Mail.Ru Group Limited

Interim Condensed Consolidated Financial Statements

For the three months ended March 31, 2017

Contents

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Independent auditor's report

To the Shareholders and Board of Directors of Mail.ru Group Limited

Report on review of interim condensed consolidated financial statements

Introduction

We have reviewed the accompanying interim condensed consolidated financial statements of Mail.Ru Group Limited and its subsidiaries (the Group), which comprise the interim consolidated statement of financial position as at March 31, 2017, the related interim consolidated statements of comprehensive income, changes in equity and cash flows for the three-month period then ended and explanatory notes. Management of Group is responsible for the preparation and presentation of these interim consolidated financial statements in accordance with IAS 34, *Interim Financial Reporting*. Our responsibility is to express a conclusion on these interim consolidated financial statements based on our review.

Scope of review

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

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IAS 34, *Interim Financial Reporting*.

Alexey Chizhikov
Partner
Ernst & Young LLC

April 27, 2017

Details of the audited entity
Name: Mail.ru Group Limited
Registered: May 4, 2005
Address: 232 28th October Street, Office 501, 3035 Limassol, Cyprus.

Details of the auditor
Name: Ernst & Young LLC
Record made in the State Register of Legal Entities on December 5, 2002, State Registration Number 1027739707203.
Address: Russia 115035, Moscow, Sadovnicheskaya naberezhnaya, 77, building 1.
Ernst & Young LLC is a member of Self-regulated organization of auditors "Russian Union of auditors" (Association) ("SRO RUA"). Ernst & Young LLC is included in the control copy of the register of auditors and audit organizations, main registration number 11603050648.

Interim Condensed Consolidated Statement of Financial Position

As of March 31, 2017
(in millions of Russian Roubles)

	Notes	As at March 31, 2017 (unaudited)	As at December 31, 2016
ASSETS			
Non-current assets			
Investments in equity accounted associates		657	649
Goodwill		132,309	132,309
Other intangible assets	6	28,773	29,894
Property and equipment	7	4,053	3,840
Financial assets at fair value through profit or loss	15	406	403
Deferred income tax assets		3,278	2,600
Other non-current assets	8	1,719	2,265
Total non-current assets		171,195	171,960
Current assets			
Trade accounts receivable	15	3,618	5,089
Prepaid income tax		74	49
Prepaid expenses and advances to suppliers		2,165	2,111
Financial assets at fair value through profit or loss	15	360	105
Other current assets	9	253	201
Cash and cash equivalents	15	8,428	5,513
Total current assets		14,898	13,068
Total assets		186,093	185,028
EQUITY AND LIABILITIES			
Equity attributable to equity holders of the parent			
Issued capital		–	–
Share premium		52,542	51,758
Treasury shares		(1,284)	(1,290)
Retained earnings		113,218	112,415
Accumulated other comprehensive income		631	470
Total equity attributable to equity holders of the parent		165,107	163,353
Non-controlling interests		65	64
Total equity		165,172	163,417
Non-current liabilities			
Deferred income tax liabilities		3,233	3,265
Deferred revenue		3,444	2,710
Other non-current liabilities	15	494	748
Total non-current liabilities		7,171	6,723
Current liabilities			
Trade accounts payable	15	3,871	3,355
Income tax payable		332	389
Financial liabilities at fair value through profit or loss	15	246	195
VAT and other taxes payable		2,182	2,231
Deferred revenue and customer advances		5,146	4,893
Short-term interest-bearing loans	15	–	122
Other payables and accrued expenses	10	1,973	3,703
Total current liabilities		13,750	14,888
Total liabilities		20,921	21,611
Total equity and liabilities		186,093	185,028

Interim Condensed Consolidated Statement of Comprehensive Income

For the three months ended March 31, 2017
(in millions of Russian Roubles)

	Notes	Three months ended March 31, 2017 (unaudited)	Three months ended March 31, 2016 (unaudited)
Online advertising		4,877	3,947
MMO games		3,208	2,090
Community IVAS		3,247	3,333
Other revenue	11	428	562
Total revenue		11,760	9,932
Net loss on venture capital investments	15	(27)	(111)
Personnel expenses		(3,220)	(2,845)
Office rent and maintenance		(512)	(512)
Agent/partner fees		(2,340)	(1,411)
Marketing expenses		(1,834)	(602)
Server hosting expenses		(429)	(517)
Professional services		(76)	(105)
Other operating expenses		(278)	(250)
Total operating expenses		(8,689)	(6,242)
EBITDA		3,044	3,579
Depreciation and amortisation		(2,114)	(1,896)
Share of profit of equity accounted associates		8	35
Finance income		119	192
Finance expenses		(12)	(427)
Other non-operating income		11	38
Net gain on derivative financial assets and liabilities at fair value through profit or loss	15	186	368
Net (loss)/gain on disposal of shares in subsidiaries	5	(15)	8,712
Net foreign exchange loss		(274)	(148)
Profit before income tax expense		953	10,453
Income tax expense	12	(149)	(189)
Net profit		804	10,264
Attributable to:			
Equity holders of the parent		803	10,258
Non-controlling interest		1	6
Other comprehensive income/(loss) that may be reclassified to profit or loss in subsequent periods			
Exchange differences on translation of foreign operations:			
Differences arising during the period		148	(50)
Available-for-sale financial assets:			
Loss arising during the period (net of tax effect of zero)		–	(234)
Total other comprehensive income/(loss) net of tax effect of 0		148	(284)
Total comprehensive income, net of tax		952	9,980
Attributable to:			
Equity holders of the parent		951	9,975
Non-controlling interest		1	5
Earnings per share, in RUR:			
Basic earnings per share attributable to ordinary equity holders of the parent		3.84	49.27
Diluted earnings per share attributable to ordinary equity holders of the parent		3.78	48.18

Interim Condensed Consolidated Statement of Cash Flows

For the three months ended March 31, 2017
(in millions of Russian Roubles)

	Three months ended March 31, 2017 (unaudited)	Three months ended March 31, 2016 (unaudited)
Cash flows from operating activities		
Profit before income tax	953	10,453
Adjustments for:		
Depreciation and amortisation	2,114	1,896
Bad debt expense/(reversal)	(3)	2
Net gain on derivative financial assets and liabilities at fair value through profit or loss	(186)	(368)
Net (gain)/loss on disposal of shares in subsidiaries	15	(8,712)
Loss on disposal of property and equipment and intangible assets	–	(1)
Finance income	(119)	(192)
Finance expenses	12	427
Share of profit of equity accounted associates	(8)	(35)
Net foreign exchange loss	274	148
Share-based payment expense	916	572
Other non-cash items	(49)	(70)
Decrease in accounts receivable	1,410	727
Increase in prepaid expenses and advances to suppliers	(168)	(2,396)
(Increase)/decrease in other assets	(50)	31
Decrease in accounts payable and accrued expenses	(50)	(470)
Decrease in other non-current assets	417	40
Increase in deferred revenue and customers advances	996	338
(Increase)/decrease in financial assets at fair value through profit or loss	(43)	111
Operating cash flows before interest and income taxes	6,431	2,501
Interest received	112	146
Interest paid	(12)	(439)
Income tax paid	(982)	(241)
Net cash provided by operating activities	5,549	1,967
Cash flows from investing activities:		
Cash paid for property and equipment	(651)	(283)
Cash paid for intangible assets	(596)	(8)
Collection of loans receivable	–	22
Cash paid for acquisitions of subsidiaries, net of cash acquired	(1,174)	–
Proceeds from disposal of subsidiaries, net of cash disposed	(43)	5,579
Collection of short-term and long term deposits	–	14
Net cash (used in)/provided by investing activities	(2,464)	5,324
Cash flows from financing activities:		
Loans repaid	(122)	(5,300)
Dividends paid by subsidiaries to non-controlling shareholders	–	(2)
Net cash used in financing activities	(122)	(5,302)
Net increase in cash and cash equivalents	2,963	1,989
Effect of exchange differences on cash balances	(48)	(95)
Cash and cash equivalents at the beginning of the period	5,513	8,676
Cash and cash equivalents at the end of the period	8,428	10,570

Interim Condensed Consolidated Statement of Changes in Equity

For the three months ended March 31, 2016
(in millions of Russian Roubles)

	Share capital								
	Number of shares issued and outstanding	Amount	Share premium	Treasury shares	Retained earnings	Accumulated other comprehensive income (net of tax effect of 0)	Total equity attributable to equity holders of the parent	Non-controlling interests	Total equity
Balance at January 1, 2016	208,127,372	–	49,328	(1,293)	100,602	(205)	148,432	15	148,447
Profit for the period	–	–	–	–	10,258	–	10,258	6	10,264
Other comprehensive income:									
Foreign currency translation	–	–	–	–	–	(49)	(49)	(1)	(50)
Net change in cumulative holding gains on available-for-sale investments	–	–	–	–	–	(234)	(234)	–	(234)
Total other comprehensive income	–	–	–	–	–	(283)	(283)	(1)	(284)
Total comprehensive income	–	–	–	–	10,258	(283)	9,975	5	9,980
Share-based payment transactions	–	–	601	–	–	–	601	–	601
Exercise of RSUs and options over the shares of the Company	304,197	–	(3)	3	–	–	–	–	–
Effect of disposal of subsidiary	–	–	–	–	–	280	280	(19)	261
Dividends by subsidiaries to non-controlling shareholders	–	–	–	–	–	–	–	(2)	(2)
Balance at March 31, 2016 (unaudited)	208,431,569	–	49,926	(1,290)	110,860	(208)	159,288	(1)	159,287

Interim Condensed Consolidated Statement of Changes in Equity (continued)

For the three months ended March 31, 2017
(in millions of Russian Roubles)

	Share capital								
	Number of shares issued and outstanding	Amount	Share premium	Treasury shares	Retained earnings	Accumulated other comprehensive income (net of tax effect of 0)	Total equity attributable to equity holders of the parent	Non-controlling interests	Total equity
Balance at January 1, 2017	208,634,437	–	51,758	(1,290)	112,415	470	163,353	64	163,417
Profit for the period	–	–	–	–	803	–	803	1	804
Other comprehensive income:									
Foreign currency translation	–	–	–	–	–	148	148	–	148
Total other comprehensive income	–	–	–	–	–	148	148	–	148
Total comprehensive income	–	–	–	–	803	148	951	1	952
Share-based payment transactions	–	–	790	–	–	–	790	–	790
Exercise of RSUs and options over the shares of the Company	2,625,769	–	(6)	6	–	–	–	–	–
Effect of disposal of subsidiary	–	–	–	–	–	13	13	–	13
Balance at March 31, 2017 (unaudited)	211,260,206	–	52,542	(1,284)	113,218	631	165,107	65	165,172

Notes to the Interim Condensed Consolidated Financial Statements

For the three months ended March 31, 2017
(in millions of Russian Roubles)

1 Corporate information and description of business

These interim condensed consolidated financial statements of Mail.Ru Group Limited (hereinafter "the Company") and its subsidiaries (collectively – "the Group") for the three months ended March 31, 2017 were authorised for issue by the directors of the Company on April 27, 2017.

The Company was registered on May 4, 2005 in the Territory of the British Virgin Islands ("BVI"), pursuant to the International Business Companies Act (the "Act"), Cap. 291. The principal office of the Company is at 232 28th October Street, Office 501, 3035 Limassol, Cyprus.

The Company consolidates or participates in businesses that operate in the Internet segment, including portals, social networking and communications, e-payment solutions, online marketplaces, massively multiplayer online games ("MMO games"), social and mobile games. The Group and its associates have leading positions in the CIS states where they are present, including Russia, Ukraine and Kazakhstan.

2 Basis of preparation

The interim condensed consolidated financial statements for the three months ended March 31, 2017 have been prepared in accordance with IAS 34.

The interim condensed consolidated financial statements do not include all the information and disclosures required in the annual financial statements, and should be read in conjunction with the Group's annual financial statements for the year ended December 31, 2016 prepared in accordance with IFRS.

2.1 Application of new and amended IFRS and IFRIC

The accounting policies adopted are consistent with those followed in the preparation of the Group's annual financial statements for the year ended December 31, 2016, except for the adoption of new standards as of January 1, 2017 listed below:

Amendments to IAS 7 Statement of Cash Flows: Disclosure Initiative

The amendments require entities to provide disclosures about changes in their liabilities arising from financing activities, including both changes arising from cash flows and non-cash changes (such as foreign exchange gains or losses). On initial application of the amendment, entities are not required to provide comparative information for preceding periods. The Group is not required to provide additional disclosures in its condensed interim consolidated financial statements, but will disclose additional information in its annual consolidated financial statements for the year ending December 31, 2017.

Amendments to IAS 12 Income Taxes: Recognition of Deferred Tax Assets for Unrecognised Losses

The amendments clarify that an entity needs to consider whether tax law restricts the sources of taxable profits against which it may make deductions on the reversal of that deductible temporary difference. Furthermore, the amendments provide guidance on how an entity should determine future taxable profits and explain the circumstances in which taxable profit may include the recovery of some assets for more than their carrying amount.

Entities are required to apply the amendments retrospectively. However, on initial application of the amendments, the change in the opening equity of the earliest comparative period may be recognised in opening retained earnings (or in another component of equity, as appropriate), without allocating the change between opening retained earnings and other components of equity. Entities applying this relief must disclose that fact.

The Group has applied the amendments retrospectively. However, their application has had no effect on the Group's financial position and performance as the Group has no deductible temporary differences or assets that are in the scope of the amendments.

3 Seasonality of operations

Due to the seasonal nature of advertising and online games, higher revenues and operating profits are usually expected in the second half of the year than in the first six months. Higher sales during the second half of the year are mainly attributed to the fact that a large portion of advertising budgets is spent in the last quarter of the year and to the increased demand for online games due to the end of the vacation period.

4 Operating segments

In reviewing the operational performance of the Group and allocating resources, the Chief Executive Officer of the Group, who is the Group's Chief Operating Decision Maker (CODM), reviews selected items of each segment's income statement, assuming 100% ownership in all of the Group's key operating subsidiaries, based on management reporting.

Management reporting is different from IFRS, because it does not include certain IFRS adjustments which are not analysed by the CODM in assessing the core operating performance of the business. Such adjustments affect such major areas as revenue recognition, deferred tax on unremitted earnings of subsidiaries, share-based payments, disposal or impairment of investments, business combinations, fair value adjustments, amortisation and impairment thereof, net foreign exchange gains and losses, share in financial results of associates, as well as irregular non-recurring items that occur from time to time and are evaluated for adjustment as and when they occur. The tax effect of these adjustments is also excluded from management reporting.

4 Operating segments (continued)

The financial information of the key subsidiaries acquired during the reporting period or after the reporting period but prior to the date of these consolidated financial statements is included into the segment disclosure starting from the later of:

- the beginning of the earliest comparative period included in the financial statements; and
- the date of the Group's acquisition of its first interest in the respective key subsidiary.

The financial information of subsidiaries disposed of prior to the date of these consolidated financial statements is excluded from the segment presentation starting from the beginning of the earliest period presented.

Accordingly, segment reporting for the three months ended March 31, 2016 has been retrospectively adjusted to include the financial information of Pixonic and Delivery Club and exclude the financial information of HeadHunter (Note 5.1) all starting from January 1, 2016.

The Group has identified its operating segments based on the types of products and services the Group offers. The Group has identified the following reportable segments on this basis:

- Email, Portal and IM;
- VK (Vkontakte);
- Social Networks (excluding VK);
- Online Games; and
- E-Commerce, Search and Other Services.

The Email, Portal and IM segment includes email, instant messaging and portal (main page and media projects). It earns substantially all revenues from display and context advertising.

The VK segment includes the Group's social network Vkontakte (VK.com) and earns revenues from (i) commission from application developers based on the respective applications' revenue, (ii) user payments for virtual gifts and stickers and (iii) online advertising, including display and context advertising.

The Social Networks (excluding VK) segment includes the Group's two other social networks (OK and My World) and earns revenues from (i) user payments for virtual gifts, (ii) commission from application developers based on the respective applications' revenue, and (iii) online advertising, including display and context advertising. OK and My World have been aggregated into a single operating segment as they have similar economic characteristics and provide similar services to similar customers in similar markets.

The Online Games segment includes online gaming services, including MMO, social and mobile games. It earns substantially all revenues from (i) sale of virtual in-game items to users and (ii) royalties for games licensed to third-party online game operators.

The E-Commerce, Search and Other Services reportable segment represents separate operating segments aggregated in one reportable segment for presentation purposes only and primarily consists of search engine services earning substantially all revenues from context advertising and e-commerce services (including O2O). This segment also includes a variety of other services, which are considered insignificant by the CODM for the purposes of performance review and resource allocation.

The Group measures the performance of its operating segments through a measure of earnings before interest, tax, depreciation and amortisation (EBITDA). Segment EBITDA is calculated as the respective segment's revenue less operating expenses (excluding depreciation and amortisation and impairment of intangible assets), including Group corporate expenses allocated to the respective segment.

EBITDA is not a measure of financial performance under IFRS. The calculation of EBITDA by the Group may be different from the calculations of similarly labeled measures used by other companies and it should therefore not be used to compare one company against another or as a substitute for analysis of the Group's operating results as reported under IFRS. EBITDA is not a direct measure of the Group's liquidity, nor is it an alternative to cash flows from operating activities as a measure of liquidity, and it needs to be considered in the context of the Group's financial commitments. EBITDA may not be indicative of the Group's historical operating results, nor is it meant to be predictive of the Group's potential future results. The Group believes that EBITDA provides useful information to the users of the consolidated financial statements because it is an indicator of the strength and performance of the Group's ongoing business operations, including the Group's ability to fund discretionary spending such as capital expenditure, acquisitions and other investments and the Group's ability to incur and service debt.

The information about the breakdown of revenue from external customers by the customers' country of domicile and non-current assets by country is not available to the management of the Group, and it considers that the cost to develop such information would be excessive.

4 Operating segments (continued)

The income statement items for each segment for the three months ended March 31, 2017, as presented to the CODM, are presented below:

	Email, Portal and IM	Social Networks (ex VK)	Online Games	VK	E-commerce, Search and other	Eliminations	Group
Revenue							
External revenue	1,107	3,815	4,168	2,655	891	–	12,636
Intersegment revenue	2	24	–	89	92	(207)	–
Total revenue	1,109	3,839	4,168	2,744	983	(207)	12,636
Total operating expenses	745	1,180	2,931	957	2,146	(207)	7,752
EBITDA	364	2,659	1,237	1,787	(1,163)	–	4,884
Net profit							3,478

The income statement items for each segment for the three months ended March 31, 2016, as presented to the CODM, are presented below:

	Email, Portal and IM	Social Networks (ex VK)	Online Games	VK	E-commerce, Search and other	Eliminations	Group
Revenue							
External revenue	1,007	3,879	2,674	1,872	725	–	10,157
Intersegment revenue	1	5	–	9	95	(110)	–
Total revenue	1,008	3,884	2,674	1,881	820	(110)	10,157
Total operating expenses	801	1,155	2,335	845	718	(110)	5,744
EBITDA	207	2,729	339	1,036	102	–	4,413
Net profit							2,775

A reconciliation of group aggregate segment revenue, as presented to the CODM, to IFRS consolidated revenue of the Group for the three months ended March 31, 2017 and 2016 is presented below:

	2017	2016
Total revenue, as presented to the CODM	12,636	10,157
Adjustments to reconcile revenue as presented to the CODM to consolidated revenue under IFRS:		
Effect of difference in dates of acquisition and loss of control in subsidiaries	–	97
Differences in timing of revenue recognition	(886)	(335)
Barter revenue	10	13
Consolidated revenue under IFRS	11,760	9,932

A reconciliation of group aggregate segment EBITDA, as presented to the CODM, to IFRS consolidated profit before income tax expense of the Group for the three months ended March 31, 2017 and 2016 is presented below:

	2017	2016
Group aggregate segment EBITDA, as presented to the CODM	4,884	4,413
Adjustments to reconcile EBITDA as presented to the CODM to consolidated profit before income tax expenses under IFRS:		
Effect of difference in dates of acquisition and loss of control in subsidiaries	–	233
Differences in timing of revenue recognition	(886)	(335)
Net loss on venture capital investments	(27)	(111)
Share-based payment transactions	(916)	(572)
Other	(11)	(49)
EBITDA	3,044	3,579
Depreciation and amortisation	(2,114)	(1,896)
Share of profit of equity accounted associates	8	35
Finance income	119	192
Finance expenses	(12)	(427)
Other non-operating income	11	38
Net gain on derivative financial assets and liabilities at fair value through profit or loss	186	368
Net (loss)/gain on disposal of shares in subsidiaries	(15)	8,712
Net foreign exchange loss	(274)	(148)
Consolidated profit before income tax expense under IFRS	953	10,453

4 Operating segments (continued)

A reconciliation of group aggregate net profit, as presented to the CODM, to IFRS consolidated net profit of the Group for the three months ended March 31, 2017 and 2016 is presented below:

	2017	2016
Total net profit, as presented to the CODM	3,478	2,775
Adjustments to reconcile net profit as presented to the CODM to consolidated net profit under IFRS:		
Share-based payment transactions	(916)	(572)
Differences in timing of revenue recognition	(886)	(335)
Effect of difference in dates of acquisition and loss of control in subsidiaries	–	219
Amortisation of fair value adjustments to intangible assets and impairment thereof	(1,318)	(1,214)
Net gain on financial instruments at fair value through profit or loss	158	256
Net (loss)/gain on disposal of shares in subsidiaries	(15)	8,712
Net foreign exchange loss	(274)	(148)
Share of profit of equity accounted associates	8	35
Other	(13)	(44)
Tax effect of the adjustments and tax on unremitted earnings	582	580
Consolidated net profit under IFRS	804	10,264

5 Business combination

5.1 HeadHunter

In February 2016 the Group sold 100% of HeadHunter for a cash consideration of RUR 10,130. As of the date of disposal the net assets of HeadHunter attributable to the Group were RUR 1,138, including goodwill of RUR 1,855 and cash and cash equivalents of RUR 421. Disposed liabilities of HeadHunter mostly included Deferred revenue and customer advances. In addition, currency translation reserve attributable to HeadHunter in the amount of RUR 280 was reclassified to profit or loss. As a result of the disposal the Group recognized a gain in the amount of RUR 8,712 recorded under "Net gain from disposal of subsidiaries" in the statement of comprehensive income.

6 Other Intangible assets

During the three months ended March 31, 2017, the Group capitalized software development costs and otherwise acquired intangible assets with a cost of RUR 680 (2016: RUR 54).

7 Property and equipment

During the three months ended March 31, 2017, the Group acquired property and equipment with a cost of RUR 670 (2016: RUR 151).

8 Other non-current assets

Other non-current assets consist of the following:

	March 31, 2017	December 31, 2016
Advance under office lease contract	647	1,075
Advances for royalties	887	1,012
Other non-current assets	185	178
Total other non-current assets	1,719	2,265

9 Other current assets

Other current assets consist of the following:

	March 31, 2017	December 31, 2016
Inventory	27	27
VAT receivable	184	111
Other current assets	42	63
Total other current assets	253	201

Notes to the Interim Condensed Consolidated Financial Statements (continued)

10 Other payables and accrued expenses

Other payables and accrued expenses consist of the following:

	March 31, 2017	December 31, 2016
Payables to personnel	964	1,260
Accrued vacations	707	611
Accrued professional consulting expenses	61	101
Payables under lease contract	156	156
Other current payables	85	1,575
Total other payables and accrued expenses	1,973	3,703

The decrease in "Other current payables" was mostly due to repayment of RUR 1,174 in 2017 of deferred consideration related to acquisitions of Pixonic and Delivery Club made in 2016.

11 Other revenue

Other revenue consists of the following:

	Three months ended March 31	
	2017	2016
Online recruitment services	–	471
Listing fees	4	20
Food delivery	274	–
Other	150	71
Total other revenue	428	562

12 Income tax

The major components of income tax expense in the interim consolidated statement of comprehensive income are as follows:

	Three months ended March 31	
	2017	2016
Current income tax expense	903	891
Deferred income tax benefit	(754)	(702)
Total income tax expense	149	189

The reconciliation between income tax expense and the product of accounting profit multiplied by domestic rates applicable to individual Group entities for the three months ended March 31, 2017 and 2016 is as follows:

	Three months ended March 31	
	2017	2016
Profit before income tax expense	953	10,453
Tax at domestic rates applicable to individual group entities	(62)	(1,288)
Non-taxable gain from disposal of subsidiary	–	1,015
Tax on unremitted earnings	2	347
Non-taxable foreign exchange and other gains	19	(6)
Non-deductible expenses	(163)	(236)
Adjustments in respect of current income tax of previous year	51	(17)
Other	4	(4)
Total income tax expense	(149)	(189)

In 2016 the Group continued to bring its legal structure in line with the operating structure. As a result of this process, in 2016 the Group reversed approximately RUR 345 million of deferred taxes accrued in prior years. Starting 2016 certain Group subsidiaries apply some income tax exemptions and related deferred tax assets and liabilities were calculated using applicable tax rates.

13 Commitments, contingencies and operating risks

13.1 Operating environment of the Group

Most of the Group's operations are in Russia. Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Russian economy has been negatively impacted by a decline in oil prices and sanctions imposed on Russia by a number of countries. The Rouble interest rates remained high. The combination of the above resulted in reduced access to capital, a higher cost of capital and uncertainty regarding economic growth, which could negatively affect the Group's future financial position, results of operations and business prospects. Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

13.2 Taxation

Russian tax, currency and customs legislation is subject to varying interpretations, and changes, which can occur frequently. Management's interpretation of such legislation as applied to the transactions and activity of the Group may be challenged by the relevant regional and federal authorities. Recent events within the Russian Federation suggest that the tax authorities are taking a more assertive position in their interpretation of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may be challenged. As such, significant additional taxes, penalties and interest may be assessed. Fiscal periods remain open to review by the authorities in respect of taxes for three calendar years preceding the year of review. Under certain circumstances reviews may cover longer periods.

The Group's management believes that its interpretation of the relevant legislation is appropriate and is in accordance with the current industry practice and that the Group's tax, currency and customs positions will be sustained. However, the interpretations of the relevant authorities could differ and the effect of additional taxes, fines and penalties on these consolidated financial statements, if the authorities were successful in enforcing their different interpretations, could be significant.

13.3 Legal proceedings

The Group has been and continues to be the subject of legal proceedings and adjudications from time to time, none of which have had, individually or in the aggregate, a material adverse impact on the Group. Management believes that the resolution of all current and potential legal matters will not have a material impact on the Group's financial position or operating results.

13.4 Competition

The development by domestic and large international internet companies of Russian language versions of the services competing with the services the Group provides could decrease the Group's user base and make it less attractive to advertisers.

Increased competition could result in a reduction in the number of users who buy the Group's IVAS – including games – which, in turn, would result in lower revenue and net income. Similarly, the Group may be required to spend additional resources to promote or improve its services in order to compete effectively, which could require additional capital or adversely affect the Group's profitability.

13.5 Private information

To become registered on websites operated by the Group, users have to input their personal data, which is then protected by the Group from access by third parties. Should such data become available to third parties as a result of hackers' attacks, the Group may become a party to litigations from its users. Management believes it takes all necessary steps to reduce the related risk to an acceptable level.

13.6 Intellectual property rights

The Group may be subject to infringement claims from third parties in the future resulting from the technology and intellectual property used in the provision and marketing of its services. If the Group is found liable for infringement, it may be required to pay significant damages, and if it is unable to license or develop non-infringing technology on a timely basis, it may be unable to continue offering the affected services without risk of liability. Similarly, third parties may obtain and use the Group's intellectual property without authorisation. The validity, application, enforceability and scope of protection of intellectual property rights for many Internet-related activities are uncertain and still evolving, which may make it more difficult for the Group to protect its intellectual property, which could have a material effect on its business, results of operations and financial condition. The Group and its associates have been subject to such proceedings in the past. Although none of them was individually significant, similar potential claims may potentially subject the Group to significant losses in the future, which currently cannot be reliably estimated.

13.7 Development

A failure to innovate, to provide popular products and services or to react quickly to changes in the market could affect the popularity of the Group's services and, in turn, could affect advertising revenue. An inability to develop products and services which are compatible with new mobile devices could result in a failure to capture a significant share of an increasingly important market.

13 Commitments, contingencies and operating risks (continued)

13.8 Regulation

New laws and regulations, or new interpretations of existing laws and regulations, could require the Group to invest in restructuring certain services or could lead to a reduction in their take-up by users, with a resulting effect on revenue and profitability.

On July 7, 2016 the President of the Russian Federation signed a package of "Anti-terror laws". The package requires organisers of the dissemination of information including subsidiaries of the Group: 1) to store data on receipt, transfer, processing of the users' information in the Russian Federation for the period of 1 year excluding content (effective from July 20, 2016); 2) to store data on receipt, transfer, processing of the users' information in the Russian Federation for the period of up to 6 months as the Russian Government shall determine including content (effective from July 1, 2018); 3) to provide competent authorities with decryption means if encryption is used or supported by the organiser of the dissemination of information (effective from July 20, 2016). The details of implementation of the package are currently under discussion. The Group will estimate the potential effects of the laws when the Russian Government determines how to store data on communications with content.

The Group complies with the new laws and none of the Group's properties have been blocked up to date.

13.9 Personnel

As competition in Russia's internet industry increases, the Group's business and operations could be adversely affected by difficulties in hiring, motivating and retaining highly-skilled people. Competition for senior managers is high. One or more could join a competitor, or set-up a competing company, with the result that operations and profitability could be affected by a loss of strategic direction, users, know-how and additional staff.

13.10 Infrastructure and capacity

If the infrastructure in Russia were not able to support increased demand, the Group's services could be interrupted or the Group's systems damaged. A limited availability of third-party providers of network and server capacity could limit the Group's ability to offer certain services or to expand. Network or power failures could result in the loss of data and in a reduction in the number of users, which could have a material effect on the Group's business, results of operations and financial condition.

14 Balances and transactions with related parties

The following table provides the total amount of transactions which have been entered into with related parties during the three month periods ending March 31, 2017 and March 31, 2016 as well as balances with related parties as of March 31, 2017 and December 31, 2016, excluding directors and key management of the Group (see below). All related party transactions were made in accordance with contractual terms and conditions agreed between the parties.

	Sales to related parties	Purchases from related parties	Amounts owed by related parties	Amounts owed to related parties
2017				
Equity accounted associates	29	–	49	2
Other entities	–	3	–	1
2016				
Equity accouned associates	31	15	64	2
Other entities	1	3	–	2

14.1 Directors of the Company

Total cash remuneration of the members of the Board of Directors (each a "Director" and collectively, "Directors") of the Company amounted to RUR 30 for the three months ended March 31, 2017 (2016: RUR 47). No options over the shares of the Company were granted to Directors for the three months ended March 31, 2017 (2016: nil). During the three months ended March 31, 2017, Directors did not forfeit any options (2016: nil), exercised an aggregate of 2,200,000 RSUs and options over shares of the Company (2016: nil). Additionally 1,100,000 RSUs held by Directors of the Company were accelerated in 2017. The corresponding share-based payment expense was RUR 675 for the three months ended March 31, 2017 (2016: a negative RUR 8).

14.2 Key management of the Group

Total cash remuneration of the key management of the Group (excluding Directors) amounted to RUR 131 for the three months ended March 31, 2017 (2016: RUR 145). In the three months ended March 31, 2017, key executive employees of the Group (excluding Directors) were not granted any RSUs or options over shares of the Company (2016: nil). During the three months ended March 31, 2017, key management of the Group (excluding Directors) did not forfeit any RSUs or options (2016: nil) and exercised 216,625 RSUs (2016: 164,750). The corresponding share-based payment expense amounted to RUR 104 for the three months ended March 31, 2017 (2016: RUR 484).

14.3 The ultimate controlling party

USM Holdings Ltd. ("USM") is the ultimate controlling party of the Group through USM`s subsidiary MegaFon Public Joint Stock Company, which became the controlling shareholder of the Group in February 2017.

15 Financial instruments

The carrying amounts of the Group's financial instruments approximated their fair values as of March 31, 2017 and December 31, 2016 and are presented by category of financial instruments in the table below:

	Category*	March 31, 2017	December 31, 2016
Financial assets			
Financial investments in associates	FAFVPL	338	322
Financial derivatives under lease and hosting contracts	FAFVPL	406	164
Derivative financial assets over the equity of subsidiary	FAFVPL	22	22
Trade accounts receivable	LR	3,618	5,089
Loans and interest receivable	LR	41	31
Cash and cash equivalents	LR	8,428	5,513
Total financial assets		12,853	11,141
Current		12,447	10,725
Non-current		406	416
Total derivative financial assets		428	186
Current		360	105
Non-current		68	81
Financial liabilities			
Short-term interest-bearing loans	FLAC	–	122
Financial liabilities at fair value through profit or loss - derivative over the equity of investee	FLFVPL	246	234
Short-term and long-term trade accounts payable	FLAC	4,365	4,064
Total financial liabilities		4,611	4,420
Current		4,117	3,672
Non-current		494	748

* Financial instruments used by the Group are included in one of the following categories:

- FAFVPL – financial assets at fair value through profit or loss;
- LR – loans and receivables;
- FLFVPL – financial liabilities at fair value through profit or loss; or
- FLAC – financial liabilities at amortised cost.

Fair value of cash and cash equivalents, short-term accounts receivable, other current assets, trade accounts payable approximate their carrying amounts largely due to the short-term maturities of these instruments.

15.1 Fair value hierarchy

The Group uses the following hierarchy for determining and disclosing the fair value of financial instruments based on the observability of the inputs used in measuring fair value:

- Level 1: quoted prices (unadjusted) in active markets for identical assets or liabilities;
- Level 2: inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as prices) or indirectly (i.e., derived from prices);
- Level 3: inputs for the asset or liability that are not based on observable market data (unobservable inputs).

As at March 31, 2017 and December 31, 2016 the Group held the following financial instruments measured at fair value:

	March 31, 2017	Level 1	Level 2	Level 3
Financial assets measured at fair value				
Financial assets at fair value through profit or loss:				
Financial investments in associates	338	–	–	338
Financial derivatives under lease and hosting contracts	406	–	–	406
Derivative financial assets over the equity of subsidiary	22	–	–	22
Total financial assets at fair value through profit or loss	766	–	–	766
Total financial assets measured at fair value	766	–	–	766
Financial liabilities measured at fair value				
Financial liabilities at fair value through profit or loss - derivative over the equity of investee	(246)	–	–	(246)
Total financial liabilities measured at fair value	(246)	–	–	(246)

Notes to the Interim Condensed Consolidated Financial Statements (continued)

15 Financial instruments (continued)

15.1 Fair value hierarchy (continued)

	December 31, 2016	Level 1	Level 2	Level 3
Financial assets measured at fair value				
Financial assets at fair value through profit or loss:				
Financial investments in associates	322	–	–	322
Financial derivatives under lease and hosting contracts	164	–	–	164
Derivative financial assets over the equity of subsidiary	22	–	–	22
Total financial assets at fair value through profit or loss	508	–	–	508
Total financial assets measured at fair value	508	–	–	508
Financial liabilities measured at fair value				
Financial liabilities at fair value through profit or loss - derivative over the equity of investee	(234)	–	–	(234)
Total financial liabilities measured at fair value	(234)	–	–	(234)

The balance of Level 3 measurements as of January 1, 2017 is reconciled to the balance of those measurements as of March 31, 2017 as follows:

	Balance as of January 1, 2017	Gains/(losses) recognized in profit and loss	Purchases	Balance as of March 31, 2017
Financial assets measured at fair value				
Financial assets at fair value through profit or loss:				
Financial investments in associates	322	(27)	43	338
Derivative financial assets over the equity of investee	22	–	–	22
Financial derivatives under lease and hosting contracts	164	242	–	406
Total financial assets at fair value through profit or loss	508	215	43	766
Financial liabilities at fair value through profit or loss - derivative over the equity of investee	(234)	(56)	44	(246)
Total financial liabilities measured at fair value	(234)	(56)	44	(246)

15.2 Risk assessment

The Group's financial instruments exposed to the equity price risk primarily relate to the Group's financial investments in associates. The Group's equity risk arises from uncertainties about future values of the investment into unlisted securities. The effects of reasonable changes of unobservable inputs on fair value presented below:

Model	Unobservable inputs	Reasonable change	March 31, 2017	December 31, 2016
DCF method	Earning stream	10.0%	12	22
DCF method	Discount rate	5.0%	26	46
Recent cash transaction	Price	5.0%	11	4

16 Events after the reporting period

There were no events after the reporting period to be separately reported.