Mail.Ru Group Limited

Interim Condensed Consolidated Financial Statements

For the six months ended June 30, 2012

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Report on review of interim condensed consolidated financial statements

To the Shareholders of Mail.Ru Group Limited

Introduction

We have reviewed the accompanying interim condensed consolidated financial statements of Mail.Ru Group Limited and its subsidiaries ('the Group'), comprising an interim consolidated statement of financial position as at June 30, 2012 and the related interim consolidated statements of comprehensive income, changes in equity and cash flows for the six-month period then ended and explanatory notes. Management is responsible for the preparation and presentation of these interim condensed consolidated financial statements in accordance with International Financial Reporting Standard IAS 34 *Interim Financial Reporting* ("IAS 34"). Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information 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.

Ernst & Young LLC

September 4, 2012

Interim Consolidated Statement of Financial Position

As of June 30, 2012
(in millions of Russian Roubles)

	Notes	As at June 30, 2012	As at December 31, 2011
ASSETS			
Non-current assets			
Investments in strategic associates		9,058	9,118
Goodwill		32,969	32,969
Other intangible assets	5	11,111	11,783
Property and equipment	6	1,290	1,159
Available-for-sale financial assets	17	44,944	69,399
Financial assets at fair value through profit or loss	17	1,182	820
Deferred income tax assets		49	43
Other non-current assets	7	212	489
Total non-current assets		100,815	125,780
Current assets			
Trade accounts receivable		1,841	2,245
Prepaid income tax		117	93
Prepaid expenses and advances to suppliers		381	235
Other current assets	8	163	122
Short-term time deposits		1,422	883
Cash and cash equivalents		31,713	4,015
Total current assets		35,637	7,593
Total assets		136,452	133,373
EQUITY AND LIABILITIES			
Equity attributable to equity holders of the parent			
Issued capital		–	–
Share premium		45,042	44,370
Treasury shares		(844)	(633)
Retained earnings		47,618	23,485
Accumulated other comprehensive income		36,834	58,903
Total equity attributable to equity holders of the parent		128,650	126,125
Non-controlling interests		2	10
Total equity		128,652	126,135
Non-current liabilities			
Financial liabilities at fair value through profit or loss	17	–	145
Deferred income tax liabilities		2,843	2,667
Total non-current liabilities		2,843	2,812
Current liabilities			
Trade accounts payable		716	829
Income tax payable		312	104
VAT and other taxes payable		782	829
Deferred revenue and customer advances		1,947	1,729
Other payables, provisions and accrued expenses	9	1,200	935
Total current liabilities		4,957	4,426
Total liabilities		7,800	7,238
Total equity and liabilities		136,452	133,373

Interim Consolidated Statement of Comprehensive Income

For the six months ended June 30, 2012
(in millions of Russian Roubles, except per share information)

	Notes	Six months ended June 30, 2012 (unaudited)	Six months ended June 30, 2011 (unaudited)
Revenues	10	9,611	6,491
Cost of revenues	11	(2,369)	(1,651)
Gross profit		7,242	4,840
Net gain on venture capital investments	17	112	28
Research and development expenses	12	(68)	(82)
Selling, general and administrative expenses	13	(2,723)	(2,309)
Impairment of intangible assets	5	(1)	(93)
Depreciation and amortisation		(1,327)	(1,274)
Operating income		3,235	1,110
Finance income		160	42
Net loss on financial assets and liabilities at fair value through profit or loss over the equity of strategic associates and subsidiaries	17	(15)	(281)
Net gain on disposal of shares in available-for-sale investments	17	20,498	–
Net foreign exchange gains/(losses)		1,616	(120)
Impairment losses related to strategic associates		–	(173)
Share of profit of strategic associates		62	61
Other income		5	–
Other expenses		(1)	(19)
Profit before income tax expense		25,560	620
Income tax expense	14	(1,418)	(515)
Net profit		24,142	105
Attributable to:			
Equity holders of the parent		24,133	94
Non-controlling interest		9	11
Other comprehensive income			
Exchange differences on translation of foreign operations:			
Differences arising during the year		1	(11)
Available-for-sale financial assets:			
Gains/(losses) arising during the year		(1,572)	9,232
Reclassification adjustments for gains included in profit or loss		(20,498)	–
Total other comprehensive income/(loss), net of tax effect of 0		(22,069)	9,221
Total comprehensive income, net of tax		2,073	9,326
Attributable to:			
Equity holders of the parent		2,064	9,316
Non-controlling interest		9	10
Earnings per share, in RUR:			
Basic earnings for the year attributable to ordinary equity holders of the parent		115,8	0,5
Diluted earnings for the year attributable to ordinary equity holders of the parent		115,6	0,4

Interim Consolidated Statement of Cash Flows

For the six months ended June 30, 2012
(in millions of Russian Roubles)

	Notes	Six months ended June 30, 2012 (unaudited)	Six months ended June 30, 2011 (unaudited)
Cash flows from operating activities			
Profit before income tax		25,560	620
Adjustments for:			
Depreciation and amortisation		1,327	1,274
Bad debt expense/ (reversal)		45	(29)
Net loss on financial assets and liabilities at fair value through profit or loss over the equity of strategic investees and subsidiaries	17	15	281
Net gain on sales of shares in available-for-sale investments	17	(20,498)	–
Loss on disposal of property and equipment		1	–
Finance income		(160)	(42)
Dividend revenue from venture capital investments	10	(36)	(41)
Share of profit of strategic associates		(62)	(61)
Impairment losses related to intangible assets	5	1	93
Impairment losses related to associates and avaiable for sales investments		–	173
Net foreign exchange (gains)/losses		(1,616)	120
Share based payment expense	11, 12, 13	774	816
Other non-cash items		8	21
Decrease in accounts receivable		361	24
Increase in inventories		(8)	–
Increase in other assets		(155)	(44)
Increase/(decrease) in accounts payable, provisions and accrued expenses		(45)	235
Decrease in other non-current assets		45	–
Increase in deferred revenue and customers advances		219	138
Increase in venture capital financial assets designated as at fair value through profit or loss	17	(367)	(120)
Operating cash flows before interest and income taxes		5,409	3,458
Dividends received from financial investments		55	40
Interest received, net of related bank commissions paid		117	34
Income tax paid		(1,065)	(704)
Net cash provided by operating activities		4,516	2,828

Interim Consolidated Statement of Cash Flows (continued)

For the six months ended June 30, 2012
(in millions of Russian Roubles)

	Notes	Six months ended June 30, 2012 (unaudited)	Six months ended June 30, 2011 (unaudited)
Cash flows from investing activities:			
Cash paid for property and equipment		(397)	(244)
Cash paid for intangible assets		(389)	(360)
Cash paid for acquisitions of subsidiaries, net of cash acquired		–	(78)
Dividends received from equity investments designated as available-for-sale financial assets		18	8
Dividends received from strategic associates		126	10
Proceeds from disposal of shares in available-for-sale investments	17	22,883	–
Issuance of loans		(2)	(135)
Collection of loans		2	125
Acquisition of short-term and long term deposits		(323)	(255)
Net cash provided by/(used in) investing activities		21,918	(929)
Cash flows from financing activities:			
Proceeds from issuance of common stock, net of share issuance costs paid		2	(4)
Cash paid for treasury shares		(297)	–
Dividends paid by subsidiaries to non-controlling shareholders		(3)	(11)
Net cash used in financing activities		(298)	(15)
Net increase in cash and cash equivalents		26,136	1,884
Effect of exchange differences on cash balances		1,562	(95)
Cash and cash equivalents at the beginning of the period		4,015	3,609
Cash and cash equivalents at the end of the period		31,713	5,398

Interim Consolidated Statement of Changes in Equity

For the six months ended June 30, 2012
(in millions of Russian Roubles)

	Notes	Share capital: Number of shares issued and outstanding	Share capital: 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, 2012		208,408,438	–	44,370	(633)	23,485	58,903	126,125	10	126,135
Profit for the period		–	–	–	–	24,133	–	24,133	9	24,142
Other comprehensive income:										
Foreign currency translation		–	–	–	–	–	1	1	–	1
Net change in cumulative holding gains on available-for-sale investments	17	–	–	–	–	–	(22,070)	(22,070)	–	(22,070)
Total other comprehensive income		–	–	–	–	–	(22,069)	(22,069)	–	(22,069)
Total comprehensive income		–	–	–	–	24,133	(22,069)	2,064	9	2,073
Share-based payment transactions		–	–	774	–	–	–	774	–	774
Exercise of options over the shares of the Company		132,335	–	(122)	86	–	–	(36)	–	(36)
Acquisition of treasury shares		(288,051)	–	–	(297)	–	–	(297)	–	(297)
Acquisitions of non-controlling interests in existing subsidiaries		–	–	14	–	–	–	14	(14)	–
Dividends by subsidiaries to non-controlling shareholders		–	–	–	–	–	–	–	(3)	(3)
Other changes in net assets of strategic associates		–	–	4	–	–	–	4	–	4
Other changes in share premium		–	–	2	–	–	–	2	–	2
Balance at June 30, 2012		208,252,722	–	45,042	(844)	47,618	36,834	128,650	2	128,652

Interim Consolidated Statement of Changes in Equity (continued)

For the six months ended June 30, 2011
(in millions of Russian Roubles)

	Notes	Share capital: Number of shares issued and outstanding	Share capital: Amount	Share premium	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, 2011		208,521,603	0	42,425	22,507	33,778	98,710	(9)	98,701
Profit for the period		–	–	–	94	–	94	11	105
Other comprehensive income:									
Foreign currency translation		–	–	–	–	(10)	(10)	(1)	(11)
Unrealised holding gains on available-for-sale financial assets		–	–	–	–	9,232	9,232	–	9,232
Total other comprehensive income		–	–	–	–	9,222	9,222	(1)	9,221
Total comprehensive income		–	–	–	94	9,222	9,316	10	9,326
Share-based payment transactions		–	–	836	–	–	836	–	836
Exercise of options over the shares of the Company		105,502	–	–	–	–	–	–	–
Other changes in net assets of strategic associates		–	–	14	–	(2)	12	–	12
Dividends by subsidiaries to non-controlling shareholders		–	–	–	–	–	–	(11)	(11)
Other changes in equity		–	–	(20)	–	–	(20)	–	(20)
Balance at June 30, 2011		208,627,105	0	43,255	22,601	42,998	108,854	(10)	108,844

Notes to the Interim Condensed Consolidated Financial Statements

1 Corporate information and description of business

These interim condensed consolidated financial statements of Mail.Ru Group Limited (formerly Digital Sky Technologies Limited and renamed in October 2010, hereinafter "the Company") and its subsidiaries (collectively – "the Group") for the six months ended June 30, 2012 were authorised for issue by the directors of the Company on September 4, 2012.

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 registered office of the Company is at Trident Chambers, Wickhams Cay, P.O. Box 146, Road Town, Tortola, BVI.

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") and social 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 six months ended June 30, 2012 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 as at December 31, 2011.

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, 2011, except for adoption of new standards as of January 1, 2012 listed below:

IFRS 7 - Disclosures - Transfers of financial assets (Amendment)

The IASB issued an amendment to IFRS 7 that enhances disclosures for financial assets. These disclosures relate to assets transferred (as defined under IAS 39). If the assets transferred are not derecognised entirely in the financial statements, an entity has to disclose information that enables users of financial statements to understand the relationship between those assets which are not derecognised and their associated liabilities. If those assets are derecognised entirely, but the entity retains a continuing involvement, disclosures have to be provided that enable users of financial statements to evaluate the nature of, and risks associated with, the entity's continuing involvement in those derecognised assets. The adoption of the amendment did not have any impact on the financial position or performance of the Group.

IFRS 1 - Severe Hyperinflation and Removal of Fixed Dates for First-time Adopters (Amendment).

When an entity's date of transition to IFRS is on or after the functional currency normalisation date, the entity may elect to measure all assets and liabilities held before the functional currency normalisation date, at fair value on the date of transition to IFRS. This fair value may be used as the deemed cost of those assets and liabilities in the opening IFRS statement of financial position. However, this exemption may only be applied to assets and liabilities that were subject to severe hyperinflation. The adoption of the amendment did not have any impact on the financial position or performance of the Group.

IAS 12 - Deferred Tax: Recovery of Underlying Assets (Amendment)

This amendment to IAS 12 includes a rebuttable presumption that the carrying amount of investment property measured using the fair value model in IAS 40 will be recovered through sale and, accordingly, that any related deferred tax should be measured on a sale basis. The presumption is rebutted if the investment property is depreciable and it is held within a business model whose objective is to consume substantially all of the economic benefits in the investment property over time, rather than through sale. Specifically, IAS 12 will require that deferred tax arising from a non-depreciable asset measured using the revaluation model in IAS 16 should always reflect the tax consequences of recovering the carrying amount of the underlying asset through sale. Effective implementation date is for annual periods beginning on or after January 1, 2012.

Reclassifications

Certain corresponding information presented in the interim condensed consolidated financial statements for the period ended June 30, 2011 has been reclassified in order to achieve comparability with the presentation used in these interim condensed consolidated financial statements.

2.2 Change of presentation currency

The interim condensed consolidated financial statements are presented in Russian Roubles ("RUR"), and all values are rounded to the nearest million (RUR '000000) except per share information and unless otherwise indicated. The Group changed the presentation currency from US dollars ("USD") to RUR as the presentation in USD is no longer required by the shareholders of the Company.

Notes to the Interim Condensed Consolidated Financial Statements (continued)

3 Seasonality of operations

Due to the seasonal nature of the 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 increased demand for online games due to the end of the vacation period and to the fact that a large portion of advertising budgets is spent in the last quarter of the year.

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, impairment of investments, business combinations, fair value adjustments, amortisation and impairment thereof, net foreign exchange gains and losses, share in financial results of non-core 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.

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.

Starting from December 2011, 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;
- Social Networks;
- Online Games and
- E-Commerce, Search and Other Services

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

The Social Networks segment includes the Group's two social networks (Odnoklassniki 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.

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 segment primarily consists of search engine services earning substantially all revenues from context advertising, E-commerce and online hiring / job search services and related display advertising. This segment also includes a variety of other services, which are considered insignificant by 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.

Notes to the Interim Condensed Consolidated Financial Statements (continued)

4 Operating segments (continued)

The Group's share of profits of strategic associates is not attributed to any operating segment and not included in the calculation of EBITDA. The Group's share of profits of key strategic associates (Qiwi Limited and VK.Com Limited) is included in Net profit reviewed by the CODM and is based on the ownership percentages as of the date of the financial statements. The net profit of key strategic associates is calculated using accounting principles used for the segment financial information of the Group's consolidated operations. The Group's share of profits of non-core strategic associates (Nikita Management Limited, Molotok Holdings Limited and Haslop Company Limited) is not included in the financial information reviewed by the CODM.

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.

The income statement items for each segment for the six months ended June 30, 2012, as presented to the CODM, are presented below:

	Email, Portal and IM	Social Networks	Online Games	E-commerce, Search and other	Eliminations	Group
Revenue						
External revenue	1,771	3,655	2,475	1,792	–	9,693
Intersegment revenue	12	–	–	126	(138)	–
Total revenue	1,783	3,655	2,475	1,918	(138)	9,693
Total operating expenses	708	977	1,701	1,127	(138)	4,375
EBITDA	1,075	2,678	774	791	–	5,318
Net profit						4,003

The income statement items for each segment for the six months ended June 30, 2011, as presented to the CODM, are presented below:

	Email, Portal and IM	Social Networks	Online Games	E-commerce, Search and other	Eliminations	Group
Revenue						
External revenue	1,489	1,894	1,960	1,173	–	6,516
Intersegment revenue	–	–	–	60	(60)	–
Total revenue	1,489	1,894	1,960	1,233	(60)	6,516
Total operating expenses	607	585	1,424	640	(60)	3,196
EBITDA	882	1,309	536	593	–	3,320
Net profit						2,409

A reconciliation of total revenue, as presented to the CODM, to IFRS consolidated revenue of the Group for the six months ended June 30, 2012 and 2011 is presented below:

	2012	2011
Total revenue, as presented to CODM	9,693	6,516
Adjustments to reconcile revenue as presented to CODM to consolidated revenue under IFRS:		
Differences in timing of revenue recognition	(142)	(97)
Barter revenue	24	31
Dividend revenue from venture capital investments	36	41
Consolidated revenue under IFRS	9,611	6,491

A reconciliation of EBITDA, as presented to the CODM, to IFRS consolidated operating income of the Group for the six months ended June 30, 2012 and 2011 is presented below:

	2012	2011
Total EBITDA, as presented to CODM	5,318	3,320
Adjustments to reconcile EBITDA as presented to CODM to consolidated operating income under IFRS:		
Impairment of intangible assets	(1)	(93)
Depreciation and amortisation	(1,327)	(1,274)
Share-based payments	(774)	(816)
Net gain on venture capital investments	112	28
Differences in timing of revenue recognition	(142)	(97)
Dividend revenue from venture capital investments	36	41
Other	13	1
Consolidated operating income under IFRS	3,235	1,110

Notes to the Interim Condensed Consolidated Financial Statements (continued)

4 Operating segments (continued)

A reconciliation of net profit, as presented to the CODM, to IFRS consolidated net profit of the Group for the six months ended June 30, 2012 and 2011 is presented below:

	2012	2011
Total net profit, as presented to CODM	4,003	2,409
Adjustments to reconcile net profit as presented to CODM to consolidated net profit under IFRS:		
Share-based payments	(774)	(816)
Differences in timing of revenue recognition	(142)	(97)
Effect of operations disposed of, difference in shareholding percentages and acquisition dates of subsidiaries and associates	–	(19)
Amortisation of fair value adjustments to intangible assets and impairment thereof	(851)	(912)
Gain/(loss) on financial instruments at fair value through profit or loss	97	(250)
Net gain on disposal of shares in available-for-sale investments	20,498	–
Impairment of investments in strategic associates	–	(173)
Net foreign exchange gains (losses)	1,616	(120)
Share in financial results of non-core associates	7	(59)
Other	(25)	2
Tax effect of the adjustments and tax on unremitted earnings	(287)	140
Consolidated net profit under IFRS	24,142	105

5 Intangible assets

During the six months ended June 30, 2012, the Group capitalised software development costs and otherwise acquired intangible assets with a cost of RUR 389 (2011: RUR 375). The Group did not acquire any intangible assets or goodwill through business combinations in the six months ended June 30, 2012 or in the six months ended June 30, 2011.

In the six months ended June 30, 2012, the Group recognized RUR 1 (2011: RUR 93) of impairment losses with respect to online game software. The impairment entirely belongs to the Online Games operating segment and is explained by underperformance of related games.

6 Property and equipment

During the six months ended June 30, 2012, the Group acquired property and equipment with a cost of RUR 401 (2011: RUR 237).

7 Other non-current assets

Other non-current assets consist of the following:

	June 30, 2012	December 31, 2011
Long-term deposits	–	234
Loans receivable	2	–
Long-term deposit under future lease contract	204	202
Other non-current assets	6	53
Total	212	489

8 Other current assets

Other current assets consist of the following:

	June 30, 2012	December 31, 2011
Inventory	21	13
VAT receivable	45	46
Interest receivable	45	2
Other current assets	52	61
Total other current assets	163	122

Notes to the Interim Condensed Consolidated Financial Statements
(continued)

9 Other payables, provisions and accrued expenses

Other payables, provisions and accrued expenses consist of the following:

	June 30, 2012	December 31, 2011
Payables to personnel	461	430
Accrued vacations	348	314
Accrued professional consulting expenses	62	103
Payables to non-controlling shareholders in a subsidiary	155	-
Other current payables and provisions	174	88
Total other payables, provisions and accrued expenses	1,200	935

10 Revenues

	Six months ended June 30	
	2012	2011
Internet value added services (IVAS)	5,354	3,398
Online advertising	3,295	2,435
Online recruitment services	871	571
Dividend revenue from venture capital investments	36	41
Other revenue	55	46
Total revenues	9,611	6,491

In the six months ended June 30, 2012, the Group recorded significant revenues of IVAS from applications operated by third parties on its social network platforms. The Group recognises related share of revenues collected from the social network platforms' users by third parties based on revenue-sharing arrangements with such third parties.

11 Cost of revenues

	Six months ended June 30	
	2012	2011
Agent/partner fees	920	479
Payroll	1,081	808
Share-based payments	59	107
Server hosting expenses	295	239
Other costs	14	18
Total cost of revenues	2,369	1,651

12 Research and development expenses

	Six months ended June 30	
	2012	2011
Payroll	58	61
Share-based payment expense	10	21
Total research and development expenses	68	82

13 Selling, general and administrative expenses

	Six months ended June 30	
	2012	2011
Payroll and other personnel expenses	*969*	*878*
Share-based payments	*705*	*688*
Office rent and maintenance	219	162
Marketing expenses	342	310
Professional fees	106	101
Other expenses	382	170
Total selling, general and administrative expenses	2,723	2,309

Notes to the Interim Condensed Consolidated Financial Statements (continued)

14 Income tax

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

	Six months ended June 30 2012	2011
Current income tax expense	1,244	671
Adjustments in respect of current income tax of previous year	4	(26)
Deferred income tax expense/(benefit)	170	(130)
Total income tax expense	1,418	515

Reconciliation between tax expense and the product of accounting profit multiplied by BVI's domestic tax rate for the six months ended June 30, 2012 and 2011 is as follows:

	Six months ended June 30 2012	2011
Profit before income tax expense	25,560	620
Income tax expense computed at statutory tax rate of 0%	–	–
Foreign tax rate differential	(997)	(324)
Adjustments in respect of current income tax of previous year	4	(26)
Tax on unremitted earnings	(355)	(76)
Non-deductible expenses	(70)	(89)
Total income tax expense	(1,418)	(515)

15 Commitments, contingencies and operating risks

15.1 Operating environment of the Group

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 is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis has resulted in uncertainty regarding further economic growth, availability of financing and cost of capital, 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.

15.2 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.

In the six months ended June 30, 2012, some of the Company's associates and subsidiaries accrued provisions for tax risks related to their operations. It is reasonably possible that relevant governmental authorities in Russia may attempt to assess additional income and non-income taxes against those associates and subsidiaries. The extent of potential assessments and the ultimate success thereof are not currently estimable. However, should the relevant governmental authorities question the management approach to the taxation of its operations and prove successful in their claim, they would be entitled to recover the amounts of the tax provisions. Management of the Group and its associates will vigorously defend their positions if such claims are assessed.

The Group uses electronic payment systems to collect cash from their customers. The regulatory environment around electronic payment systems in Russia and Ukraine is evolving and may be subject to varying interpretations. Therefore, there is a risk that related arrangements of the Group may be challenged by the taxing authorities and may result in additional taxes for the Group.

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 interim consolidated financial statements, if the authorities were successful in enforcing their different interpretations, could be significant.

Notes to the Interim Condensed Consolidated Financial Statements (continued)

15 Commitments, contingencies and operating risks (continued)

15.3 Legal proceedings

The Group has been and continues to be the subject of legal proceedings and adjudications from time to time, none of which has 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.

15.4 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.

15.5 Private information

To become registered on a website operated by the Group, users have to input their personal data, which are 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.

15.6 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 offer 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.

15.7 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 sites 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.

15.8 Regulation

New laws and regulations, or new interpretations of existing laws and regulations (especially in the payment processing business), 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.

15.9 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.

15.10 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.

Notes to the Interim Condensed Consolidated Financial Statements (continued)

15 Commitments, contingencies and operating risks (continued)

15.11 Operating lease commitments – the Group as a lessee

In November 2011, the Group committed to enter into a long-term lease for office space subject to certain conditions that management estimates will be fulfilled in the first six months of 2013. The Group expects to pay an aggregate of USD 0.3 billion in 2012-2019 under and in connection with the agreement, including payments for leasehold improvements, furniture and related professional fees.

16 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 six month periods ending 30 June 2012 and 30 June 2011 as well as balances with related parties as of 30 June 2012 and 31 December 2011, 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
2012				
Strategic associates	120	86	144	3
Other entities	–	3	2	–
2011				
Strategic associates	98	32	76	–
Other entities	–	–	–	–

The Group's sales to and receivables from related parties mainly include sales to and receivables from Haslop Company Limited ("Mamba") and VK.com Limited ("VK").

The Group's sales to, and receivables from Mamba primarily arise from a revenue sharing arrangement relating to IVAS generated by a dating website operated by Mamba.

The Group's sales to, and receivables from VK primarily arise from the Group's social games offered via the VK social network. The arrangement with VK is entered into on terms equivalent to those that prevail in arm's length transactions.

The Group's purchases from, and payables to related parties mainly include purchases from and payables to Qiwi Limited ("Qiwi") and primarily arise from revenue collection services. The arrangement with Qiwi is entered into on terms equivalent to those that prevail in arm's length transactions.

16.1 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 22 for the six months ended June 30, 2012 (2011: RUR 19). No options over the shares of the Company were granted to Directors in the six months ended June 30, 2012 (2011: options over 733,388 ordinary shares of the Company at the exercise price of USD 27.7 per share). During the six months ended June 30, 2012, Directors forfeited options over 152,566 shares (2011: nil) and exercised options over 179,332 shares of the Company (2011: nil). The corresponding share-based payment expense was insignificant in the six months ended June 30, 2012 (2011: RUR 82).

16.2 Key management of the Group

Total cash remuneration of the key management of the Group (excluding Directors) amounted to RUR 274 for the six months ended June 30, 2012 (2011: RUR 217). In addition to the cash remuneration in 2012, key executive employees of the Group were granted options to acquire 166,000 ordinary shares of the Company at the exercise price of USD 27.7 per share (2011: 35,000) and options to acquire 2,490,000 ordinary shares of the Company at the exercise price of USD 25.6 per share (2011: nil). During the six months ended June 30, 2012, key management of the Group (excluding Directors) forfeited options over 22,500 shares (2011: 55,000) and exercised options over 159,988 shares of the Company (2011: nil). The corresponding share based payment expense amounted to RUR 671 for the six months ended June 30, 2012 (2011: RUR 573).

16.3 The ultimate controlling party

The Company has no ultimate controlling party.

Notes to the Interim Condensed Consolidated Financial Statements (continued)

17 Financial instruments

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

- 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 June 30, 2012 and December 31, 2011 the Group held the following financial instruments measured at fair value:

	June 30, 2012	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	1,136	–	–	1,136
Derivative financial assets over the equity of investees, non-current	46	–	–	46
Total financial assets at fair value through profit or loss	1,182	–	–	1,182
Available-for-sale equity investments	44,944	11,631	32,697	616
Total financial assets measured at fair value	46,126	11,631	32,697	1,798

	December 31, 2011	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	769	–	–	769
Derivative financial assets over the equity of investees	51	–	–	51
Total financial assets at fair value through profit or loss	820	–	–	820
Available-for-sale equity investment	69,399	–	15,493	53,906
Total financial assets measured at fair value	70,219	–	15,493	54,726
Financial liabilities measured at fair value				
Financial liabilities at fair value through profit or loss over the equity of investees	(145)	–	–	(145)
Total financial liabilities measured at fair value	(145)	–	–	(145)

The Group's available-for-sale investments in Groupon and Zynga were reclassified from Level 2 to Level 1 and the investment in Facebook were reclassified from Level 3 to Level 2 due to change in valuation methodology, whereby the fair values of these investments as of June 30, 2012 was determined using observable market inputs.

In June 2012, other shareholders of Headhunter exercised put options over 2.8% of Headhunter for RUR 155 payable by the Group in the fourth quarter of 2012. The Group accounted for the transaction as an acquisition of non-controlling interest in Headhunter. Accordingly, the transaction resulted in a decrease of RUR 14 in non-controlling interest and an increase of RUR 14 in Share premium. Additionally, as part of the transaction, the Group de-recognised the respective financial liability over the equity of Headhunter and recognised a payable under "Other payables, provisions and accrued expenses" in its consolidated statement of financial position as of June 30, 2012 in the amount of RUR155.

The balance of Level 3 measurements as of December 31, 2011 is reconciled to the balance of those measurements as of June 30, 2012 as follows:

	Balance as of December 31, 2011	Purchases	Settlements	Gains/(losses) recognized in profit and loss	Balance as of June 30, 2012
Financial investments in associates	769	255	–	112	1,136
Derivative financial assets over the equity of investees	51	–	–	(5)	46
Total financial assets measured at fair value	820	255	–	107	1,182
Financial liabilities at fair value through profit or loss - derivative financial liabilities over the equity of investees	(145)	–	155	(10)	–
Total financial liabilities measured at fair value	(145)	–	155	(10)	–

Notes to the Interim Condensed Consolidated Financial Statements (continued)

17 Financial instruments (continued)

The balance of available-for-sale equity investments as of December 31, 2011 is reconciled to the balance of those investments as of June 30, 2012 as follows:

	Fully diluted shareholding as of December 31, 2011	Balance as of December 31, 2011	Sales	Gains/(losses) recognised in other comprehesive income	Balance as of June 30, 2012	Fully diluted shareholding as of June 30, 2012
Investment in CED	15.00%	255		361	616	15.00%
Investment in Facebook	2.25%	53,652	(22,883)	1,929	32,698	1.34%
Investment in Groupon	4.21%	12,927	–	(3,153)	9,774	4.11%
Investment in Zynga	1.16%	2,565	–	(709)	1,856	1.15%
Total		69,399	(22,883)	(1,572)	44,944	

In May 2012 the Company sold 19 600 699 shares of Facebook for RUR 22,883 and recognised a gain in the amount of RUR 20,498 under "*Net gain on disposal of shares in available-for-sale investments*" in the statement of comprehensive income.

18 Events after the reporting period

18.1 Payment of a special dividend

On August 6, 2012 the Group announced that it will pay a special dividend on August 28th, 2012 of US$3.80 per share for shareholders on the record date of August 17th 2012 representing a total payout of USD 795 million. The dividend was approved by the Board of Directors and shareholders of the Company on August 6th 2012 and paid on August 28, 2012 in the amount of RUR 25,337 million. On August 6th, 2012 the Board of Directors and shareholders of the Company approved a reduction of US$ 3.80 in the exercise price of the 2010 option plan share options.

18.2 Decline in available-for-sale investments share price

Closing share price deviation of the Group's publicly traded available-for-sale investments after the reporting period were as follows:

Groupon: USD 4.15 per share on September 3rd, 2012, down from USD 10.63 per share as of June 30, 2012.
Facebook: USD 18.06 per share on September 3rd, 2012, down from USD 31.095 per share as of June 30, 2012.
Zynga: USD 2.80 per share on September 3rd, 2012, down from USD 5.44 per share as of June 30, 2012, which is below the cost of the Group's investment in Zynga and may result in an impairment of the investment.

18.3 Changes in regulation

On July 23, 2012, new legislation was enacted in Russia prohibiting internet advertising of alcoholic beverages, including beer and beer-based drinks. Management expects the legislation may negatively affect the Group's online advertising revenues.

In July 2012 a special law introducing a unified register (the "Black List") of domain names, web sites and IP addresses containing materials prohibited for dissemination in Russia was adopted to become effective from November 1, 2012. The Black List is to be maintained by a designated authority. Once the law is effective, no court order will be required to include in the Black List domain names, web sites and IP addresses containing such materials as child pornography, information about production, distribution and sale of illegal drugs, and suicide propaganda. Failure by any property to comply with the authority's takedown request within 24 hours will result in immediate blocking of internet access to such property. While the law requires a number of subordinate legislative acts to be developed by Russian government bodies, the criteria for applying the provisions of the law are currently unclear. Abusive or erroneous application of the Black List legislation may potentially lead to one or more of the Group's properties being blocked, which may have a significant adverse effect on the Group's revenues and profitability.