22, 2014	Was transferred to the position of Senior Vice-President and relieved of his duties as Vice-President. Head of Corporate Communications Division.
A. Chupin	May 7, 2014	Was relieved of his duties as Vice-President.
D. Khidasheli	September 30, 2014	Was relieved of his duties as Vice-President.
M. Hecker	February 12, 2014	Was appointed Vice-President, Head of Strategy Division.
A. Shlyakhturov,=	September 10, 2014	Was transferred to the position of Advisor to the Chairman of the Board of Directors and relieved of his duties as Executive Vice-President, Head of Security and IT Department.
V.S Shukshi	September 10, 2014	Was appointed Executive Vice-President, Head of Security and IT Department.

Internal Control and Audit

The internal control process in the Corporation is realised at all levels of the Corporation's management, including the Board of Directors, Committees of the Board of Directors, management of the Corporation and the Internal Control and Audit Department.

[10] As of December 31, 2014. May 2014, Aleksey Buyanov and Aleksey Chupin retired from the Management Board. For brief biographical data on the members of the Management Board and information about their shareholding in Sistema, see Annexes.

The internal audit processes in the Corporation and Group companies are included in the scope of responsibilities of the Internal Control and Audit Department which functionally reports to the Board of Directors and administratively reports to the President. The Head of the Department is appointed and released from this position by the President based on resolution of the Corporation's Board of Directors after preliminary approval by the Ethics and Control Committee of the Board of Directors. The Department Head is a certified internal auditor with over 15 years of experience in the field.

The key tasks of the Internal Control and Audit Department are:

- provide assistance to the shareholders and management to improve the internal control system by performing regular audits of the internal control, risk management and corporate governance systems in the Corporation;
- contribute to achievement of the Corporation's strategic goals in a most efficient manner;
- provide objective information on the presence and probability of internal risks to the Corporation's management and shareholders;
- increase the level of information on the Sistema Group's performance available to the Corporation's management;
- monitor the achievement of shareholding objectives of the Corporation and Group companies.

To fulfil its key tasks, the Internal Control and Audit Department performs the following functions:

- performs independent audits of certain operations, processes and departments;
- assesses the efficiency of the internal control system;
- assesses the efficiency of the risk management system;
- assesses the efficiency of corporate governance system, including measures to prevent violation of law, requirements of regulatory documents of the company, maintain high professional and ethical standards and develop recommendations for improvement;
- develops recommendations on rectification of any identified deficiencies and controls the rectification process;
- performs expert review and assessment of investment project materials for compliance with current regulatory documents, performs scheduled and unscheduled monitoring over fulfilment of project indicators;
- ensures smooth realisation of the programme for notification about deficiencies and violations;
- administers and conducts investigations;
- verifies compliance with the requirements of internal regulatory documents of the Corporation;
- verifies fulfilment of instructions issued by the Management Board and the President of the Corporation;
- carries control and inspection activities to investigate the facts with attributes of disciplinary violation and/or non-compliance with performance discipline and/or conflict situation in the Corporation and Group companies.

The Internal Control and Audit Department has all the resources and authority required for performance of the above functions.

The Internal Control and Audit Department closely cooperates with external auditors of the Corporation, coordinates the work and provides consultations in the course of preparing the annual audit plan of the Department as related to the assessment of the efficiency of internal control over preparation of financial statements and during discussion and assessment of identified risks.

In 2014, the Internal Control and Audit Department performed 65 scheduled and unscheduled audits to assess the efficiency of internal control and risk management systems. According to the results of audits performed by the Department, no deficiencies or risks which could affect the stability of the Corporation's business in general were found.

Reports on results of activities performed by the Internal Control and Audit Department for H1 2014 and FY2014 were provided to the Audit, Finance and Risks Committee and to the Ethics and Control Committee of Sistema's Board of Directors[11]. The Department's report on the results of 2014 was reviewed by Sistema's Board of Directors.

[11] Joint meeting of Committees.

In December 2014, in accordance with the Listing Rules of the Moscow Exchange, the Corporation's Board of Directors approved the Regulations on Internal Audit in Sistema, which defines the goals, objectives and powers of the Internal Control and Audit Department.

After the end of the reporting period, the Board of Directors approved the Regulations on the Internal Control System in February 2015. This top level document sets forth the main principles of organising internal control as a continuous and integrated process which involves all structural units of the Corporation and its governance bodies. The Regulations on Internal Control System define, in particular, the following:

- tasks and objectives of the internal control system;
- principles of operation of the internal control system;
- structure of the internal control system and a list of units governed by this system;
- distribution of responsibilities and functions between units subject to the regulation by the internal control system (management, Internal Control and Audit Department, Board of Directors and its Committees).

External Audit

In accordance with the resolution made by the Audit and Finance Committee of Sistema's Board of Directors, the Corporation established procedures for selection of external consultants to perform audit of financial and accounting statements of Sistema. The Audit and Finance Committee assesses the quality of auditor services on an annual basis. If the quality of services provided by the current auditor is acknowledged insufficient, the Audit Committee organises a tender for selecting a new auditor. If the quality of services provided by the current auditor is acknowledged satisfactory, negotiations will be held with this auditor regarding the prices of auditing services for the next period. To ensure sufficient degree of objectivity and impartiality of the auditor, the Audit and Finance Committee of Sistema's Board of Directors passed a resolution to hold a tender for auditing services at least once every five years.

Specific Features of the Development of the Corporate Governance System in 2014

In 2014, 13 members were elected to the Corporation's Board of Directors; eight of them meet the independence criteria in accordance with the requirements of Moscow Exchange and Corporate Governance Code of the Russian Federation. In particular, the following independent directors were elected to the Board of Directors:

- David Yakobachvili
- Brian Dickie;
- Robert Kocharyan
- Jeannot Krecke;
- Peter Mandelson;
- Roger Munnings;
- Mark Holtzman;
- Serge Tchuruk.

All the independent directors have vast practical work experience and solid reputation among the international professional community, which means that their judgment in the capacity of members of the Board of Directors will not depend on the influence of management or certain shareholders. One of the members of the Board of Directors has vast experience in the audit of financial statements.
Independent directors constitute the majority in the Board of Directors, which ensures the due level of objectivity and freedom from the influence by the Corporation's executive bodies in the course of decision-making by the Board of Directors.

In June 2014, ordinary shares of the Corporation were included in the first (top) quotation list at Moscow Stock Exchange, thus confirming the fact that the Corporation's shares are ranked among the first class securities in the Russian market, attesting to the high appraisal of Sistema corporate governance standards and granting access to a wider investor base.

In view of the above, the Corporation assumes additional commitments to maintain the corporate governance system at the high level and bring some of its elements in compliance with the new requirements of the Listing Rules of the Moscow Exchange. In December 2014, the Board of Directors approved new revisions of provisions on a number of Committees of the Board of Directors and on the Corporate Secretary and adopted new Regulations on Internal Audit. The changes were made to stipulate the functions of the Committees of the Board of Directors and Corporate Secretary in the Regulations in line with the functions which are directly specified in the Listing Rules and to introduce regulations on the appointment of Head of Internal Control and Audit Department. In the near future, the Corporation also plans to amend the Regulations on the General Meeting of Shareholders and Regulations on the Board of Directors.

In June 2014, the Annual General Meeting of Shareholders approved paument of dividends in the amount of RUB 19,879 mln, which is equivalent to RUB 2.06 per each ordinary share of Sistema and a dividend year of about 5.22% per annum. The amount of dividends was determined in accordance with the current dividend policy, applied by Sistema for the second year in a row.

Remuneration

Remuneration and compensation due to the members of the Board of Directors of Sistema are calculated in accordance with the Regulations on Remuneration and Compensation to be Paid to Members of the Corporation's Board of Directors approved by the resolution of the General Meeting of Shareholders of Sistema on June 30, 2006 (Minutes No. 1-06), including additions introduced by the resolution made by the extraordinary General Meeting of Shareholders of Sistema on February, 16, 2009 (Minutes No. 1-09). These Regulations provide for the following payments to the members of the Board of Directors:

- fixed amounts of compensation for attending meetings of the Board of Directors and Committees, including compensation of expenses associated with attendance of meetings held by the Board of Directors;
- fixed amounts for performance of the functions of Chairman and Deputy Chairman of the Board of Directors and for presiding over the Committees of the Board of Directors;
- based on the annual performance results, the members of the Board of Directors are paid additional remuneration in the form of fixed amount, half of which is paid in the form of shares (USD 250,000-325,000);
- in case of an increase in the capitalisation of the Corporation based on the year end results, the members of the Board of Directors are paid additional remuneration in the amount of 0.1% of the increase in capitalisation.

The Corporation's Regulations on Remuneration and Compensation to be Paid to Members of the Corporation's Board of Directors provides for standard liability insurance for the members of the Board of Directors.

The Corporation does not grant loans to the members of the Corporation's Board of Directors.

The system of short-term (up to one year) incentives for top management of Sistema in 2014 includes the following components:

- monthly base salary determined in accordance with the internal system of positions;
- bonuses paid for implementation of projects and generation of cash profit. The remuneration is paid based on the individual performance of employees and availability of a positive cash flow generated by the projects, Investment Portfolios and functional divisions and department of Sistema. Payments amount to 20% of the realised cash profit exceeding the target profitability.

In 2014, the three-year programme of long-term incentives for top management of Sistema (2012-2014) was completed. Under this programme, the members were allocated the last shares due for distribution for the last programme period.

The long-term financial incentive system for top management of Sistema was extended for another three years (2015-2017). The programme is aimed at increasing the shareholder value of Sistema and create additional basis for maintaining long-term employment and corporate relations between the Corporation and its management.

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

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.

During the calendar year 2014, senior executives of the Corporation were paid a total remuneration of RUB 2,746,764,517 in the form of salary and bonuses. The amount of payments to the specified persons made under the long-term incentive programme in the form of shares in the Corporation was RUB

1,659,419,767 in 2014, including RUB 1,559,140,150 for the years 2013 and 2012 when this programme was in effect.

The remuneration paid to the members of the Board of Directors of Sistema in 2014 amounted to RUB 334,447,900. The members of the Board of Directors also received compensation of their expenses incurred in connection with performance of their duties amounting to RUB 3,608,900.

SISTEMA JSFC
AND SUBSIDIARIES

Consolidated Financial Statements
As of December 31, 2014 and 2013
and for the Years Then Ended

SISTEMA JSFC AND SUBSIDIARIES

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Russia

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INDEPENDENT AUDITORS' REPORT

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

We have audited the accompanying consolidated financial statements of Sistema Joint Stock Financial Corporation and its subsidiaries, which comprise the consolidated statements of financial position as of December 31, 2014 and 2013, and the related consolidated statements of operations and comprehensive income, cash flows and changes in shareholders' equity for the years then ended, and the related notes to the consolidated financial statements and appendix thereto.

Management's Responsibility for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with the Russian Federal Auditing Standards and auditing standards generally accepted in the United States of America. Those standards require that we comply with ethical requirements and plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sistema Joint Stock Financial Corporation and its subsidiaries as of December 31, 2014 and 2013, and the results of their operations and their cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Deloitte & Touche

April 2, 2015
Moscow, Russian Federation

ОБЩЕСТВО
для аудиторских заключений
Россия, г. Москва, ул. Лесная, д. 5

Raikhman M.V., Partner
(Certificate no. 01-00[illegible] dated January 14, 2013)

SISTEMA JSFC AND SUBSIDIARIES

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

	Notes	2014	2013
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents		$ 1,288,722	$ 1,537,492
Short-term investments	8	479,341	1,562,547
Assets from banking activities, current portion (including cash and cash equivalents of $843,715 and $1,132,368)	7	2,180,196	3,898,740
Accounts receivable	9	1,163,092	1,630,593
VAT receivable		236,438	335,289
Inventories and spare parts	11	1,244,509	1,131,302
Deferred tax assets	21	245,571	330,388
Other current assets	10	832,060	1,084,547
Current assets of Bashneft	2	-	3,054,728
Total current assets		7,669,929	14,565,626
NON-CURRENT ASSETS:			
Property, plant and equipment	12	7,191,394	11,151,341
Advance payments for non-current assets		84,560	162,978
Goodwill	13	817,537	1,327,779
Other intangible assets	14	1,721,389	2,162,700
Investments in affiliates	16	356,018	365,266
Assets from banking activities, net of current portion	7	1,374,367	2,554,229
Debt issuance costs		42,267	78,348
Deferred tax assets	21	392,866	297,419
Long-term investments	17	316,625	249,071
Other non-current assets		703,525	714,458
Non-current assets of Bashneft	2	-	9,619,779
Total non-current assets		13,000,548	28,683,368
TOTAL ASSETS		$ 20,670,477	$ 43,248,994

See notes to the consolidated financial statements and appendix thereto.

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

	Notes	2014	2013
LIABILITIES AND EQUITY			
CURRENT LIABILITIES:			
Accounts payable		$ 1,584,251	$ 1,943,133
Liabilities from banking activities, current portion	18	2,180,491	3,864,415
Taxes payable		290,635	490,564
Deferred tax liabilities	21	64,947	114,192
Subscriber prepayments, current portion		390,736	620,281
Accrued expenses and other current liabilities	19	1,315,656	1,567,890
Short-term loans payable		129,938	40,836
Current portion of long-term debt	20	1,598,770	2,102,911
Current liabilities of Bashneft	2	-	2,663,432
Total current liabilities		7,555,424	13,407,654
LONG-TERM LIABILITIES:			
Long-term debt, net of current portion	20	6,534,055	8,375,161
Subscriber prepayments, net of current portion		59,064	101,240
Liabilities from banking activities, net of current portion	18	167,860	772,525
Deferred tax liabilities	21	787,631	902,591
Asset retirement obligations	28	53,715	83,809
Postretirement benefits obligations		45,344	53,943
Property, plant and equipment contributions		41,358	74,174
Other long-term liabilities		475,713	443,032
Non-current liabilities of Bashneft	2	-	3,734,024
Total long-term liabilities		8,164,740	14,540,499
TOTAL LIABILITIES		15,720,164	27,948,153
Commitments and contingencies	30	-	-
Redeemable noncontrolling interests	29	792,766	805,130
SHAREHOLDERS' EQUITY:			
Share capital (9,650,000,000 shares issued; 9,435,902,596 and 9,274,755,045 shares outstanding with par value of 0.09 Russian Rubles, respectively)	24	30,057	30,057
Treasury stock (214,097,404 and 375,244,955 shares with par value of 0.09 Russian Rubles, respectively)		(246,351)	(426,715)
Additional paid-in capital		2,604,913	2,616,608
Retained earnings		4,210,623	8,993,469
Accumulated other comprehensive loss	24	(3,743,402)	(906,718)
Total shareholders' equity		2,855,840	10,306,701
Non-redeemable noncontrolling interests		1,301,707	4,189,010
TOTAL EQUITY		4,157,547	14,495,711
TOTAL LIABILITIES AND EQUITY		$ 20,670,477	$ 43,248,994

See notes to the consolidated financial statements and appendix thereto.

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013
(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	2014	2013
Sales		$ 15,886,775	$ 17,623,153
Revenue from banking activities		698,182	878,832
TOTAL REVENUES		16,584,957	18,501,985
Cost of sales, exclusive of depreciation and amortization shown separately below		(7,460,524)	(7,907,148)
Cost related to banking activities, exclusive of depreciation and amortization shown separately below		(760,084)	(523,960)
Selling, general and administrative expenses		(3,431,075)	(3,896,207)
Depreciation and amortization		(2,292,118)	(2,633,548)
Taxes other than income tax		(193,122)	(239,814)
Equity in results of affiliates		73,124	29,866
Impairment of goodwill	15	-	(258,048)
Impairment of other assets	15	(864,629)	(804,545)
Gain on disposal of investment in RussNeft	4	-	1,200,000
Gain from reentry into Uzbekistan	6	181,305	-
Gain on Bitel case resolution	30	-	371,100
Other operating expenses		(99,385)	(273,109)
OPERATING INCOME		1,738,449	3,566,572
Interest income		212,774	182,447
Interest expense		(811,346)	(960,136)
Change in fair value of derivative instruments		-	30,199
Foreign currency transaction loss		(548,596)	(298,264)
Income before income tax		591,281	2,520,818
Income tax expense	21	(453,417)	(842,107)
Net income excluding Bashneft		137,864	1,678,711
Income of Bashneft operations, net of tax effect of $427,716 and $455,637	2	1,517,054	1,540,489
Loss on deconsolidation of Bashneft, net of tax effect of nil	2	(4,969,011)	-
NET (LOSS) / INCOME		(3,314,093)	3,219,200
Noncontrolling interests		(773,539)	(961,672)
NET (LOSS) / INCOME ATTRIBUTABLE TO SISTEMA JSFC		$ (4,087,632)	$ 2,257,528
Including:			
From continuing operations		(278,161)	1,102,161
From Bashneft operations and its deconsolidation		(3,809,471)	1,155,367
OTHER COMPREHENSIVE (LOSS)/INCOME, NET OF TAX			
Currency translation loss		$ (3,886,388)	$ (885,770)
Unrealized (loss)/gain on available-for-sale securities		(52,099)	32,200
Unrealized gain on derivatives		72,899	45,499
Unrecognized actuarial gain		172	5,310
Other comprehensive (loss)/income, net of tax		(3,865,416)	(802,761)
TOTAL COMPREHENSIVE (LOSS)/INCOME		$ (7,179,509)	$ 2,416,439
Including:			
Attributable to noncontrolling interests		(255,193)	738,912
Attributable to Sistema JSFC		(6,924,316)	1,677,527
Weighted average number of common shares outstanding – basic and diluted		9,350,539,484	9,239,817,019
Earnings per share, basic and diluted, U.S. cent			
(Loss)/earnings per share from continuing operations		(2.98)	11.93
(Loss)/earnings per share from Bashneft operations and its deconsolidation		(40.74)	12.50
Total (loss)/earnings per share attributable to Sistema JSFC shareholders		(43.72)	24.43

See notes to the consolidated financial statements and appendix thereto.

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013
(Amounts in thousands of U.S. dollars)

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net (loss) / income	$ (3,314,093)	$ 3,219,200
Income of Bashneft operations	(1,517,054)	(1,540,489)
Loss on deconsolidation of Bashneft	4,969,011	-
Net income excluding Bashneft	137,864	1,678,711
Adjustments to reconcile net income to net cash provided by operations:		
Depreciation and amortization	2,292,118	2,633,548
Equity in results of affiliates	(73,124)	(29,866)
Deferred income tax expense	36,338	140,292
Foreign currency transaction loss	548,596	298,264
Gain from disposal of investment in RussNeft	-	(1,200,000)
Gain on Bitel case resolution, net of cash received of $125,000	-	(246,100)
Gain on reentry into Uzbekistan	(181,305)	-
Gain on disposal of property, plant and equipment	(26,731)	(7,226)
Gain on disposal of subsidiaries	(139,082)	-
Amortization of connection fees	(23,019)	(60,309)
Allowance for loan losses	260,417	212,081
Dividends received from affiliates	70,369	65,247
Non-cash compensation to employees	79,430	54,158
Impairment of goodwill	-	258,048
Impairment of other assets	864,629	804,545
Other non-cash items	19,937	(15,057)
Changes in operating assets and liabilities, net of effects from purchases of businesses:		
Trading securities	267,153	(406,687)
Accounts receivable	(44,241)	(240,586)
VAT receivable	(17,192)	(174,951)
Inventories and spare parts	(490,362)	(171,320)
Other current assets	(114,574)	(93,381)
Accounts payable	560,603	533,948
Subscriber prepayments	(11,593)	110,112
Taxes payable	(5,394)	109,503
Accrued expenses and other current liabilities	281,592	(54,127)
Net cash from operating activities excluding Bashneft	4,292,429	4,198,847
Net cash from operating activities of Bashneft	2,755,291	2,629,988
Net cash provided by operating activities	7,047,720	6,828,835
CASH FLOWS FROM INVESTING ACTIVITIES:		
Payments for purchases of property, plant and equipment	(2,362,652)	(2,455,276)
Proceeds from sale of property, plant and equipment	80,332	39,592
Payments for purchases of intangible assets	(539,930)	(539,117)
Payments for businesses, net of cash acquired	(392,409)	(34,664)
Proceeds from sale of subsidiaries, net of cash disposed	150,000	561,402
Purchase of investments in affiliated companies	(201,582)	(63,753)
Payments for purchases of long-term investments	(836,916)	(105,000)
Proceeds from sale of long-term investments	511,227	1,286,292
Payments for purchases of short-term investments	(1,327,702)	(1,337,304)
Proceeds from sale of short-term investments	1,622,718	1,047,317
Payments for purchases of other non-current assets	-	(44,879)
Increase in restricted cash	-	(15,819)
Net decrease/(increase) in loans to customers of the banking segment	664,089	(70,458)
Net cash used in investing activities excluding Bashneft	(2,632,825)	(1,731,667)
Net cash used in investing activities of Bashneft (net of cash disposed of $961,733)	(3,256,540)	(1,158,995)
Net cash used in investing activities	$ (5,889,365)	$ (2,890,662)

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013 (CONTINUED)
(Amounts in thousands of U.S. dollars)

	2014	2013
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from/(principal payments on) short-term borrowings, net	$ 185,838	$ (231,036)
Net decrease in deposits from customers of the banking segment	(701,620)	(177,105)
Proceeds from long-term borrowings	2,850,171	1,900,322
Principal payments on long-term borrowings	(2,274,350)	(2,539,405)
Acquisition of noncontrolling interests in existing subsidiaries	(67,432)	(299,184)
Dividends paid	(1,198,028)	(1,225,440)
Proceeds from capital transactions with shares of existing subsidiaries	41,141	69,002
Net cash used in financing activities excluding Bashneft	(1,164,280)	(2,502,846)
Net cash provided by/(used in) financing activities of Bashenft	885,338	(580,164)
Net cash used in financing activities	(278,942)	(3,083,010)
Effect of foreign currency translation on cash and cash equivalents	(1,938,436)	(293,247)
Net (decrease)/increase in cash and cash equivalents	(1,059,023)	561,916
Cash and cash equivalents at the beginning of the year, including Bashneft	3,191,460	2,629,544
Cash and cash equivalents at the end of the year, including Bashneft	2,132,437	3,191,460
Less: cash and cash equivalents of Bashneft at the end of the year	-	(521,600)
Cash and cash equivalents at the end of the year	$ 2,132,437	$ 2,669,860
Comprising:		
Non-banking activities	1,288,722	1,537,492
Banking activities	843,715	1,132,368
CASH PAID DURING THE YEAR FOR:		
Interest, net of amounts capitalized	$ (876,692)	$ (1,160,300)
Income taxes	(377,298)	(735,797)
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Acquisition of intangible assets	-	670,300
Equipment and licenses acquired under capital leases	203,904	223,628
Amounts owed for capital expenditures	401,206	124,826
Payables related to business acquisitions	1,760	345

See notes to the consolidated financial statements and appendix thereto.

SISTEMA JSFC AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2014 AND 2013
(Amounts in thousands of U.S. dollars, except share amounts)

	Share capital		Treasury stock		Additional paid-in	Retained	Accumulated other compre-hensive	Shareholders'	Non-redeemable non-controlling		Redeemable non-controlling
	Shares	Amount	Shares	Amount	capital	earnings	Loss	equity	interests	Total equity	interests
Balances at January 1, 2013	**9,650,000,000**	**30,057**	**(440,425,038)**	**(501,109)**	**2,859,491**	**7,110,467**	**(326,717)**	**9,172,189**	**4,109,505**	**13,281,694**	**731,661**
Net income/(loss)	-	-	-	-	-	2,257,528	-	2,257,528	1,021,588	3,279,116	(59,916)
Other comprehensive (loss)/income	-	-	-	-	-	-	(580,001)	(580,001)	(229,192)	(809,193)	6,432
Settlements under long-term motivation program	-	-	65,180,083	74,394	(13,262)	-	-	61,132	-	61,132	-
Accrued compensation cost	-	-	-	-	54,158	-	-	54,158	-	54,158	-
Business combinations, disposals and capital transactions of subsidiaries	-	-	-	-	(283,779)	-	-	(283,779)	237,429	(46,350)	27,547
Change in fair and redemption value of noncontrolling interests	-	-	-	-	-	(99,406)	-	(99,406)	-	(99,406)	99,406
Dividends declared by Sistema JSFC	-	-	-	-	-	(275,120)	-	(275,120)	-	(275,120)	-
Dividends declared by subsidiaries	-	-	-	-	-	-	-	-	(950,320)	(950,320)	-
Balances at December 31, 2013	**9,650,000,000**	**30,057**	**(375,244,955)**	**(426,715)**	**2,616,608**	**8,993,469**	**(906,718)**	**10,306,701**	**4,189,010**	**14,495,711**	**805,130**
Net (loss)/income	-	-	-	-	-	(4,087,632)	-	(4,087,632)	852,476	(3,235,156)	(78,937)
Other comprehensive (loss)/income	-	-	-	-	-	-	(5,128,557)	(5,128,557)	(974,348)	(6,102,905)	(54,384)
Settlements under long-term motivation program	-	-	122,129,298	132,811	(141,239)	-	-	(8,428)	-	(8,428)	-
Accrued compensation cost	-	-	-	-	79,430	-	-	79,430	-	79,430	-
Business combinations, disposals and capital transactions of subsidiaries	-	-	39,018,253	47,553	50,114	-	-	97,667	(491,574)	(393,907)	-
Change in fair and redemption value of noncontrolling interests	-	-	-	-	-	(120,957)	-	(120,957)		(120,957)	120,957
Dividends declared by Sistema JSFC	-	-	-	-	-	(574,257)	-	(574,257)		(574,257)	-
Dividends declared by subsidiaries	-	-	-	-	-	-	-	-	(889,068)	(889,068)	-
Deconsolidation of Bashneft	-	-	-	-	-	-	2,291,873	2,291,873	(1,384,789)	907,084	
Balances at December 31, 2014	**9,650,000,000**	**30,057**	**(214,097,404)**	**(246,351)**	**2,604,913**	**4,210,623**	**(3,743,402)**	**2,855,840**	**1,301,707**	**4,157,547**	**792,766**

See notes to the consolidated financial statements and appendix thereto.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

1. BASIS OF PREPARATION

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

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

Below are the Group’s significant entities and their principal activities as of December 31, 2014:

			Beneficial ownership as of December 31,	
Significant entities	**Short name**	**Principal activity**	**2014**	**2013**
Sistema Joint Stock Financial Corporation	Sistema	Investing and financing		
Mobile TeleSystems	MTS	Telecommunications	53%	53%
Sistema Shyam TeleServices Limited	SSTL	Telecommunications	57%	57%
MTS Bank	MTS Bank	Banking	87%	87%
RTI	RTI	Technology	85%	85%
Detsky mir-Center	Detsky mir	Retail trading	99%	100%
Medsi	Medsi	Healthcare services	75%	75%
Targin	Targin	Oilfield services	100%	100%
Bashkirian Power Grid Company (Note 5)	BPGC	Energy transmission	91%[1]	79%[1]
LesInvest (Note 3)	LesInvest	Timber	100%	-
Leader-Invest	Leader-Invest	Real estate	100%	100%

[2] Voting interests as of December 31, 2014 and 2013 – 93%.

The accompanying consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (“U.S. GAAP”). The Group’s entities maintain accounting records in the local currencies of the countries of their domicile in accordance with the requirements of respective accounting and tax legislation. The accompanying financial statements differ from the financial statements prepared for statutory purposes in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the accounting books of the Group’s entities.

In determining and applying accounting policies, judgement is often required in respect of items where the choice of specific policy, accounting estimate or assumption could materially affect the reported results of operations or financial position of the Group.

Management considers that certain accounting estimates and assumptions relating to business combinations and disposals, property, plant and equipment, intangible assets and goodwill, provisions and contingent liabilities and impairment are the Group’s critical accounting estimates.

A discussion of these estimates together with the summary of the Group’s significant accounting policies is provided in appendix A1 to the notes to these consolidated financial statements.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

2. DECONSOLIDATION OF BASHNEFT

In September 2014, a civil claim was filed with the Moscow Court of Arbitration by the Prosecutor General's Office of the Russian Federation seeking the transfer to the Russian Federation of all shares in Bashneft held by the Group. The civil claim asserted that the transfer of Bashneft from the property of the Russian Federation into the property of Bashkortostan in 1992-1993 had been unlawful, as no requisite consent had been obtained from the federal authorities, and therefore all subsequent transactions with Bashneft shares should be considered null and void. In November 2014, the court ruled in favour of the plaintiff and ordered the transfer of the Bashneft shares held by the Group to the Russian Federation. The transfer of the shares took place in December 2014.

The Group deconsolidated Bashneft in December 2014 and recognized a loss upon loss of control, measured as the difference between the carrying amount of noncontrolling interests in the former subsidiary (including accumulated other comprehensive income attributable to the noncontrolling interests) at the date Bashneft was deconsolidated and the carrying amount of its assets and liabilities. The Group also removed the amount previously accumulated in the translation adjustment component of equity and attributable to Bashneft and reported it as part of the loss on transfer of Bashneft shares to the Russian Federation.

The loss on deconsolidation of Bashneft recognized in the consolidated statement of operations and comprehensive income for the year ended December 31, 2014 is measured as follows:

Net assets as at deconsolidation date	$	4,061,927
Noncontrolling interests		(1,384,789)
Accumulated currency translation adjustment		2,291,873
Loss on deconsolidation of Bashneft		4,969,011
Tax effect		-
Loss on deconsolidation of Bashneft, net of tax	$	**4,969,011**

Bashneft results were separately presented in the consolidated statements of operations and comprehensive income for the years ended December 31, 2014 and 2013 as follows:

		2014		2013
Revenues	$	16,224,383	$	17,783,111
Income from Bashneft, before income taxes		1,944,770		1,996,126
Income tax expense		(427,716)		(455,637)
Income from Bashneft, net of tax effect		1,517,054		1,540,489

(Amounts in thousands of U.S. dollars, unless otherwise stated)

Additionally, the assets and liabilities pertaining to Bashneft have been presented separately within the consolidated statement of financial position as of December 31, 2013 as follows:

Cash and cash equivalents	$	625,417
Accounts receivable		593,016
Inventories and spare parts		716,847
Other current assets		2,659,069
Intragroup balances		(1,539,621)
Current assets of Bashneft		**3,054,728**
Property, plant and equipment		8,794,360
Other non-current assets		941,695
Intragroup balances		(116,276)
Non-current assets of Bashneft		**9,619,779**
Accounts payable		(1,351,326)
Debt, current portion		(367,147)
Other current liabilities		(1,096,320)
Intragroup balances		151,361
Current liabilities of Bashneft		**(2,663,432)**
Debt, long-term portion		(2,419,639)
Other long-term liabilities		(1,344,437)
Intragroup balances		30,052
Long-term liabilities of Bashneft	$	**(3,734,024)**

The Group retains no continuing involvement with Bashneft after it has been deconsolidated, other than routine transactions in the normal course of business.

In December 2014, the Group filed a claim with the Moscow Court of Arbitration for the recovery of RUB 70.7 billion losses from Ural-Invest, a legal successor of the seller of the Bashneft shares to the Group. In February 2015, the court upheld the Group's claim. In March 2015, the Group and Ural-Invest signed a settlement agreement. In accordance with its terms, all assets owned by Ural-Invest of RUB 46.5 billion, will be transferred to the Group, which will invest RUB 4.6 billion of this amount into the projects of Ural charitable fund. In March 2015 the Moscow Court of Arbitration approved the settlement agreement between the Group and Ural-Invest. The transfer of assets did not occur as of the date of the issuance of the consolidated financial statements and therefore the Group did not recognize the gain in the consolidated statement of operations and comprehensive income.

3. Business combinations

Business combinations in 2014

LesInvest – In September 2014, LesInvest, a wholly owned subsidiary of the Group, acquired 100% of the share capital of OJSC Segezha Pulp and Paper Mill and LLC Derevoobrabotka-Proekt (together with their subsidiaries – "LesInvest Group"), a leading manufacturer of sack paper and paper sacks and exporter of timber products and ply wood, for a total cash consideration of $287 million. The Group sees high growth potential for the LesInvest Group business, to be unlocked by improving operating efficiency and upgrading production facilities. The following table summarizes consideration paid and the amounts of the assets acquired and liabilities assumed that were recognized at the acquisition date:

Property, plant and equipment	**$**	110,917
Inventories		109,876
Deferred tax assets		76,047
Other assets		117,367
Accounts payable and other liabilities		(127,000)
Cash consideration paid	**$**	**287,207**

(Amounts in thousands of U.S. dollars, unless otherwise stated)

The purchase price allocation of LesInvest Group was not finalized as of the date of these consolidated financial statements, as the Group had not completed the valuation of individual assets and liabilities of LesInvest Group. The Group's consolidated financial statements reflect the allocation of the purchase price based on a preliminary fair value assessment of the assets acquired and liabilities assumed.

Other acquisitions – The information on other business combinations which took place in 2014 is summarized below:

Acquiree	**Principal activity**	**Date of acquisition**	**Interest acquired**	**Acquiring segment**	**Purchase price**
SMARTS-Ivanovo	Mobile operator	December	100%	MTS	7,480
SMARTS-Ufa	Mobile operator	December	100%	MTS	7,040
Penza-GSM	Mobile operator	December	100%	MTS	34,121
Step Group	Grain production	December	85%	Corporate	63,965
Total					**$ 112,606**

The following table summarizes the amounts of the assets acquired and liabilities assumed relating to such acquisitions at the acquisition date:

Current assets	$	25,935
Property, plant and equipment		78,467
Rights to use radio frequencies		25,759
Goodwill		29,247
Other non-current assets		5,061
Current liabilities		(32,722)
Non-current liabilities		(9,546)
Noncontrolling interests		(9,595)
Purchase price	$	**112,606**

The purchase price allocations of SMARTS-Ivanovo**,** SMARTS-Ufa and Penza-GSM were not finalized as of the date of these financial statements as the Group had not completed the valuation of the individual assets of each entity. The Group's consolidated financial statements reflect the allocation of the purchase price based on a preliminary fair value assessment of the assets acquired and liabilities assumed. The excess of the consideration paid over the value of net assets in the amount of $29 million was preliminarily allocated to goodwill which was attributable to the MTS segment. Goodwill is mainly attributable to the expected synergies from combining the operations of MTS and acquired companies.

In December 2014, Krasnodar Agro, a wholly owned subsidiary of the Group, acquired 85% of the voting shares of the five grain producers in Krasnodar region (Step Group).

Pro forma results of operations (unaudited)

The following pro forma financial data for the years ended December 31, 2014 and 2013 give effect to the acquisition of LesInvest Group as if it had occurred as of January 1, 2013:

		2014		**2013**
Revenues	$	17,130,212	$	19,199,485
Net income		(3,346,547)		3,052,629

(Amounts in thousands of U.S. dollars, unless otherwise stated)

The pro forma information is based on various assumptions and estimates. The pro forma information is neither necessarily indicative of the operating results that would have occurred if the Group acquisitions had been consummated as of January 1, 2013, nor is it necessarily indicative of future operating results. The pro forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions. The actual results of operations of these companies are included into the consolidated financial statements of the Group only from the respective dates of acquisition.

The following amounts of revenue and earnings of LesInvest Group since the acquisition date in September 2014 are included into the consolidated statement of operations and comprehensive income for the year ended December 31, 2014:

		2014
Net revenues	$	151,227
Net income		14,178

The results of operations of other acquired businesses have not been included because the effects of these business combinations, individually and in aggregate, were not material to the Group's consolidated results of operations.

Business combinations in 2013

SITRONICS-Nano – In May 2013, the Group acquired an additional 12.3% ownership interest in SITRONICS-Nano, previously an affiliate, from RUSNANO for cash consideration of RUB 2 billion ($61.1 million at the acquisition date) increasing its voting interest to 62.1%. Simultaneously, the Group and RUSNANO amended existing call and put option agreements. Under the amended agreements, the Group had a call option to acquire RUSNANO's shares in Sitronics-Nano for RUB 6.1 billion plus 7.63% p.a. at any time till November 1, 2017. RUSNANO had a put option to sell its remaining shares in SITRONICS-Nano for RUB 8.1 billion not earlier than October 31, 2016 and not later than November 1, 2017. This acquisition allowed the Group to secure its rights for use of 180 and 90 nanometre equipment that has been leased from SITRONICS-Nano.

As a result of the transactions, the Group obtained control over SITRONICS-Nano and accounted for this business combination by applying the acquisition method. The following table summarizes the consideration paid for SITRONICS-Nano and the assets acquired and liabilities assumed recognized at the acquisition date, as well as the fair value of the noncontrolling interests in the investee:

Current assets	$	73,231
Net investment in the lease		518,916
Current liabilities		(76,700)
Non-current liabilities		(18,829)
Noncontrolling interests		(187,164)
		309,454
Fair value of previously held interest		(248,309)
Cash consideration	**$**	**61,145**

As part of this business combination, the Group recognised a revaluation gain resulting from the remeasurement of its previously held interest. The difference in the amount of $22.4 million between the fair value of previously held interest and the carrying value of the Group's investment has been recorded within other operating expenses, net in the consolidated statement of operations and comprehensive income. The fair value of previously held interest and the noncontrolling interests in SITRONICS-Nano were estimated based on the amount of consideration in the transaction described above.

In May 2014, following the issuance of additional shares in Mikron, a subsidiary of RTI, such put and call option agreements between the Group and ROSNANO were amended (Note 5).

4. DISPOSALS

Disposals in 2014

NIIDAR-Nedvizhimost – In 2014, the Group sold its 100% interest in NIIDAR-Nedvizhimost, a subsidiary of RTI which managed rental property, for a total cash consideration of $150.0 million. As a result of this transaction, the Group recognized gain on disposal of subsidiaries of $139.1 million, included in other operating expenses in the consolidated statement of operations and comprehensive income.

Disposals in 2013

SG-trans – During 2013, the Group completed a reorganisation of its transportation assets. As a result of the reorganization, SG-trans, which was acquired in 2012 was split into two legal entities: SG-trading which comprised the non-core non-transportation assets and SG-trans which retained all the core transport assets. In April 2013 the Group sold a 70% stake in SG-trans to Financial Alliance, an affiliate of the Group, for cash consideration of RUB 12 billion ($380.2 million at the disposal date), thereby reducing its direct ownership in SG-trans from 100% to 30%.

Upon disposal, the Group deconsolidated SG-trans and accounted for its remaining interest using the equity method. As a result of the transaction, the Group recognized a gain of $4.0 million in the consolidated statement of operations and comprehensive income.

In July 2013, the Group further sold additional 15% of SG-trans to Unirail, a shareholder of Financial Alliance, for a cash consideration of RUB 2.5 billion ($76.4 million) with no gain or loss recognized as a result of this transaction.

RussNeft – In July 2013, the Group sold its 49% stake in RussNeft, the Group’s affiliate, for cash consideration of $1,200 million. Prior to the disposal, the Group has been accounting for this investment using the equity method. As of the disposal date, the carrying value of the Group’s investment in RussNeft was nil. Accordingly, the Group recognized a $1,200 million gain on this disposal being the difference between the consideration received and the carrying value of investment disposed.

5. CAPITAL TRANSACTIONS OF SUBSIDIARIES

Transactions in 2014

MTS Bank – In December 2014, the Group participated in additional share issue of MTS Bank for $309.0 million. The transaction resulted in no change in noncontrolling interests and additional paid-in capital.

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

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

NVision – In January 2014, the Group acquired an additional 38.75% stake in NVision from minority shareholders for $82.5 million, $37.5 million of which was paid in cash and $45.0 million in the Company's treasury shares. Upon completion of this transaction, the Group's ownership in NVision was 88.75%. The transaction was accounted for directly in equity and resulted in an increase of noncontrolling interests by $42.0 million and a decrease of additional paid-in capital by $121.8 million. In December 2014, the Group acquired the remaining 11.25% stake in NVision for approximately $10.0 million. The transaction was accounted for directly in equity and resulted in a decrease of noncontrolling interests by $13.8 million and a decrease of additional paid-in capital by $24.0 million.

Transactions in 2013

Business-Nedvizhimost – In December 2013, MTS sold a 51% stake in Business-Nedvizhimost to the Company for RUB 3.2 billion ($98.5 million as of the transaction date). This transfer of ownership interest within the Group resulted in an increase of noncontrolling interests and a decrease of additional paid-in capital by $42.7 million.

RTI – In December 2013, RTI issued 4,687,500,000 common shares with par value of 1 Russan ruble which were acquired by existing shareholders, the Company and the Bank of Moscow, for cash consideration of RUB 6.0 billion ($183.9 million as of the purchase date) in proportion to their existing ownership interests. The Bank of Moscow received a put option to sell its 703,125,000 shares acquired upon their issuance to the Group at a price of $27.5 million plus 8.25% p.a. not earlier than December 26, 2016 and not later than December 26, 2018. As a result of this put option, the Group classified the underlying noncontrolling interests as redeemable.

Targin – In September 2013, the Company acquired a 100% stake in Bashneft Services Assets, (renamed to Targin in July 2014) from Bashneft for RUB 4.1 billion ($126.8 million as at transaction date). This transfer of ownership interest within the Group resulted in a decrease of noncontrolling interests and an increase of additional paid-in capital by $24.4 million.

MTS – In September-December 2013, the Group acquired 0.6% of MTS ordinary shares on the open market for $120.0 million. The transaction was accounted for directly in equity and resulted in a decrease of noncontrolling interests by $23.0 million and a decrease of additional paid-in capital by $97.0 million.

Detsky mir – In September 2013, Detsky mir purchased 25%+1 of its own shares from Sberbank for cash consideration of $140.0 million. The transaction was accounted for directly in equity and resulted in a decrease of noncontrolling interests by $5.4 million and a decrease of additional paid-in capital by $134.6 million. The Group took a long-term loan from Sberbank to fund the purchase. Simultaneously the Group has pledged these shares to Sberbank as security against the loan.

SITRONICS-N – In September 2013, the Group undertook restructuring of certain RTI assets. Upon completion of a series of transactions, SITRONICS, a subsidiary of RTI, spun off two companies, SITRONICS-N and RTI Microelectronics, with allocation of all its major assets and liabilities to these companies. To complete the restructuring process a 100% stake in SITRONICS was sold to SITRONICS-N for 1 RUB. In October 2013, the Company acquired a 100% stake in SITRONICS-N from RTI for RUB 1.0 billion ($31.0 million as at transaction date). This transaction resulted in an increase of noncontrolling interests and a decrease of additional paid-in capital by $11.0 million.

Mikron – In August 2013, Mikron issued 691,962 ordinary shares which were purchased by the RF for cash consideration of RUB 465 million ($14.1 million). This transaction was accounted for directly in equity and resulted in an increase of noncontrolling interests by $5.2 million and an increase of additional paid-in capital by $8.9 million.

MTS Bank – In April 2013, MTS acquired a 25.0945% stake in MTS Bank through the purchase of its additional share issuance for RUB 5 billion ($123 million). Upon completion of the transaction, the Group's effective ownership in MTS Bank decreased from 99% to 87%. This transfer of ownership interest within the Group resulted in an increase of noncontrolling interests and a decrease of additional paid-in capital by $105 million.

Capital transactions of Bashneft and its subsidiaries

UPC – In September 2014, the Group terminated a contract for the acquisition of a 98% stake in UPC from Bashneft. As a consequence of this transaction, Bashneft obtained control over UPC. This resulted in the Group's ownership in UPC decreasing from 99.0% to 78.0% and the Group's ownership in Ufaorgsintez decreasing from 86.5% to 78.7%. These transactions resulted in an increase of noncontrolling interests in the amount of $4.8 million and a decrease of additional paid-in capital by $20.9 million.

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

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

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

UPC – In September 2013, the Company acquired a 98% stake in United Petrochemical Company ("UPC") from Bashneft for RUB 6.2 billion ($192.0 million as at transaction date), which resulted in a decrease of noncontrolling interests and an increase of additional paid-in capital by $41.4 million.

6. REENTRY into UZBEKISTAN

Following unsuccessful tenders on sale of Uzdunrobita equipment, the representatives of the Republic of Uzbekistan and MTS commenced negotiations in relation to the return of MTS to the market. In July 2014, MTS signed a settlement agreement with the Republic of Uzbekistan eliminating all mutual claims ("Settlement Agreement"). International arbitration proceedings between MTS and the Republic of Uzbekistan in the International Center for Settlement of Investment Disputes, Member of the World Bank Group (ICSID), were discontinued following the submission of a joint application by the both parties.

The government authorities provided certain guarantees to MTS in relation to the protection of any future investment in the Republic of Uzbekistan to encourage the return of MTS to the market. Also, the Republic of Uzbekistan established a legal entity, Universal Mobile Systems LLC ("UMS"), with such entity having no legal connection to the previously liquidated entity, Uzdunrobita. UMS was granted 2G, 3G and LTE licenses and received frequencies, numbering capacity and other permits required for the launch of operations.

In September 2014, a 50.01% ownership interest in UMS was transferred to the Group by a state-owned enterprise established and managed by the State committee for communications, development of information systems and telecommunications technologies of the Republic of Uzbekistan, which retained the remaining 49.99% in UMS.The Group concluded that, upon receiving the 50.01% ownership interest, the Group obtained control over UMS and consolidated the entity. The Group estimated the fair value of the entity's assets and liabilities, as well as the noncontrolling interests in UMS as of the date of the transfer, and recognized a gain from reentry into Uzbekistan pursuant to the Settlement Agreement in the amount of $181 million.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

The Group has determined that the Settlement Agreement primarily addressed two separate elements – the elimination of all mutual claims and guarantees granted to MTS in connection with its reentry into the Republic of Uzbekistan. The Group concluded that the aforementioned consideration of $181 million related to, in its entirety, a financial incentive to encourage the reentry into the Republic of Uzbekistan and as such, recognition in continuing operations was appropriate. No element was allocated to the non-satisfaction and elimination of mutual claims as this was deemed to have minimal value.

The following table summarizes the amounts of the assets and liabilities recognized at the date of obtaining control, as well as the fair value of the noncontrolling interests at that date:

Property, plant and equipment	$	119,211
Intangible assets		132,333
Other non-current assets		31,610
Noncontrolling interests		(101,849)
Gain from reentry into Uzbekistan	$	**181,305**

7. Assets from banking activities

Assets from banking activities, net of an allowance for loan losses, as of December 31, 2014 and 2013 consisted of the following:

		2014		2013
Cash and cash equivalents	$	843,715	$	1,132,368
Loans to customers		2,597,696		4,842,982
Investments in securities (trading)		368,567		551,513
Loans to banks		131,919		161,229
Investments in securities (available-for-sale)		87,652		154,356
Other investments		85,956		127,096
Less: allowance for loan losses		(560,942)		(516,575)
Assets from banking activities, net		3,554,563		6,452,969
Less: amounts maturing after one year		(1,374,367)		(2,554,229)
Assets from banking activities, current portion	**$**	**2,180,196**	**$**	**3,898,740**

Major categories of loans to customers as of December 31, 2014 and 2013 comprise the following:

		2014		2013
Corporate customers	$	1,294,744	$	2,739,345
Individuals		1,302,952		2,103,637
Total	**$**	**2,597,696**	**$**	**4,842,982**

As of December 31, 2014, 79.7% and 0.6% of the balance of loans to corporate customers and individuals, respectively, were evaluated individually for impairment (2013: 80.0% and 0.5%).

The following table presents the effective average interest rates by category of loans as of December 31, 2014 and 2013:

	2014			2013		
	RUB	USD	Other	RUB	USD	Other
Loans to customers						
- corporate customers	10.5%	8.8%	9.2%	10.8%	7.0%	9.8%
- individuals	19.0%	4.4%	6.5%	23.4%	8.3%	4.2%
Loans to banks	7.9%	0.01%	0.01%	4.5%	0.1%	0.1%

(Amounts in thousands of U.S. dollars, unless otherwise stated)

The movement in the allowance for loan losses in 2014 and 2013 was as follows:

	2014	2013
Allowance for loan losses, beginning of the year	$ 516,575	$ 329,803
Additions charged to operating results less recovery of allowance	423,121	248,032
Amounts written off against the allowance	(162,705)	(37,185)
Currency translation adjustment	(216,049)	(24,075)
Allowance for loan losses, end of the year	**$ 560,942**	**$ 516,575**

8. SHORT-TERM INVESTMENTS

Short-term investments as of December 31, 2014 and 2013 consisted of the following:

	2014	2013
Bank deposits with original maturities exceeding three months	$ 202,644	$ 647,077
Trading securities	97,550	499,437
Available-for-sale securities	74,149	354,838
Promissory notes and loans	104,998	61,195
Total	**$ 479,341**	**$ 1,562,547**

Promissory notes and loans to third parties are primarily denominated in USD and bear interest rates varying from 4.0% to 6.0% as of December 31, 2014.

The effective interest rates on bank deposits with original maturities exceeding three months as of December 31, 2014 are between 1.0% and 5.3% (December 31, 2013: 4.2% and 14.0%).

9. ACCOUNTS RECEIVABLE

Accounts receivable, net of provision for doubtful accounts, as of December 31, 2014 and 2013 consisted of the following:

	2014	2013
Trade receivables	$ 1,246,580	$ 1,808,403
Less: provision for doubtful accounts	(83,488)	(177,810)
Total	**$ 1,163,092**	**$ 1,630,593**

Write-off of trade receivables against provision for doubtful accounts in 2014 and 2013 amounted to $134.7 million and $96.5 million respectively.

10. Other current assets

Other current assets as of December 31, 2014 and 2013 consisted of the following:

	2014	2013
Prepaid expenses and other receivables	$ 564,594	$ 763,791
Tax advances and overpayments	121,360	136,164
Advances paid to third parties	242,184	246,727
	928,138	**1,146,682**
Less: provision for doubtful accounts	(96,078)	(62,135)
Total	**$ 832,060**	**$ 1,084,547**

(Amounts in thousands of U.S. dollars, unless otherwise stated)

11. INVENTORIES and spare parts

Inventories and spare parts as of December 31, 2014 and 2013 consisted of the following:

	2014	2013
Finished goods and goods for resale	$ 405,243	$ 593,500
Raw materials and spare parts	232,248	377,292
Work-in-progress	89,506	151,434
Costs and estimated earnings in excess of billings on uncompleted contracts	531,052	116,984
	1,258,049	**1,239,210**
Less: long-term portion	(13,540)	(107,908)
Total	**$ 1,244,509**	**$ 1,131,302**

12. PROPERTY, PLANT AND EQUIPMENT

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

	2014	2013
Switches, transmission devices, network and base station equipment	$ 9,066,682	$ 14,083,007
Buildings and leasehold improvements	1,392,585	2,166,179
Power and utilities	496,303	760,686
Other plant, machinery and equipment	1,495,420	2,620,291
Construction in progress and equipment for installation	897,260	1,576,285
Land	148,238	160,973
	13,496,488	**21,367,421**
Less: accumulated depreciation	(6,305,094)	(10,216,080)
Total	**$ 7,191,394**	**$ 11,151,341**

Depreciation expense for the years ended December 31, 2014 and 2013 amounted to $1,778.6 million and $2,089 million respectively.

Impairments of property, plant and equipment for the years ended December 31, 2014 and 2013 amounted to $290.4 million and $285.9 million respectively (Note 15).

(Amounts in thousands of U.S. dollars, unless otherwise stated)

13. GOODWILL

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

	MTS	SSTL	RTI	MTS Bank	Other	Total
Balance as of January 1, 2013						
Gross amount of goodwill	1,441,836	339,059	278,449	67,919	95,636	2,222,899
Accumulated impairment loss	(48,261)	(339,059)	-	(67,919)	-	(455,239)
	$ 1,393,575	**$ -**	**$ 278,449**	**$ -**	**$ 95,636**	**$ 1,767,660**
Impairment (Note 15)	-	-	(258,048)	-	-	(258,048)
Disposals	(722)	-	-	-	(67,816)	(68,538)
Currency translation adjustment	(93,958)	-	(17,210)	-	(2,127)	(113,295)
Balance as of December 31, 2013						
Gross amount of goodwill	1,343,717	300,047	254,291	63,068	25,693	1,986,816
Accumulated impairment loss	(44,822)	(300,047)	(251,100)	(63,068)	-	(659,037)
	$ 1,298,895	**$ -**	**$ 3,191**	**$ -**	**$ 25,693**	**$ 1,327,779**
Business combinations (Note 3)	29,247	-	-	-	-	29,247
Currency translation adjustment	(524,502)	-	(1,335)	-	(13,652)	(539,489)
Balance as of December 31, 2014						
Gross amount of goodwill	829,716	293,424	147,937	36,691	12,041	1,319,809
Accumulated impairment loss	(26,076)	(293,424)	(146,081)	(36,691)	-	(502,272)
	$ 803,640	**$ -**	**$ 1,856**	**$ -**	**$ 12,041**	**$ 817,537**

14. OTHER INTANGIBLE ASSETS

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

	2014			2013		
	Gross carrying value	Accumu-lated amortization	Net carrying value	Gross carrying value	Accumu-lated amortization	Net carrying value
Amortized intangible assets:						
Billing and telecommunication software	$ 974,142	(603,303)	370,839	1,053,559	(580,156)	473,403
Operating licenses	704,536	(214,352)	490,184	768,488	(157,778)	610,710
Radio frequencies	203,419	(101,034)	102,385	301,042	(149,954)	151,088
Acquired customer base and customer relationships	225,495	(136,714)	88,781	468,497	(247,643)	220,854
Software and other	855,003	(376,890)	478,113	973,084	(481,941)	491,143
	2,962,595	**(1,432,293)**	**1,530,302**	**3,564,670**	**(1,617,472)**	**1,947,198**
Unamortized intangible assets:						
Trademarks	184,811	-	184,811	206,135	-	206,135
Numbering capacity with indefinite contractual life	6,276	-	6,276	9,367	-	9,367
Total	**$ 3,153,682**	**(1,432,293)**	**1,721,389**	**3,780,172**	**(1,617,472)**	**2,162,700**

Impairments of intangible assets other than goodwill for the years ended December 31, 2014 and 2013 amounted to $nil and $298.2 million respectively (Note 15).

(Amounts in thousands of U.S. dollars, unless otherwise stated)

Amortization expense recorded on other intangible assets for the years ended December 31, 2014 and 2013 amounted to $513.5 million and $544.6 million, respectively. The estimated amortization expense for the five years ending December 31, 2019 and thereafter is as follows:

Year ending December 31,		
2015	$	367,272
2016		306,060
2017		214,242
2018		122,424
2019		61,212
Thereafter		459,092
	$	**1,530,302**

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

15. Impairment of other assets

Impairment of other assets recognized by the Group in the years ended December 31, 2014 and 2013 comprised the following:

		2014		**2013**
Impairment of long-lived assets in India	$	290,438	$	-
Impairment of 180 and 90 nm equipment and intangible assets		-		357,906
Impairment of system integration intangible assets		-		125,747
Impairment of other long-lived assets		175,386		106,753
Impairment of available-for-sale securities		135,000		-
Provision for cash and deposits in Delta Bank (Ukraine)		92,517		-
Provision for doubtful accounts		103,625		134,392
Inventory obsolescence		30,442		46,504
Other		37,221		33,243
Total impairments of other assets	**$**	**864,629**	**$**	**804,545**

Impairment of long-lived assets in India – As of December 31, 2014, following the continuing operating losses incurred by SSTL, the Group carried out a review of the recoverable amount of its long-lived assets attributable to the SSTL segment. The Group concluded that the segment's fixed assets with a carrying value of $290.4 million were impaired and recognized a loss in the consolidated statement of operations and comprehensive income for the year ended December 31, 2014, which was allocated to the SSTL segment.

The segment's remaining long-lived assets mostly comprise spectrum and licenses with the total carrying value of $306.3 million. The Group conducted their impairment analysis based on the available market data. The market data utilizes the data of the recent spectrum auction in India. The auction in March 2015 demonstrated significant demand for spectrum in the 800 MHz spectrum bands in the circles of SSTL operations at prices significantly higher than the carrying value of equivalent bands owned by SSTL. Therefore, the Group has concluded that the carrying value of SSTL spectrum and licenses was not impaired as of December 31, 2014.

Impairment of 180 and 90 nm equipment and intangibles assets – As of December 31, 2013 the Group carried out a review of the recoverable amount of long-lived assets used in the production of microchips. As a result of this impairment review, an impairment charge of $357.9 million was recognized in the consolidated statement of operations and comprehensive income for the year ended December 31, 2013, which was allocated to the RTI segment.

As of December 31, 2014, the Group identified indicators that the carrying amounts of 180 and 90 nm equipment with a total carrying value of $108.4 million may not be recoverable. These indicators included lower than expected revenue and profitability levels. The Group carried out review that supported the carrying value of the equipment and indicated that no additional impairment is required.

The estimated fair value of such long-lived assets was determined based on unobservable inputs (“Level 3” of the hierarchy established by U.S. GAAP guidance). When calculating the future cash flows used in the assessment of the fair value of long-lived assets, the Group considered historical and projected revenue and operating costs, market conditions, asset ages, asset utilization and other relevant information. The key assumptions used in the fair value calculations included pre-tax discount rate of 25.0%-56.3% depending on the business line (2013: 21.5%-43.8%), compound annual growth rate during the projected twelve-year period of 21.8% (2013: 11.7%), growth rate after that period of 2.3% (2013: 2.3%).

Impairment of system integration intangible assets – During the year ended December 31, 2013, the Group identified indicators that the carrying amounts of long-lived assets attributable to NVision, a subsidiary of RTI, may not be recoverable. These indicators included lower than expected revenue and profitability levels and downward revisions to management’s forecasts for the NVision business.

Subsequent to its acquisition by the Group in 2012, NVision experienced a significant decrease in purchases made by its key customers and, as a result, revenue forecasts were substantially reduced as compared to those existing at the acquisition date. Based on the revised forecasts, the Group determined that the carrying value of the NVision asset group exceeded its undiscounted cash flows. The Group then compared the fair value of the asset group to its carrying value and determined the impairment loss. The impairment loss was allocated to the carrying values of the long-lived assets, but not below their individual fair values. The Group estimated the fair value of the assets primarily using an income approach based on unobservable inputs (“Level 3” of the hierarchy established by U.S. GAAP guidance), with the key assumptions including a discount rate of 16.5% and 3-7% of revenue royalty payments for the trademark. The decline in the fair value of the NVision reporting unit and its intangible assets, as well as fair value changes for other assets and liabilities in the two-step goodwill impairment test, resulted in an implied fair value of goodwill being substantially below its carrying value.

As a result of the impairment review, for certain intangible assets with a carrying value of $129.1 million the Group concluded that the fair value amounted to $3.3 million and recorded an impairment charge of $125.7 million in the consolidated statement of operations and comprehensive income for the year ended December 31, 2013. The Group also recorded an impairment charge on goodwill of $258.0 million based on its implied fair value. The relevant impairment charges were allocated to the RTI segment.

Provision for cash and deposits in Delta Bank (Ukraine) – As of December 31, 2014, MTS Ukraine, a subsdiary of MTS, held $90.2 million in current accounts and deposits in Delta Bank, the fourth largest bank in Ukraine. In December 2014, Delta Bank delayed customer payments and put limits on cash withdrawals. In March 2015, the National Bank of Ukraine adopted a resolution declaring Delta Bank to be insolvent. The Group treated Delta Bank’s insolvency as a recognized subsequent event and provided against the full amount of deposited funds ($90.2 million) and related interest ($2.3 million).

(Amounts in thousands of U.S. dollars, unless otherwise stated)

16. INVESTMENTS IN AFFILIATES

Investments in affiliates as of December 31, 2014 and 2013 consisted of the following:

	2014		2013	
	Voting power	Carrying value	Voting power	Carrying value
MTS Belarus	49.0%	$ 107,237	49.0%	$ 165,174
OZON	21.6%	91,080	-	-
SG-trans (2013: SG-trans and Financial Alliance, Note 4)	50.0%	83,555	50.0%	133,551
Concept Group	40.0%	18,913	-	-
Other		55,233		66,541
Total		**$ 356,018**		**$ 365,266**

Investment in OZON – In April 2014, the Group acquired a 21.6% of ownership interest in OZON Holdings Limited ("OZON"), a leading Russian e-commerce company, through an additional share issuance for $150.0 million. The Group has the right to nominate two out of eight representatives to the board of directors. Management concluded that, upon completion of the acquisition, the Group gained significant influence over OZON and therefore adopted equity method of accounting for this investment. The Group also obtained a call option for an additional 4.6% stake in OZON exercisable through August 2015. The difference between the equity investment carrying amount of $91 million and underlying equity in net assets as of December 31, 2014 of $26.0 million represents equity-method goodwill, mainly attributable to the expected synergies from commercial arrangements and co-branding programs.

Investment in Concept Group – In October 2014, the Group acquired a 40% of ownership interest in Rangecroft Ltd, a holding company of Concept Group, one of Russia's leading fashion clothing retailers, for $26.0 million, and obtained a call option to acquire another 14.2% of its share capital exercisable till October 2017. In accordance with the shareholders agreement, the Group has the right to nominate three out of nine representatives to the board of directors and, if the call option is exercised, up to five of the nine representatives. A number of key operating decisions for Concept Group, including an approval of an operating budget, require seven out of nine votes; such operating decisions represent participating rights of the shareholders. As a consequence of this, the Group has concluded that it does not have control over the investee and has therefore adopted the equity method of accounting for this investment.

Merger of SG-trans and Finance Alliance – In January 2014, SG-trans and Finance Alliance merged into a single legal entity named SG-trans. The Group retained 50% beneficial interest in the newly established entity.

The financial position and results of operations of significant affiliates as of and for the year ended December 31, 2014 were as follows:

	(unaudited)			
	MTS Belarus	OZON	SG-trans	Concept Group
Total assets	$ 303,315	192,860	641,193	91,607
Total liabilities	(94,102)	(71,403)	(453,119)	(65,646)
Net income/(loss)	194,317	(77,690)	12,059	5,792

(Amounts in thousands of U.S. dollars, unless otherwise stated)

The financial position and results of operations of significant Group affiliates as of and for the year ended December 31, 2013 were as follows:

		(unaudited)	
		MTS Belarus	**Financial Alliance[1]**
Total assets	$	379,050	1,480,703
Total liabilities		(96,580)	(1,185,979)
Net income/(loss)		145,975	13,435

[1] Including SG-trans amounts.

17. LONG-TERM INVESTMENTS

Long-term investments as of December 31, 2014 and 2013 consisted of the following:

		2014		2013
Bank deposits	$	242,006	$	90,727
Loans and notes		51,400		129,638
Other		23,219		28,706
Total	**$**	**316,625**	**$**	**249,071**

The effective interest rates on long-term investments as of December 31, 2014 were between 6.2% and 6.3% for EUR denominated investments (2013: 6.0% – 8.6%).

18. LIABILITIES FROM BANKING ACTIVITIES

Liabilities from banking activities as of December 31, 2014 and 2013 consisted of the following:

		2014		2013
Term deposits	$	1,567,548	$	2,561,569
Deposits repayable on demand		537,365		1,859,832
Promissory notes issued and other liabilities		243,438		215,539
		2,348,351		**4,636,940**
Less: amounts maturing within one year		(2,180,491)		(3,864,415)
Total liabilities from banking activities, net of current portion	**$**	**167,860**	**$**	**772,525**

As of December 31, 2014 the fair value of liabilities from banking activities amounted to $2,270 million; as of December 31, 2013 – approximated their carrying value.

The following table presents the effective average interest rates by categories of bank deposits and notes issued as of December 31, 2014 and 2013:

	2014			2013		
	RUB	**USD**	**Other**	**RUB**	**USD**	**Other**
Term deposits:						
- corporate customers	14.5%	3.0%	2.9%	7.4%	1.8%	2.1%
- individuals	10.0%	3.7%	3.4%	9.7%	3.7%	2.3%
Promissory notes issued	8.0%	-	-	7.3%	-	-
Deposits repayable on demand:						
- corporate customers	0.5%	-	-	4.9%	-	-
- individuals	0.5%	0.1%	0.2%	0.6%	0.07%	0.1%

(Amounts in thousands of U.S. dollars, unless otherwise stated)

19. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of December 31, 2014 and 2013 consisted of the following:

	2014	2013
Customers' advances	$ 546,793	$ 350,896
Accrued payroll	267,971	430,946
Accruals for services	210,924	328,050
Accrued interest on loans	51,805	74,621
Financial instruments at fair value	47,086	13,199
Dividends payable	1,369	6,729
Other	189,708	363,449
Total	**$ 1,315,656**	**$ 1,567,890**

20. LONG-TERM DEBT

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

	2014	2013
Loans from banks and financial institutions	$ 5,049,820	$ 5,447,071
Notes and corporate bonds	2,781,512	4,888,603
Capital leases	239,401	80,506
Loans from related parties	37	64
Vendor financing	16,662	31,871
Other borrowings	45,393	29,957
	8,132,825	**10,478,072**
Less: amounts maturing within one year	(1,598,770)	(2,102,911)
Total	**$ 6,534,055**	**$ 8,375,161**

The schedule of repayments of long-term debt for the next five years and thereafter is as follows:

Year ended December 31	
2015	$ 1,598,770
2016	1,185,257
2017	1,469,871
2018	1,022,949
2019	1,148,236
Thereafter	1,707,742
Total	**$ 8,132,825**

(Amounts in thousands of U.S. dollars, unless otherwise stated)

Loans from banks and financial institutions – Loans from banks and financial institutions as of December 31, 2014 and 2013 consisted of the following:

	Maturity	Interest rate (as at December 31, 2014)	2014	2013
USD-denominated:				
Calyon, ING Bank, Nordea Bank, Raiffeisen Zentralbank Osterreich	2015-2020	LIBOR+1.15% (1.51%)	$ 673,698	$ 798,440
China Development Bank	2015-2018	LIBOR+1.5% (1.86%)	179,421	187,497
Bank of China	2015-2021	LIBOR+1.5%-3.5% (1.86%-3.86%)	170,552	170,615
Skandinavska Enskilda Banken	2015-2017	LIBOR+0.23%-1.8% (0.59%-2.16%)	91,987	129,494
Bank of Moscow	2015	LIBOR+7.5% (7.76%)	82,552	82,552
HSBC Bank and ING BHF Bank			-	12,022
Other			14,230	27,223
			1,212,440	**1,407,843**
EUR-denominated:				
Credit Agricole Corporate Bank and BNP Paribas	2015-2018	EURIBOR+1.65% (1.82%)	33,649	47,574
Bank of Moscow	2015-2017	EURIBOR+5.0% (5.15%)	27,333	-
LBBW	2015-2017	EURIBOR+1.52% (1.69%)	16,995	25,630
Bank of China			-	74,403
Other			12,187	14,398
			90,164	**162,005**
RUB-denominated:				
Sberbank	2015-2021	8.45%-15.0%	3,007,244	2,922,817
Gazprombank	2015-2018	9.0%-10.6%	253,170	294,439
Raiffeisenbank	2015-2016	Mosprime+1.45%-5.25% (23.42%-29.02%), 9.45%	149,568	71,891
Bank of Moscow	2015-2018	CBR+3.0% (11.25%); Mosprime+4.5%-8.85% (28.27%-31.02%);	128,993	256,258
VTB	2015-2018	9.0%-22.75%	86,461	77,571
Unicredit	2016	Mosprime+5.2% (12.17%); 10.1-10.4%	37,179	73,248
Alfa-Bank	2015	9.75%-14.18%	27,143	92,486
Credit bank of Moscow	2016	19.0%	8,888	30,554
Other			30,928	53,560
			3,729,574	**3,872,824**
Other currencies			17,642	4,399
Total			**$ 5,049,820**	**$ 5,447,071**

The fair value of loans from banks and financial institutions, including the current portion, is estimated using discounted cash flows and market-based expectations for interest rates, credit risk and the contractual terms of the debt instruments ("Level 2" of the hierarchy established by the U.S. GAAP guidance). As of December 31, 2014 the fair value of loans from banks and financial institutions, including the current portion, amounted to $4,730 million; as of December 31, 2013 – approximates their carrying value.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

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

		2014			2013
	Currency	Interest rate	Fair value	Carrying value	Carrying value
MTS International Notes due 2020	USD	8.625%	$ 601,019	$ 623,140	$ 747,634
MTS International Notes due 2023	USD	5.00%	369,641	478,500	500,000
Sistema International Bonds due 2019	USD	6.95%	338,193	464,979	487,854
MTS OJSC Notes due 2020	RUB	8.15%	253,296	266,627	458,306
SSTL Bonds due 2019	INR	15.75%	202,111	202,111	206,795
MTS OJSC Notes due 2023	RUB	8.25%	133,313	177,751	305,538
MTS OJSC Notes due 2017	RUB	8.70%	151,181	171,894	294,191
Sistema JSFC Bonds due 2016	RUB	8.75%	113,840	145,949	329,790
MTS OJSC Notes due 2015	RUB	7.75%	131,364	134,045	230,567
Sistema JSFC Bonds due 2016	RUB	7.65%	60,376	65,271	406,985
MTS OJSC Notes due 2016	RUB	8.75%	29,851	31,780	54,627
DM-Center Bonds due 2015	RUB	8.50%	16,238	16,418	35,137
MTS OJSC Notes due 2018	RUB	12.00%	2,298	2,419	117,442
MTS OJSC Notes due 2014	RUB	-	-	-	416,098
Sistema JSFC Bonds due 2014	RUB	-	-	-	296,544
Other			531	628	1,095
Total			**$ 2,403,252**	**$ 2,781,512**	**$ 4,888,603**

All Group RUB-denominated notes and corporate bonds are traded on Moscow Exchange. USD-denominated notes issued by MTS International due 2020 and 2023 and Sistema International due 2019 are traded on the Irish Stock Exchange. The fair values of notes and corporate bonds are based on the market quotes as of December 31, 2014 at the exchanges which they are traded on.

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

MTS OJSC Notes due 2018	December 2015
MTS OJSC Notes due 2020	November 2015
MTS OJSC Notes due 2023	March 2018

Available credit facilities – As of December 31, 2014, the Group's total available unused credit facilities amounted to $1,344.2 million and related to the following credit lines:

	Maturity	Interest rate	Available till	Available amount
Sberbank	2015 – 2018	9.3% - 18%	2015 – 2018	766,013
CitiBank Europe	2024	LIBOR 6M+0.9%;	2015	300,009
Gazprombank	2016 – 2021	9.75% - 25%	2016 – 2021	198,291

(Amounts in thousands of U.S. dollars, unless otherwise stated)

ING Bank Eurasia	2015	Mosprime/LIBOR/ EURIBOR + 1.50%	2015	44,438
Other				35,468
Total				**$ 1,344,219**

Covenants – Loans and notes payable by the Group are subject to various restrictive covenants, including, but not limited to compliance with certain financial ratios, limitations on dispositions of assets and transactions within the Group and retention of principal telecom licenses. The adverse court's ruling in respect of the Bashneft shares owned by the Group and their further disposition (Note 2) gave certain lenders the right to call the debt under several loan agreements. The lenders waived their rights to demand early repayment with regard to these covenant violations prior to the issuance date of these consolidated financial statements, and the Group retained noncurrent classification for this long-term debt in its consolidated statement of financial position as of December 31, 2014. As of December 31, 2014, the Group also had $138.5 million of its RUB-denominated long-term debt which was presented within current liabilities in the consolidated statement of financial position because of non-compliance with certain financial ratios by its subsidiaries.

21. INCOME TAX

The Group's income tax expense for the years ended December 31, 2014 and 2013 was as follows:

	2014	2013
Current provision	$ 417,079	$ 619,643
Deferred income tax expense	36,338	222,464
Total	**$ 453,417**	**$ 842,107**

Income tax expense calculated by applying the Russian statutory income tax rate of 20% to income from continuing operations before income tax differs from income tax expense recognized in the consolidated statements of operations and comprehensive income as a consequence of the following adjustments:

	2014	2013
Income tax expense computed on income from continuing operations before income tax at the Russian statutory income tax rate	$ 118,256	$ 504,164
Adjustments due to:		
Equity in earnings of subsidiaries	147,678	144,647
Other non-deductible expenses	98,094	129,330
Change in valuation allowance	165,819	148,909
Settlements with tax authorities	11,553	(9,108)
Effect of rates different from standard	(43,477)	(44,044)
Currency exchange and translation differences	(5,685)	(10,828)
Non-taxable income	(21,491)	-
Other	(17,330)	(20,963)
Income tax expense	**$ 453,417**	**$ 842,107**

(Amounts in thousands of U.S. dollars, unless otherwise stated)

The tax effects of temporary differences that give rise to the deferred tax assets and liabilities are presented below:

	2014	2013
Deferred tax assets:		
Tax losses carried forward	$ 1,088,645	$ 855,851
Accrued expenses and accounts payable	165,569	248,061
Property, plant and equipment	243,112	152,210
Intangible assets	143,917	182,846
Other	111,686	209,147
	1,752,929	**1,648,115**
Less: valuation allowance	(1,194,858)	(996,221)
Total deferred tax assets	**558,071**	**651,894**
Deferred tax liabilities:		
Property, plant and equipment	(348,206)	(534,109)
Intangible assets	(219,907)	(218,014)
Undistributed earnings of subsidiaries and affiliates	(124,444)	(208,995)
Other	(79,655)	(79,752)
Total deferred tax liabilities	**$ (772,212)**	**$ (1,040,870)**
Net deferred tax assets, current portion	$ 245,571	$ 330,388
Net deferred tax assets, long-term portion	392,866	297,419
Net deferred tax liabilities, current portion	(64,947)	(114,192)
Net deferred tax liabilities, long-term portion	(787,631)	(902,591)

The Group has the following balances for income tax losses carried forward as of December 31, 2014 and 2013:

Jurisdiction	**Period for carry-forward**	**2014**	**2013**
India	2015-2020	$ 521,547	$ 483,680
Russia	2015-2024	442,370	246,870
Luxembourg	Unlimited	124,728	125,301
Total		**$ 1,088,645**	**$ 855,851**

Management has established valuation allowances against certain deferred tax assets, which are less likely than not to be realized in future periods. In evaluating the Group's ability to realize its deferred tax assets, the Company considers all available positive and negative evidence, including operating results, ongoing tax planning, and forecasts of future taxable income on a jurisdiction by jurisdiction basis. The valuation allowance as of December 31, 2014 and 2013 relates to the following deferred tax assets:

	2014	2013
Tax losses carried forward	$ 850,118	$ 689,731
Sale of investment in Svyazinvest	51,103	65,996
Impairment of long-lived assets in SSTL	128,286	70,194
Other	165,351	170,300
Total	**$ 1,194,858**	**$ 996,221**

(Amounts in thousands of U.S. dollars, unless otherwise stated)

22. HEDGING ACTIVITIES

The Group regularly enters into variable-to-fixed interest rate swap agreements to manage exposure to changes in variable interest rates related to its debt obligations. The instruments qualify for cash flow hedge accounting under U.S. GAAP. Each interest rate swap matches the exact maturity dates of the underlying debt allowing for highly-effective hedges. Interest rate swap contracts outstanding as of December 31, 2014 mature in 2015, 2018 and 2020

In addition to the above, the Group has also entered into several cross-currency interest rate swap agreements. These contracts hedged the risk of both interest rate and currency fluctuations and assumed periodic exchanges of both principal and interest payments from RUB-denominated amounts to USD- and Euro- denominated amounts to be exchanged at a specified rate. The rate was determined by the market spot rate upon issuance. Cross-currency interest rate swap contracts mature in 2019-2020. The Group entered into cross-currency interest rate swap agreements designated to manage the exposure of changes in variable interest rate and currency exchange rate for 21.7% of its USD- and Euro- denominated bank loans and Eurobonds outstanding as of December 31, 2014.

The following table presents the fair value of the Group’s derivative instruments designated as hedges in the consolidated statements of financial position December 31, 2014 and 2013.

	Location	2014	2013
Assets			
Cross-currency interest rate swaps	Other non-current assets	$ 389,915	$ 55,760
Interest rate swaps	Other non-current assets	142	367
Total		**390,057**	**56,127**
Liabilities			
Interest rate swaps	Accrued expenses and other current liabilities	(47,086)	(13,199)
Total		**$ (47,086)**	**$ (13,199)**

The following table presents the effect of the Group’s derivative instruments designated as hedges (i.e. gain/(loss) recognized) in the consolidated statements of operations and comprehensive income for the years ended December 31, 2014 and 2013. The amounts presented include the ineffective portion of derivative instruments and the amounts reclassified into earnings from accumulated other comprehensive income.

	Location	2014	2013
Interest rate swaps, including ineffective portion of 4,503 and (879)	Interest income / (expense)	$ 6,012	$ (5,778)
Cross-currency interest rate swaps, including ineffective portion of (60,252) and nil	Foreign currency transaction loss / (gain)	397,901	(24,397)
Total		**$ 403,913**	**$ (30,175)**

The following table presents the effect of the Group’s agreements designated as hedges in accumulated other comprehensive income for the years ended December 31, 2014 and 2013 (net of tax).

	2014	2013
Accumulated gain, beginning of the year	$ 46,210	$ 807
Fair value adjustments	376,582	21,697
Reclassified into earnings	(303,683)	23,706
Accumulated gain	**$ 119,109**	**$ 46,210**

(Amounts in thousands of U.S. dollars, unless otherwise stated)

As of December 31, 2014, the outstanding hedging instruments were highly effective. $18.0 million of accumulated gain is expected to be reclassified into net income during the next twelve months.

Cash inflows and outflows related to hedging instruments were included in cash flows from operating and financing activities in the consolidated statements of cash flows for the years ended December 31, 2014 and 2013.

23. Fair value measurements

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

	Fair value measurements using			
	Quoted prices in active markets for identical assets (Level 1)	**Significant other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**Total fair value**
December 31, 2014				
Assets at fair value:				
Trading securities	$ 466,117	$ -	$ -	$ 466,117
Available-for-sale securities	158,370	-	3,431	161,801
Derivative instruments	-	390,057	-	390,057
Total assets	**624,487**	**390,057**	**3,431**	**1,017,975**
Liabilities at fair value:				
Derivative instruments	(12,128)	(59,933)	-	(72,061)
Contingent consideration	-	-	(1,760)	(1,760)
Redeemable noncontrolling interests	-	-	(56,734)	(56,734)
Total liabilities	**$ (12,128)**	**$ (59,933)**	**$ (58,494)**	**$ (130,555)**
December 31, 2013				
Assets at fair value:				
Trading securities	$ 1,050,950	$ -	$ -	$ 1,050,950
Available-for-sale securities	248,534	253,255	7,405	509,194
Derivative instruments	1,575	56,127	-	57,702
Total assets	**1,301,059**	**309,382**	**7,405**	**1,617,846**
Liabilities at fair value:				
Derivative instruments	-	(12,863)	-	(12,863)
Contingent consideration	-	-	(336)	(336)
Redeemable noncontrolling interests	-	-	(89,583)	(89,583)
Total liabilities	**$ -**	**$ (12,863)**	**$ (89,919)**	**$ (102,782)**

(Amounts in thousands of U.S. dollars, unless otherwise stated)

24. SHARE CAPITAL

As of December 31, 2014 and 2013, the Company had 9,650,000,000 voting common shares with a par value of RUB 0.09 issued, of which 9,435,902,596 and 9,274,755,045 shares were outstanding, respectively.

Dividends declared by the Company in the years ended December 31, 2014 and 2013 are as follows:

	2014	2013
Dividends declared (including dividends on treasury shares of $16,842 and $8,080 respectively)	591,099	283,200

Accumulated other comprehensive loss – The following table represents components of accumulated other comprehensive loss balance, net of taxes, as of December 31, 2014 and 2013:

		2014		2013
Accumulated currency translation loss	$	(5,402,999)	$	(1,516,611)
Unrealized (loss)/gain on available-for-sale securities		(14,499)		37,600
Unrealized gain on derivatives		119,109		46,210
Unrecognized actuarial gain		9,553		9,381
Total accumulated other comprehensive loss	**$**	**(5,288,836)**	**$**	**(1,423,420)**
Less: amounts of accumulated other comprehensive loss attributable to noncontrolling interests		1,545,434		516,702
Total accumulated other comprehensive loss attributable to Sistema JSFC	**$**	**(3,743,402)**	**$**	**(906,718)**

25. SEGMENT INFORMATION

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

See Note 1 for a description of the activities of each operating segment of the Group. The accounting policies of the reportable segments are the same as the Group’s accounting policies described in appendix A1.to the notes to the financial statements. Segment profit represents the operating income/(loss).

(Amounts in thousands of U.S. dollars, unless otherwise stated)

Financial information by reportable segment is presented below:

For the year ended December 31, 2014	MTS	RTI	MTS Bank	SSTL	Corporate	Total reportable segments	Other	Total
Net sales to external customers[(a)]	10,837,126	1,528,287	698,182	220,717	49,967	13,334,279	3,250,678	16,584,957
Intersegment sales	28,521	316,820	17,263	-	25,391	387,995	37,242	425,237
Equity in results of affiliates[(b)]	(37,940)	-	-	-	-	(37,940)	(24,477)	(62,417)
Net interest revenue/(expense) [(c)]	-	-	(377,575)	-	-	(377,575)	-	(377,575)
Depreciation and amortization	1,934,339	85,796	17,735	60,374	14,274	2,112,518	179,600	2,292,118
Operating income/(loss)	2,765,484	172,070	(396,963)	(431,828)	(546,842)	1,561,921	286,744	1,848,665
Interest income	120,926	42,160	-	7,477	106,825	277,388	50,609	327,997
Interest expense	435,117	143,175	-	90,277	135,031	803,600	73,809	877,409
Income tax expense/(benefit)	533,856	33,831	(61,779)	-	(127,264)	378,644	74,773	453,417
Investments in affiliates	152,262	36	-	-	100,448	252,746	95,815	348,561
Segment assets	11,014,182	2,125,279	3,882,609	485,465	1,949,713	19,457,248	3,201,538	22,658,786
Indebtedness[(d)]	5,191,423	841,307	-	568,170	1,223,056	7,823,956	438,807	8,262,763
Capital expenditures [(e)]	2,314,951	105,052	27,592	43,296	28,099	2,518,990	383,592	2,902,582

For the year ended December 31, 2013	MTS	RTI	MTS Bank	SSTL	Corporate	Total reportable segments	Other	Total
Net sales to external customers[(a)]	12,488,877	1,685,546	878,832	209,432	46,237	15,308,924	3,193,061	18,501,985
Intersegment sales	21,884	509,963	24,301	-	36,742	592,890	18,115	611,005
Equity in results of affiliates[(b)]	77,615	(1,696)	-	-	-	75,919	(40,165)	35,754
Net interest revenue/(expense) [(c)]	-	-	40,678	-	-	40,678	-	40,678
Depreciation and amortization	2,244,014	96,374	19,152	63,666	14,378	2,437,584	195,964	2,633,548
Operating income/(loss)	3,662,740	(776,878)	18,954	(210,185)	834,945	3,529,576	84,721	3,614,297
Interest income	87,704	45,045	-	9,522	116,328	258,599	45,791	304,390
Interest expense	486,636	138,020	-	121,513	159,215	905,384	129,802	1,035,186
Income tax expense/(benefit)	720,893	(80,025)	(2,645)	-	140,376	778,599	63,508	842,107
Investments in affiliates	153,168	-	-	-	45,210	198,378	166,886	365,264
Segment assets	15,218,084	2,530,299	6,919,610	847,342	3,572,805	29,088,140	3,250,757	32,338,897
Indebtedness[(d)]	6,682,047	1,228,635	-	596,641	1,574,531	10,081,854	437,054	10,518,908
Capital expenditures [(e)]	2,561,310	95,009	21,379	45,765	73,224	2,796,687	197,706	2,994,393

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

(b) Equity in results of affiliates of MTS segment for the year,2014 includes $135 million of its share of the earnings of MTS Bank and Stream, which is further eliminated on consolidation (2013: $5 million).

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

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

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

The following table summarizes dividends to Corporate, declared in 2014 and 2013:

	2014	2013
Bashneft	$ 818,456	$ 1,162,041
MTS	744,460	635,369
Other	89,903	49,084

(Amounts in thousands of U.S. dollars, unless otherwise stated)

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

	2014	2013
Operating income – reportable segments	$ 1,561,921	$ 3,529,576
Operating income – other	286,744	84,721
	1,848,665	**3,614,297**
Intersegment eliminations	(110,216)	(47,725)
Operating income	**$ 1,738,449**	**$ 3,566,572**
Interest income	212,774	182,447
Change in fair value of derivative financial instruments		30,199
Interest expense	(811,346)	(960,136)
Foreign currency transaction loss	(548,596)	(298,264)
Income from continuing operations before income tax	**$ 591,281**	**$ 2,520,818**

	2014	2013
Total assets – reportable segments	$ 19,457,248	$ 29,088,140
Total assets – Bashneft	-	12,674,507
Total assets – other	3,201,538	3,250,757
	22,658,786	**45,013,404**
Intersegment eliminations	(1,988,309)	(1,764,410)
Total assets	**$ 20,670,477**	**$ 43,248,994**

For the years ended December 31, 2014 and 2013, the Group did not have revenues from transactions with a single external customer amounting to 10% or more of the Group's consolidated revenues. For the years ended December 31, 2014 and 2013 the Group's revenues outside of the RF were as follows:

	2014	2013
Ukraine	$ 813,708	$ 1,282,410
India	272,863	253,196
Armenia	186,120	156,883
Central and Eastern Europe	107,372	40,997
Other	154,753	210,661
Total	**$ 1,534,816**	**$ 1,944,147**

As of December 31, 2014 and 2013, the Group's long-lived assets located outside of the RF were as follows:

	2014	2013
Ukraine	$ 332,987	$ 755,373
India	320,604	710,225
Armenia	288,308	354,840
Central and Eastern Europe	68,369	34,953
Other	87,870	111,887
Total	**$ 1,098,138**	**$ 1,967,278**

(Amounts in thousands of U.S. dollars, unless otherwise stated)

26. RELATED PARTY TRANSACTIONS

The Group sells goods and provides services to and purchases goods and services from its related parties on normal commercial terms. During the years ended December 31, 2014 and 2013, the Group entered into transactions with related parties as follows:

	2014	2013
Sales	$ 17,220	$ 14,921
Revenue from banking activities	34	51
Cost related to banking activities	(48,385)	(30,370)
Cost of sales	(45,595)	(1,188)
Selling, general and administrative expenses	(515)	(12,110)

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

	2014	2013
Assets:		
Short-term investments	$ 5,212	$ 9,840
Accounts receivable, net	5,469	1,362
Other current assets	27,083	4,907
Long-term investments	36,174	17,402
Liabilities:		
Accounts payable	$ (4,134)	$ (890)
Liabilities from banking activities	(541,556)	(526,056)
Accrued expenses and other current liabilities	(3,411)	(646)
Long-term debt	(37)	(64)

27. SHARE-BASED COMPENSATION

The Company and several of its subsidiaries operate share-based compensation plans in order to compensate their employees. This is done through either “equity” plans, in which employees may exercise their options for shares, or “phantom” plans, which generally allow employees to receive cash compensation which varies depending on the share price that the options are linked to.

All such plans, including those of MTS, are immaterial to the Group and consequently have not been disclosed here. A discussion has been included below of the plans operated at the Company level.

Sistema JSFC share-based long-term motivation program – In 2014 and 2013 the Company’s Board of Directors established two-year motivational programs for senior and mid-level management. Participants of the programs upon fulfillment of certain performance conditions and subject to continuing employment with the Group will be granted ordinary shares in the Company. As a result, the Group recognized an expense of $79.4 million and $54.2 million in the consolidated statement of operations and comprehensive income for the years ended December 31, 2014 and 2013, respectively. The fair value of awards granted was measured based on the fair value of the Company’s ordinary shares.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

28. ASSET RETIREMENT OBLIGATIONS

As of December 31, 2014 and 2013, the estimated present value of the Group's asset retirement obligations and change in liabilities were as follows:

	2014	2013
Balance, beginning of the year	$ **83,809**	$ **90,986**
Liabilities incurred in the current period	1,900	9,257
Property dispositions	(1,067)	-
Accretion expense	6,559	2,963
Revisions in estimated cash flows	677	(13,840)
Currency translation adjustment	(38,163)	(5,557)
Balance, end of the year	**$ 53,715**	**$ 83,809**
Current portion	-	-
Long-term portion	53,715	83,809
Balance, end of the year	**$ 53,715**	**$ 83,809**

The Group's asset retirement obligations relate primarily to the cost of removing telecommunication equipment from sites. Revisions in estimated cash flows are attributable to changes in economic assumptions, such as inflation rates.

The Group recorded the long-term portion of asset retirement obligations as a separate line item in the consolidated statements of financial position, the current portion – as a component of accrued expenses and other current liabilities.

29. REDEEMABLE NONCONTROLLING INTERESTS

Redeemable noncontrolling interests as of December 31, 2014 and 2013 consisted of the following:

	2014	2013
SSTL	$ 720,000	$ 688,000
K-Telecom, MTS subsidiary in Armenia	56,734	89,583
RTI (Note 5)	16,032	27,547
Total	**$ 792,766**	**$ 805,130**

The Group is a party to a put option agreement to acquire the RF's 17.14% interest in SSTL during one year beginning March 2016 at the higher of $777 million or its market value at that date determined by an independent appraiser. The Group accounted for the redeemable noncontrolling interests in SSTL at the redemption value and presented this as temporary equity in its consolidated statements of financial position.

(Amounts in thousands of U.S. dollars, unless otherwise stated)

30. COMMITMENTS AND CONTINGENCIES

Operating leases – The Group leases land, buildings and office space mainly from municipal organizations through contracts which expire in various years through 2068.

Rental expense under operating leases amounting to $641.0 million and $678.5 million for the years ended December 31, 2014 and 2013, respectively, is included in selling, general and administrative expenses. Rental expense under operating leases amounting to $204.6 million and $238.1 million for the years ended December 31, 2014 and 2013 respectively, is included in cost of sales.

Future minimum rental payments under operating leases in effect as of December 31, 2014, are as follows:

Year ended December 31		
2015	$	282,393
2016		204,009
2017		202,489
2018		204,662
2019		199,758
Thereafter		303,487
Total	**$**	**1,396,798**

Capital commitments – As of December 31, 2014, the Group had executed purchase agreements of approximately $840.0 million to acquire property, plant and equipment and intangible assets.

Guarantees – As of December 31, 2014, MTS Bank and its subsidiaries guaranteed loans for several companies, including related parties, which totaled $217.2 million. These guarantees would require payment by the Group only in the event of default on payment by the respective debtor. As of December 31, 2014, no event of default has occurred under any of the guarantees issued by the Group.

Commitments on loans and unused credit lines – As of December 31, 2014, MTS Bank and its subsidiaries had $126.9 million of commitments on loans and unused credit lines available to its customers.

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

Generally, according to Russian tax legislation, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2014, tax declarations of certain companies of the Group in Russia for the preceding three fiscal years were open for further review.

The Group purchases supplemental software from foreign suppliers of telecommunications equipment in the ordinary course of business. The Group's management believes that customs duties are calculated in compliance with applicable legislation. However there is a risk that the customs authorities may take a different view and impose additional customs duties.

Pricing of revenue and expenses between each of the Group's subsidiaries and various discounts and bonuses to the Group's subscribers in the course of performing its marketing activities may be subject to transfer pricing rules. The Group's management believes that taxes payable are calculated in compliance with the applicable tax regulations relating to transfer pricing. However there is a risk that the tax authorities may take a different view and impose additional tax liabilities. As of December 31, 2014 and 2013, no provision was recorded in the consolidated financial statements in respect of such additional claims.

In November 2014, the Russian legislation was amended to introduce the concept of "controlled foreign companies" and the new tax regime for such entities. It is expected that the adoption of the new rules will generally lead to an increase in the administrative and, in certain cases, tax burden for the Russian entities that have subsidiary structures incorporated outside the Russian Federation. The management does not believe the law can materially impact the Group's tax obligations as of December 31, 2014.

Management believes that it has adequately provided for tax and customs liabilities in the accompanying consolidated financial statements. As of December 31, 2014 and 2013, the provision accrued amounted to $53.3 million and $69.6 million, respectively. In addition, the accrual for unrecognized income tax benefits, potential penalties and interest recorded in accordance with the authoritative guidance on income taxes totaled $6.1 million and $18.8 million as of December 31, 2014 and 2013, respectively. However, the risk remains that the relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

With regard to matters where practice concerning payment of taxes is unclear, management estimated possible tax exposure to be $21 million and $nil as of December 31, 2014 and 2013, respectively.

Operating environment – Starting from March 2014, sanctions have been imposed in several tranches by the U.S. and the E.U. on certain Russian officials, businessmen and companies. Following the decline in oil prices in 2014 and early 2015, Russia, which is the main market of the Group's operations, has experienced significant economic instability, characterized by the substantial depreciation of the Russian rouble, growth of interest rates caused by the decision of the Central Bank of the Russian Federation to significantly increase its key interest rate, a forecasted decline in gross domestic product and a significant decline in the value of shares traded on the Russian stock exchanges. International credit agencies downgraded Russia's long-term foreign currency sovereign rating with a negative outlook. Neither the Company, nor any of its subsidiaries are subject to the current sanctions, and the Group does not appear on the U.S. or E.U. lists of sanctioned parties. However, there is significant uncertainty regarding the extent or timing of any potential further economic or trade sanctions. Any continuing economic and political instability could have a negative impact on the Group's operating results.

Although the Group's reporting currency is the U.S. dollar, it generates most of its revenues in Russian roubles, which is also the functional currency of its principal operating subsidiaries. Therefore, the Group's reported results of operations are significantly impacted by the fluctuations in the exchange rate between the U.S. dollar and the Russian rouble, which depreciated against the U.S. dollar by 42% in 2014, and was on average 17% lower than the average value of the Russian rouble compared to the U.S. dollar during 2013. Also, given that most of the Group's revenues are generated in Russian roubles, the Group faces exchange rate risk relating to payments that the Group must make in currencies other than the Russian rouble.

During 2014, a deterioration in the political environment in Ukraine, the second largest market of the Group's operations, has led to general instability, economic deterioration and armed conflict in the eastern portion of Ukraine. The deterioration has further exacerbated the country's already weak macroeconomic trends, which have led to reduced credit ratings, significant depreciation of its national currency and increased inflation. In 2014, the Ukrainian Parliament adopted a law allowing for the imposition of sanctions against countries, persons and companies deemed by the Ukrainian government to threaten Ukrainian national interests, national security, sovereignty or the territorial integrity of Ukraine. The National Bank of Ukraine passed a decree prohibiting Ukrainian companies from paying dividends to foreign investors. These circumstances, combined with continued political and economic instability in Ukraine, could result in a negative impact on our business, including the Group's financial position and results of operations. For example, such risks apply to the Group's funds deposited in Ukrainian banks, the liquidity of which is negatively affected by the economic downturn. As of December 31, 2014, the Group held $376.9 million in current accounts and deposits in Ukrainian banks, including $90.2 million in Delta Bank (Note15) (fully provided as of December 31, 2014) and $25.1 million in Kyivska Rus Bank (Note 31).

LTE license – In July 2012, the Federal Service for Supervision in the Area of Communications, Information Technologies and Mass Media allocated MTS the necessary license and frequencies to provide LTE telecommunication services in Russia. Under the terms and conditions of the LTE license, the Group is obligated to fully deploy LTE networks within seven years, commencing from January 1, 2013 and deliver LTE services in each population center with over 50,000 inhabitants in Russia by 2019. Also, the Group is obligated to invest at least 15 billion rubles ($266.6 million using December 31, 2014 exchange rate) annually toward the LTE roll-out until the network is fully deployed. Management believes that as of December 31, 2014 the Group is in compliance with these conditions.

Bitel – In June 2013, an agreement was reached between Altimo, Altimo Holdings, MTS and its subsidiary MTS Finance, Nomihold and other associated parties to settle all disputes that have arisen from the Group's investment in Bitel made in 2005. The agreement covered matters involving a number of parties and legal proceedings, including those in the Isle of Man, London, Luxembourg and other jurisdictions. Pursuant to the agreement, all proceedings between the parties and their associated parties were discontinued and waived, and MTS received a total payment of $150 million. All parties made the necessary submissions to the respective courts and tribunals to document the settlement, which, among other actions, fully discharged any and all outstanding obligations under the award previously rendered by the London Court of International Arbitration (LCIA) against MTS Finance in 2011, as well as settled the tripartite LCIA arbitration between MTS, MTS Finance and Nomihold and a tort action filed by Nomihold against MTS in the English Courts.

Upon concluding the settlement agreement, the Group released a provision of $221 million, comprising $170 million set by the LCIA plus $51 million in damages, interest and other costs, that had been previously provided for in relation to the dispute with Nomihold. The Group also recognized a gain of $150 million with respect to the settlement payment in the consolidated statement of operations and comprehensive income for the year ended December 31, 2013.

Restriction on transactions with the shares of BPGC and Ufaorgsintez – In 2014, in the course of a litigation, which the Group is not a party to, the court imposed restrictions on transactions with the shares of BPGC and Ufaorgsintez, owned by the Group. The restrictions do not limit the Group's voting rights, rights to receive dividends or any other shareholders rights.

Investigations into former operations in Uzbekistan – In March 2014, the Group received requests for the provision of information from the United States Securities and Exchange Commission and the United States Department of Justice relating to an investigation of the Group's former subsidiary in Uzbekistan. The Group cannot predict the outcome of the investigations, including any fines or penalties that may be imposed, and such fines or penalties could be significant.

Other – In the ordinary course of business, the Group is a party to various legal proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which the Group operates. In the opinion of management, the Group's liability, if any, in all pending litigation, other legal proceedings or other matters will not have a material effect upon the financial condition, results of operations or liquidity of the Group. Management estimates the range of reasonably possible losses, if any, in all pending litigations or other legal proceedings being up to $28.0 million.

31. SUBSEQUENT EVENTS

For the purpose of the accompanying consolidated financial statements, subsequent events have been evaluated through April 2, 2015.

Acquisition of 3G license in Ukraine – In February 2015, MTS-Ukraine won a tender to acquire a nationwide license for the provision of 3G telecommunications services. The license with the cost of UAH 2,715 million ($156.9 million at the acquisition date) has been granted for 15 years. In accordance with the terms of the license MTS-Ukraine is required to launch provision of 3G services in all of the regional centers across Ukraine within 18 months upon allocation of the license.

Bond placement – In February 2015, the Company completed the placement of Series BO-01 unconvertible interest-bearing RUB-denominated bonds for the total amount of RUB 10 billion ($160.3 million at the date of the placement) at the coupon rate of 17% per annum.

Insolvency of Kyivska Rus Bank – In March 2015, the National Bank of Ukraine adopted a resolution declaring Kyivska Rus Bank (Ukraine) to be insolvent. As of December 31, 2014, the Group held $25.1 million in deposits in the bank. Management determined that insolvency of the bank did not provide evidence related to conditions existing as of December 31, 2014, and therefore considered to be a nonrecognized subsequent event.

A1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of consolidation – The consolidated financial statements include the accounts of the Company, as well as entities where the Company has operating and financial control, most often through the direct or indirect ownership of a majority voting interest. Those ventures where the Group exercises significant influence but does not have operating and financial control are accounted for using the equity method. Investments in which the Group does not have the ability to exercise significant influence over operating and financial policies are accounted for under the cost method and included in long-term investments in the consolidated statements of financial position. The consolidated financial statements also include accounts of variable interest entities ("VIEs") in which the Group is deemed to be the primary beneficiary. An entity is generally a VIE if it meets any of the following criteria: (i) the entity has insufficient equity to finance its activities without additional subordinated financial support from other parties, (ii) the equity investors cannot make significant decisions about the entity's operations or (iii) the voting rights of some investors are not proportional to their obligations to absorb the expected losses of the entity or receive the expected returns of the entity and substantially all of the entity's activities involve or are conducted on behalf of the investor with disproportionately few voting rights.
All significant intercompany transactions, balances and unrealized gains and losses on transactions have been eliminated.

Use of estimates – The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses of the reporting period. Actual results could differ from those estimates.

Significant estimates for the Group include the allowances for doubtful accounts, customer loans and deferred tax assets, the valuation of goodwill and other long-lived assets, asset retirement obligations, unrecognized income tax benefits, redeemable noncontrolling interests, derivative instruments, share-based compensation, assets acquired and liabilities assumed in business combinations, the recoverability of investments, and the estimates of oil and gas reserves.

Concentration of business risk – The Group's principal business activities are in the RF, Ukraine and India. Laws and regulations affecting businesses operating in these countries are subject to rapid changes, which could impact the Group's assets and operations.

Foreign currency – Management has determined that the functional currencies of most of the Group's operating subsidiaries are the currencies of the countries of their domicile.

In preparing the financial statements of the entities within the Group, transactions in currencies other than the entities' functional currency are recognized at the rates of exchange prevailing on the dates of the transactions. At each balance sheet date, monetary assets and liabilities that are denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are translated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not restated.

The Group has selected USD as its reporting currency. The Group's assets and liabilities are translated into USD at exchange rates prevailing on the reporting period end date. Revenues, expenses, gains and losses are translated into USD at average exchange rates prevailing during the reporting period. Equity is translated at the applicable historical rates. The resulting translation gain or loss is recorded as a separate component of other comprehensive income.

On the disposal of a subsidiary whose financial statements are prepared in a currency other than the reporting currency of the Group, all of the accumulated currency translation adjustments in respect of that operation attributable to the Group are reclassified to profit or loss.

As of December 31, 2014, the official exchange rate of the Russian Ruble, the functional currency of most of the Group's subsidiaries, determined by the Central Bank of the RF was RUB 56.26 for 1 USD (RUB 32.73 for 1 USD as of December 31, 2013).

Revenue recognition – Generally, revenues are recognized when all of the following conditions have been met: (i) there is persuasive evidence of an arrangement; (ii) delivery has occurred; (iii) the fee is fixed and determinable; and (iv) collectability of the fee is reasonably assured. Revenue amounts are presented net of value-added taxes.

Revenues under arrangements specific to the respective reportable segments of the Group are recognized as follows:

MTS

Revenues derived from wireless, local telephone, long distance, data and video services are recognized when services are provided. This is based upon either usage (minutes of traffic processed, volume of data transmitted) or period of time (monthly subscription fees).

Content revenue is presented net of related costs when MTS acts as an agent of the content providers while the gross revenue and related costs are recorded when MTS is a primary obligor in the arrangement.

Upfront fees received for connection of new subscribers, installation and activation of wireless, wireline and data transmission services ("connection fees") are deferred and recognized over the estimated average subscriber life, as follows:

Mobile subscribers	1 -12.5 years
Residential wireline voice phone subscribers	15 years
Residential subscribers of broadband internet service	1 year
Other fixed line subscribers	3-5 years

MTS calculates an average life of mobile subscribers for each region in which it operates and amortizes connection fees based on the average life specific to that region.

Incentives provided to customers are usually offered on signing a new contract or as part of a promotional offering. Incentives representing the reduction of the selling price of the service (free minutes and discounts) are recorded in the period to which they relate, when the respective revenue is recognized, as a reduction to both accounts receivable and revenue. However, if the sales incentive is a free product or service delivered at the time of sale, the cost of the free product or service is classified as an expense. In particular, the Group sells handsets at prices below cost to contract subscribers. Such subsidies are recognized in the cost of sales.

RTI

Revenues from the long-term contracts are recognised using the percentage-of-completion method of accounting, measured by the percent of contract costs incurred to-date to estimated total contract costs. The completed-contract method is used for a single contract or a group of contracts for which reasonably dependable estimates cannot be made or for which inherent hazards make estimates doubtful. Provisions for estimated losses on construction contracts in progress are made in their entirety in the period in which such losses are determined. A total expected loss on a contract is recognised immediately in profit or loss.

Contract expenses are recognised as incurred unless they create an asset related to future contract activity.

The sales of software products and system integration services are generally multiple-element arrangements, involving the provision of related services, including customization, implementation and integration services, as well as ongoing support and maintenance provided to customers.

A multiple-element arrangement is separated into more than one unit of accounting if all of the following criteria are met: (a) the delivered items have value to the customer on a standalone basis; and (b) the arrangement includes a general right of return relative to the delivered items, delivery or performance of the undelivered items is considered probable and substantially in the control of the Group.

If evidence of the fair value of the undelivered elements of the arrangement does not exist, all revenue from the arrangement is deferred until such time that evidence of fair value does exist, or until all elements of the arrangement are delivered. Fees allocated to post-contract support are recognized as revenue on a pro rata basis over the support period. Fees allocated to other services are recognized as revenue as services are performed.

In cases where extended payment terms exist, license and related customization fees are recognized when payments are due, unless a history of collection, without providing concessions, has been established under comparable arrangements.

When sale agreements provide price protection to the dealer, the revenue is deferred until the dealer sells the merchandise to a third party due to the frequent sales price reductions and rapid technology obsolescence.

Where certain products of this segment are sold with a product return right, a reserve is established. In addition other post-contract support obligations are accrued at the time of sale.

MTS Bank

Revenues from interest bearing assets are recognized on an accrual basis using the effective interest method. The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

The effective interest rate is the rate that exactly discounts estimated future cash receipts (including all fees on points paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the debt instrument, or (where appropriate) a shorter period, to the net carrying amount on initial recognition.

Regulated services – Regulated tariff services provided by the Group primarily consist of local fixed-line telephone services and services rendered to other operators, such as traffic charges, connection fees and line rental services, provided by MTS in certain regions of RF, and energy transmission services provided by BPGC. Changes in the rate structure for such services are subject to the Federal Tariff Service approval. Revenues from regulated tariff services represented approximately 5.5% and 6.0% of the consolidated revenues for the years ended December 31, 2014 and 2013, respectively.

Cash and cash equivalents – Cash equivalents include demand deposits and other highly liquid investments with an original maturity of three months or less. Within the cash and cash equivalents balance are cash equivalents of $777.2 million and $1,211.8 million as of December 31, 2014 and 2013, respectively, which primarily comprise term deposits with banks and bank promissory notes with original maturities of three months or less.

Restricted cash – Restricted cash includes cash and cash equivalents restricted by agreements with third parties for special purposes.

Financial instruments – The Group's financial instruments include cash and cash equivalents, short-term investments, accounts receivable, derivative financial instruments, financial assets and liabilities from banking activities, accounts payable and short-term and long-term debt.

Hedging activities – The Group uses derivative instruments, including swap, forward and option contracts to manage foreign currency and interest rate risk exposures.

The Group designates derivatives as either fair value hedges or cash flow hedges in case the required criteria are met. Changes in the fair value of derivatives that are designated and qualify as fair value hedges are recorded in the consolidated statement of operations and comprehensive income together with any changes in the fair value of the hedged asset or liability that is attributed to the hedged risk.

The effective portion of changes in the fair value of derivatives that are designated and qualify as cash flow hedges are recognized in accumulated other comprehensive loss. Gains and losses associated with the related hedged items are recognized in the consolidated statements of operations and comprehensive income, depending on their nature. The gain or loss relating to the ineffective portion is recognized immediately in the consolidated statement of operations and comprehensive income. For derivatives that do not meet the conditions for hedge accounting, gains and losses from changes in the fair value are included in the consolidated statement of operations and comprehensive income (Note 22).

Assets and liabilities related to multiple derivative contracts with one counterparty are not offset by the Group.

The Group does not use financial instruments for trading or speculative purposes.

Fair value of financial instruments – The fair value of certain financial instruments approximates their carrying value due to the short-term nature of these amounts, namely cash and cash equivalents, short-term investments, accounts receivable and accounts payable, short-term debt and assets and liabilities from banking activities which are included in current assets and liabilities.

Fair value measurements – The Group reviews its fair value hierarchy classifications quarterly. Changes in significant observable valuation inputs identified during these reviews may trigger reclassification of fair value hierarchy levels of financial assets and liabilities. During the years ended December 31, 2014 and 2013 no reclassifications occurred.

A three-level valuation hierarchy has been established under U.S. GAAP for disclosure of fair value measurements. The valuation hierarchy is based on the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – inputs to the valuation methodology are quoted prices (unadjusted) for identical assets or liabilities in active markets;
- Level 2 – inputs to the valuation methodology include quoted prices for similar assets and liabilities in active markets, and inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the financial instrument;
- Level 3 – one or more inputs to the valuation methodology are unobservable and significant to the fair value measurement.

Accounts receivable – Accounts receivable are stated at their net realizable value after deducting a provision for doubtful accounts. Such provision reflects either specific cases of delinquencies or defaults or estimates based on evidence of collectability.

Assets from banking activities – Assets from banking activities comprise assets (cash and cash equivalents, loans, investments and other) involved in operations of MTS Bank. Impairment losses on loans to customers and banks are included in the allowance for loan losses. The allowance for loan losses represents management's best estimate of probable credit losses inherent in the lending portfolios as of the reporting period end. Loans that are not individually reviewed are evaluated as a group using reserve factor percentages based on historic loss experience and qualitative factors. Loans deemed to be uncollectible are charged against the allowance for loan losses. Correspondingly, recoveries of amounts previously charged as uncollectible are credited to the allowance for loan losses. A provision for loan losses is charged to the consolidated statement of operations and comprehensive income based on management's evaluation of the estimated losses, after giving consideration to the net chargeoffs which have been incurred in the Group's loan portfolio.

The Group performs detailed reviews of its lending portfolios on a periodic and systematic basis to identify inherent risks and to assess the overall collectability of those portfolios. The allowance on certain homogeneous loan portfolios, which generally consist of consumer and mortgage loans, is based on an evaluation of aggregated portfolios of homogeneous loans, generally by loan type.

Loss forecast models are utilized for portfolios of homogeneous loans which consider a variety of factors including, but not limited to, historical loss experience, anticipated defaults or foreclosures based on portfolio trends, delinquencies and credit scores, and estimated loss factors by loan type. The remaining loan portfolios are reviewed on an individual loan basis.

Loans subject to individual reviews are analyzed and segregated by risk according to the Group's internal risk rating scale. These risk classifications, in conjunction with an analysis of historical loss experience, current economic conditions and performance trends within specific portfolio segments, and any other pertinent information result in the estimation allowances for loan losses. An allowance for loan losses is established for individually impaired loans. A loan is considered impaired when, based on current information and events, it is probable that the Group will be unable to collect all amounts due, including principal and interest, according to the contractual terms of the agreement. Individually impaired loans are measured based on the present value of payments expected to be received, or for loans that are solely dependent on the collateral for repayment, the estimated fair value of the collateral. If the recorded investment in impaired loans exceeds the measure of estimated fair value, an allowance is established as a component of the allowance for loan losses.

Inventories and spare parts – Inventories comprise raw materials, work-in-progress, finished goods and goods for resale. Inventory and spare parts are stated at the lower of cost or market value. Inventory is accounted for using either first-in, first-out or the weighted-average cost method.

The cost of raw materials includes the cost of purchase, customs duties, transportation and handling costs. Work-in-progress and finished goods are stated at production cost which includes direct production expenses and manufacturing overheads. Costs and estimated earnings in excess of billings on uncompleted contracts include the accumulated costs of projects contracted with third parties, net of related progress billings. The Group periodically assesses its inventories and spare parts for obsolete or slow-moving stock.

Value-added taxes – Value-added taxes ("VAT") related to sales are payable to the tax authorities on an accrual basis based on invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions that will be reclaimed against future sales are recorded as VAT receivable in the accompanying financial statements.

Property, plant and equipment – Property, plant and equipment are stated at historical cost. Cost includes major expenditures for improvements and replacements, which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance, including preventative maintenance, are charged to the consolidated statement of operations and comprehensive income as incurred.

The cost of major overhauls and replacements, which extend useful lives of the assets or increase their revenue generating capacity, are capitalized to the cost of the assets.

Depreciation for property, plant and equipment is computed under the straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	20-50 years
Leasehold improvements	Lesser of the estimated useful life or the term of the lease
Switches and transmission devices	7-31 years
Network and base station equipment	4-12 years
Power and utilities	3-47 years
Other plant, machinery and equipment	3-25 years

Whilst there are certain assets within the Group that have useful lives longer than those presented above, these assets are quantitatively insignificant in comparison to the overall Group balance for each category. As such, the Group has taken the approach of reporting the useful economic lives which most faithfully represent the majority of assets, in order to provide a more reasonable range that more closely relates to the Group norm.

Assets held under capital leases are initially recognized as assets of the Group at their fair value at the inception of a lease or, if lower, at the present value of minimum lease payments. The discount rate used in determining the present value of the minimum lease payments is the Group's incremental borrowing rate, unless (1) it is practicable to determine the implicit rate computed by the lessor; and (2) the implicit rate is less than the Group's incremental borrowing rate. If both of those conditions are met, the interest rate implicit in the lease is used.

Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the consolidated statement of financial position along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is included in the determination of net income.

Construction in progress and equipment for installation are not depreciated until an asset is placed into service.

Asset retirement obligations – The Group calculates asset retirement obligations and an associated asset retirement cost when the Group has a legal or constructive obligation in connection with the retirement of tangible long-lived assets.

Business combinations – Acquisitions of businesses from third parties are accounted for using the acquisition method, with assets and liabilities of an acquired entities being measured at their fair values as at the date of acquisition. Noncontrolling interests are measured at fair value.

Goodwill – Goodwill is determined as the excess of the consideration transferred plus the fair value of any noncontrolling interests in the acquiree at the acquisition date over the fair values of the identifiable net assets acquired. The excess of the fair values of the identifiable net assets acquired over the cost of the business combination plus the fair value of any noncontrolling interests in the acquiree at the acquisition date is credited to income ("negative goodwill").

Goodwill is not amortized to operations, but instead is reviewed for impairment at least annually. At first step, the Group asseses qualitative factors to determine whether it is more likely than not that goodwill is impaired as a basis for determining whether it is necessary to perform the quantitative impairment test. Goodwill is than reviewed for impairment by comparing the carrying value of each reporting unit's net assets (including allocated goodwill) to the fair value of the reporting unit. If the reporting unit's carrying amount is greater than its fair value, the next step is performed whereby the implied fair value that relates to the reporting unit's goodwill is compared to the carrying value of the reporting unit's goodwill. The Group recognizes a goodwill impairment charge for the amount by which the carrying value of goodwill exceeds the fair value.

Other intangible assets – Other intangible assets include billing and telecommunication software and other software, operating licenses, acquired customer bases and customer relationships, radio frequencies, trademarks and telephone numbering capacity.

All finite-life intangible assets are amortized using the straight-line method utilizing estimated useful lives of the assets as follows:

Billing and telecommunication software	1-20 years
Operating licenses	3-20 years
Acquired customer base	1-8 years
Acquired radio frequencies	2-15 years
Software and other	1-10 years

Trademarks and numbering capacity with indefinite contractual life are not amortized, but are reviewed, at least annually, for impairment.

If the fair value of the intangible asset is less than its carrying value, an impairment loss is recognized in an amount equal to the difference. The Group also evaluates the remaining useful life of its intangible assets that are not subject to amortization on an annual basis to determine whether events and circumstances continue to support an indefinite useful life. If an intangible asset that is not being amortized is subsequently determined to have a finite useful life, that asset is tested for impairment.

Investments – The Group's share in the net assets and net income of certain entities, where the Group has the ability to exercise significant influence over their operating and financial policies ("affiliates") is included in the consolidated financial statements using the equity method of accounting. The Group's share in the net income of affiliates is included within operating income, given that the Group has day-to-day involvement in the business activities and they are considered to be integral to the Group's business. Other-than-temporary decreases in the value of investments in affiliates are recognized in net income.

All other equity investments, which consist of investments for which the Group does not have the ability to exercise significant influence, are accounted for under the cost method or at fair value. Investments in private companies are carried at cost, less provisions for other-than-temporary impairment in value. For public companies that have readily determinable fair values, the Group classifies its equity investments as available-for-sale or trading. For available-for-sale securities, the Group records these investments at their fair values with unrealized holding gains and losses included in the consolidated statement of operations and comprehensive income/(loss), net of any related tax effect. For trading securities, the Group records the investment at fair value. Unrealized holding gains and losses for trading securities are included in earnings.

The Group purchases promissory notes for investing purposes. These notes are carried at cost and the discount against the nominal value is accrued over the period to maturity. A provision is made, based on management assessment, for notes that are considered uncollectible. The notes are classified as held-to-maturity.

Investments which are expected to be realized within twelve months after the statement of financial position date are classified as short-term investments. Other investments are classified as long-term investments.

Debt issuance costs – Debt issuance costs are recorded as an asset and amortized using the effective interest method over the terms of the related loans.

Impairment of long-lived assets other than goodwill and indefinite lived intangible assets – The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets. Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group compares the undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets (Note 15).

Liabilities from banking activities – Liabilities from banking activities include deposits from banks and customers, promissory notes issued and other liabilities that arise out of operations of MTS Bank.

Property, plant and equipment contributions – Telecommunication equipment and transmission devices, installed at newly constructed properties in Moscow, have been historically transferred to OJSC Moscow City Telephone Network (hereinafter, "MGTS"), a fixed line operator and subsidiary of the Group, by the Moscow City Government free of charge. These assets are capitalized by the Group at their market value at the date of transfer. Simultaneously, deferred revenue is recorded in the same amount and is amortized as a reduction of the depreciation charge in the consolidated statement of operations and comprehensive income over the contributed assets' life.

Income taxes – Income taxes of the Group's Russian entities have been computed in accordance with RF laws. The corporate income tax rate in the RF is 20%. The income tax rate on dividends paid within Russia is 9% or 0% subject to meeting certain conditions. The foreign subsidiaries of the Group are paying income taxes in their respective jurisdictions.

Deferred tax assets and liabilities are recognized for differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the tax bases of assets and liabilities that will result in future taxable or deductible amounts. The deferred tax assets and liabilities are measured using the enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Deferred tax assets are reduced by a valuation allowance when, in the opinion of management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. In making such determination, the Group considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations.

Uncertain tax positions are recognized in the consolidated financial statements for positions which are not considered more likely than not of being sustained based on the technical merits upon examination by the tax authorities. The measurement of the tax benefit recognized in the consolidated financial statements is based upon the largest amount of tax benefit that, in management’s judgment, is greater than 50% likely of being realized based on a cumulative probability assessment of the possible outcomes.

The Group recognizes interest and penalties relating to unrecognized tax benefits within income taxes.

Treasury stock – If the Group reacquires the Company’s own equity instruments, those instruments (“treasury shares”) are recognized as a deduction of equity at cost, being the consideration paid to reacquire the shares. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Company’s own equity instruments. Such treasury shares may be acquired and held by the Company or by other subsidiaries of the Group.

Share-based compensation – The Group calculates and records the fair value of equity instruments, such as stock options or restricted stock, awarded to employees for services received and recognizes such amounts in the consolidated statement of operations and comprehensive income. The fair value of the equity instruments is measured on the date they are granted and is recognized over the period during which the employees are required to provide services in exchange for the equity instruments (Note 27). Share-based compensation expense includes the estimated effects of forfeitures. Such estimates are adjusted over the requisite service period to the extent actual forfeitures differ, or are expected to differ from such estimates. Changes in estimated forfeitures are recognized in the period of change and also impact the amount of expense to be recognized in future periods.

For share-based compensation that include a component that will be settled in cash, and a component that is settled in equity, the Group accounts for the awards separately, based on their substance. For the component that is settled in cash, the awards generally are accounted for as liabilities with compensation cost recognized over the service (vesting) period of the award based on the fair value of the award remeasured at each reporting period. For the component that is settled in equity, compensation cost is measured based on the fair value of the award on the date of grant and the compensation cost is recognized over the service (vesting) period of the award.

Retirement and postretirement benefits – Subsidiaries of the Group contribute to local state pension funds and social funds, on behalf of their employees.

In Russia all social contributions paid during the year ended December 31, 2014 are represented by payments to governmental social funds, including the Pension Fund of the Russian Federation, the Social Security Fund of the Russian Federation and the Medical Insurance Fund of the Russian Federation.

In the Ukraine, subsidiaries of the Group are required to contribute a specified percentage of each employee’s payroll up to a fixed limit into a pension fund, an unemployment fund and a social security fund. The contributions are expensed as incurred.

In addition to the above, MGTS have defined benefit plans to provide their employees certain benefits upon and after retirement. The net period cost of the Group's defined benefit plans is measured on an actuarial basis using the projected unit credit method and several actuarial assumptions. The recognition of expense for defined benefit plans is significantly impacted by estimates made by management such as discount rates used to value certain liabilities, expected return on assets, mortality rates, future rates of compensation increase and other related assumptions. Gains and losses occur when actual experience differs from actuarial assumptions. If such gains or losses exceed ten percent of the greater of plan assets or plan liabilities the Company amortizes those gains or losses over the average remaining service period of the employees.

The Group records in the statement of financial position the funded status of its pension plans based on the projected benefit obligation.

Borrowing costs – Borrowing costs are recognized as an expense in the period in which they are incurred. Borrowing costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets' estimated useful lives.

Advertising costs – Advertising costs are expensed as incurred. Advertising costs for the year ended December 31, 2014 and 2013 were $266.0 million and $328.7 million, respectively, and were reflected as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations and comprehensive income.

Redeemable noncontrolling interests – From time to time, in order to optimize the structure of business acquisitions and to defer payment of the purchase price the Group enters into put and call option agreements to acquire noncontrolling interests in the existing subsidiaries. As these put and call option agreements are not freestanding, the underlying shares of such put and call option agreements are classified as redeemable securities and are accounted for at either redemption value or the fair value of redeemable noncontrolling interests as of the reporting date. The fair value of redeemable noncontrolling interests is assessed based on discounted future cash flows of the acquired entity ("Level 3" significant unobservable inputs of the hierarchy established by U.S. GAAP guidance). Any changes in redemption value of redeemable noncontrolling interests are accounted for in the Group's retained earnings. Redeemable noncontrolling interests are presented as temporary equity in the consolidated statement of financial position.

Earnings per share – Basic earnings per share ("EPS") is based on net income attributable to the Group divided by the weighted average number of shares outstanding during the year.

Diluted EPS is based on net income attributable to the Group adjusted in certain circumstances, divided by the weighted average number of shares outstanding during the year, adjusted for the dilutive effect of all potential shares that were outstanding during the year. Such potentially dilutive shares are excluded when the effect would be to increase diluted earnings per share or reduce the diluted loss per share.

Distributions to shareholders – Distributable retained earnings of the Group are based on amounts extracted from the standalone statutory accounts of the Company (based on the Russian accounting standards) and may significantly differ from consolidated amounts calculated on the basis of U.S. GAAP.

Reclassifications and revisions – Certain comparative information presented in the consolidated financial statements for the year ended December 31, 2013 has been revised in order to achieve comparability with the presentation used in the consolidated financial statements for the year ended December 31, 2014. Such reclassifications and revisions were not significant to the Group financial statements, except for presentation of the loss on deconsolidation of Bashneft (Note 2).

Recently adopted accounting pronouncements – Effective January 1, 2014, the Group adopted Accounting Standards Update ("ASU") 2013-05, Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity, ASU 2013-07, Liquidation Basis of Accounting and ASU 2013-11, Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The adoption of these amendments did not have a material impact on the Group's consolidated balance sheet or results of operations.

Transition to International Financial Reporting Standards –To conform with the Russian legislation, the Group will prepare its consolidated financial statements for the year ended December 31, 2015 in accordance with International Financial Reporting Standards ("IFRS").