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THIS OFFERING MEMORANDUM AND THE OFFER WHEN MADE ARE ONLY ADDRESSED TO AND DIRECTED AT PERSONS IN MEMBER STATES OF THE EUROPEAN ECONOMIC AREA (THE "**EEA**") WHO ARE "QUALIFIED INVESTORS" WITHIN THE MEANING OF ARTICLE 2(1)(E) OF THE PROSPECTUS DIRECTIVE (DIRECTIVE 2003/71/EC) ("**QUALIFIED INVESTORS**"). IN ADDITION, IN THE UNITED KINGDOM, THIS OFFERING MEMORANDUM IS BEING DISTRIBUTED ONLY TO, AND IS DIRECTED ONLY AT, QUALIFIED INVESTORS (I) WHO HAVE PROFESSIONAL EXPERIENCE IN MATTERS RELATING TO INVESTMENTS FALLING WITHIN ARTICLE 19(5) OF THE FINANCIAL SERVICES AND MARKETS ACT 2000 (FINANCIAL PROMOTION) ORDER 2005, AS AMENDED (THE "**ORDER**"), OR (II) WHO FALL WITHIN ARTICLE 49(2)(A) TO (D) OF THE ORDER (ALL SUCH PERSONS TOGETHER BEING REFERRED TO AS "**RELEVANT PERSONS**"). THIS OFFERING MEMORANDUM MUST NOT BE ACTED ON OR RELIED UPON (I) IN THE UNITED KINGDOM, BY PERSONS WHO ARE NOT RELEVANT PERSONS, AND (II) IN ANY MEMBER STATE OF THE EEA OTHER THAN THE UNITED KINGDOM, BY PERSONS WHO ARE NOT QUALIFIED INVESTORS. ANY INVESTMENT OR INVESTMENT ACTIVITY TO WHICH THIS DOCUMENT RELATES IS AVAILABLE ONLY TO (I) IN THE UNITED KINGDOM, RELEVANT PERSONS, AND (II) IN ANY MEMBER STATE OF THE EEA OTHER THAN THE UNITED KINGDOM, QUALIFIED INVESTORS, AND WILL BE ENGAGED IN ONLY WITH SUCH PERSONS.

Confirmation of your representation: In order to be eligible to view the Offering Memorandum or make an investment decision with respect to the securities referred to herein, investors must be (i) outside the United States (within the meaning of Regulation S) or (ii) a QIB that is acquiring the securities for its own account or the account of another QIB. By accepting this e-mail and accessing the Offering Memorandum, you shall be deemed to have represented to us that: (1) (A) you and any customers you represent are a person that is located outside the United States or (B) you are a QIB acquiring the securities referred to herein for your own account and/or for another QIB and (2) you consent to delivery of such Offering Memorandum by electronic transmission.

This Offering Memorandum is being sent to you in an electronic form. You are reminded that documents transmitted via this medium may be altered or changed during the process of electronic transmission and, consequently, neither the Company, nor the Joint Bookrunners (as defined in the Offering Memorandum) nor any person who controls any of them, nor any director, officer, employee, agent of it or affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between this Offering Memorandum distributed to you in electronic format and the hard copy version available to you on request. No representation or warranty, expressed or implied, is made by any of the Joint Bookrunners or their respective affiliates as to the accuracy, completeness or sufficiency of the information set out in this electronic transmission or the attached Offering Memorandum.

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Public Joint Stock Company "Detsky mir"

(organised as a public joint stock company organised under the laws of the Russian Federation)

Offering of up to 247,912,160 Shares

Offer Price Range: RUB 85 to RUB 105 per Share

This is an offering (the "**Offering**") by (i) Sistema Public Joint Stock Financial Corporation ("**Sistema**"), (ii) FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED (acting jointly and in concert) , and (iii) the other selling shareholders named herein under "*Principal and Selling Shareholders—Selling Shareholders*" (collectively, the "**Selling Shareholders**") of up to 247,912,160 ordinary shares of Public Joint Stock Company "Detsky mir" (the "**Company**"), a public joint stock company registered under the laws of the Russian Federation, with a nominal value of RUB0.0004 each (each, an "**Ordinary Share**"). The up to 247,912,160 Ordinary Shares being offered pursuant to the Offering are referred to as the "**Shares**", and each such offered Ordinary Share, a "**Share**".

The Offering comprises an offering of the Shares (i) outside the United States in reliance on Regulation S ("**Regulation S**", and such Shares, the "**Regulation S Offering**") under the U.S. Securities Act of 1933, as amended (the "**Securities Act**"), and (ii) within the United States to certain qualified institutional buyers ("**QIBs**") as defined in, and in reliance on, Rule 144A ("**Rule 144A**", and such Shares, the "**Rule 144A Offering**") under the Securities Act. See "*Plan of Distribution*".

In connection with the Offering, Sistema, FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED have granted the Joint Bookrunners (as defined below) an option exercisable within 30 calendar days of the announcement of the Offer Price (the "**Stabilisation Period**") to purchase up to 31,397,491 Ordinary Shares at the Offer Price (the "**Over-Allotment Option**") to cover over-allotments in connection with the Offering, if any, and cover short positions resulting from any such over-allotments.

The Ordinary Shares were registered by the Federal Service for Financial Markets of the Russian Federation, whose administrative functions were transferred to the Central Bank of Russia (the "**CBR**"), under the state registered number No. 1-02-00844-A. The Ordinary Shares have been admitted to trading in the "Level 3" part of the List of Securities Admitted to Trading on Public Joint-Stock Company "Moscow Exchange MICEX-RTS" ("**Moscow Exchange**"), a part of the Moscow Exchange Group, since 15 December 2016 under the symbol "DSKY". With effect from 8 February 2017, subject to compliance with the applicable minimum free float requirement, the Ordinary Shares will be transferred to the "Level 1" part of the List of Securities Admitted to Trading on the Moscow Exchange. Prior to the Offering, there has been no public market for the Ordinary Shares. Trading in the Ordinary Shares on Moscow Exchange is expected to commence on or about the Share Delivery Date. No assurance can be given that thereafter the Ordinary Shares will continue to be admitted to trading on Moscow Exchange. See "*Risk Factors—Risks Relating to the Shares and the Trading Market—The Ordinary Shares may be delisted*".

AN INVESTMENT IN THE SHARES INVOLVES A HIGH DEGREE OF RISK. SEE "*RISK FACTORS*" FOR A DISCUSSION OF CERTAIN RISKS THAT SHOULD BE CONSIDERED IN CONNECTION WITH AN INVESTMENT IN THE SHARES. THE SHARES ARE OF A SPECIALIST NATURE AND SHOULD ONLY BE PURCHASED AND TRADED BY INVESTORS WHO ARE PARTICULARLY KNOWLEDGEABLE IN INVESTMENT MATTERS.

The Offering does not constitute an offer to sell, or solicitation of an offer to buy, securities in any jurisdiction in which such offer or solicitation would be unlawful. The Shares have not been or will not be registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction of the United States and may not be offered or sold within the United States, except to persons reasonably believed to be QIBs, or outside the United States in offshore transactions in reliance on Regulation S. Prospective purchasers are hereby notified that sellers of the Shares may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A. For a discussion of certain restrictions on transfers of the Shares, see "*Selling and Transfer Restrictions*".

The Shares will be priced in Russian Roubles. It is expected that delivery of the Shares to purchasers thereof and payment for the Shares by the purchasers will commence on or about 10 February 2017 (the "**Share Delivery Date**"). Potential purchasers of the Shares must indicate their payment currency at the time of placing an order with the Joint Bookrunners, which cannot be changed after the order book has been closed. Each purchaser of the Shares must pay for such Shares by the date agreed with the Joint Bookrunners. Subject to Russian currency control requirements, the Shares may be paid for in Russian Roubles or in US Dollars using the WM/Reuters closing spot rate at 16:00 London time effective on the day preceding the day on which the Offer Price is announced minus 15 kopecks. The Shares will be delivered to purchasers through the settlement facilities of the National Settlement Depositary ("**NSD**"). To take delivery of the Shares, purchasers need to have: (i) a depo account with the NSD, or (ii) a depo account with a depositary that has a depositary account with the NSD. The purchasers shall take all actions required in accordance with the depositary rules and applicable law to take delivery of the purchased Shares, including issuing appropriate credit instructions to their depositaries.

The Offering may be extended or revoked at any time without cause. The Shares offered hereby are offered severally by the Joint Bookrunners, subject to receipt and acceptance by them of any order in whole or in part. The Joint Bookrunners reserve the right to reject any offer to purchase the Shares, in whole or in part, and to sell to any prospective purchaser less than the amount of Shares sought by such investor.

Joint Global Coordinators

Credit Suisse **Goldman Sachs International** **Morgan Stanley**

Joint Bookrunners

Credit Suisse **Goldman Sachs International** **Morgan Stanley** **Sberbank CIB** **UBS Investment Bank**

Offering Memorandum dated 26 January 2017

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SUMMARY

This summary must be read as an introduction to this Offering Memorandum, and any decision to invest in the Shares should be based on a consideration of the Offering Memorandum as a whole including the more detailed information regarding our business and the Financial Statements and related notes included elsewhere in this Offering Memorandum. Prospective investors should read the entire Offering Memorandum carefully, especially the discussion of risks of investing in the Shares discussed in the "Risk Factors". Certain statements in this Offering Memorandum include forward-looking statements that involve risks and uncertainties as described under "Forward-Looking Statements".

Overview

We are the largest specialised children's goods retailer in Russia with a diversified product portfolio comprising toys, products for newborns, fashion (apparel and footwear), large items and other products. We are the market leader in terms of the size of our store network and in terms of revenue in a highly fragmented market for children's goods in Russia. According to Ipsos Comcon, in 2015, we had an estimated share of 32% (24% in 2014) of the specialised children's goods retail market in Russia and 13% (10% in 2014) of the total market of children's goods in Russia (including hyper- and supermarkets). Our largest competitor had a share of 9% of the specialised children's goods retail market and 4% of the total market of children's goods, also according to Ipsos Comcon.

We strongly benefit from the "Detsky mir" brand which dates back to the opening of the first "Detsky mir" branded store in central Moscow in 1947. Thereafter, during the Soviet period, all large children's stores or departments selling children's goods were named "Detsky mir". Accordingly, "Detsky mir" was closely associated with the entire children's goods retail industry in the Soviet Union and subsequently in Russia. This superior brand recognition persists and is confirmed by the findings of a recent consumer survey by Ipsos Comcon, where 97% of respondents mentioned our brand when prompted and 84% of respondents mentioned our brand without prompting.

As at 31 December 2016, we operated a network of 525 stores, comprising 468 stores in Russia and 12 stores in Kazakhstan operating under the "Detsky mir" brand ("**Detsky Mir stores**"), and 45 Early Learning Center ("**ELC**") stores in Russia. Our total selling space as at 31 December 2016 was approximately 596 thousand square metres. Headquartered and originated in Moscow, we have gradually expanded our footprint outside Moscow since 2003, and at present our network outside Moscow accounts for approximately 70% of our revenue. We primarily seek to operate in cities with populations in excess of 50,000 people. In Russia, we have a nationwide presence with stores located in 171 of over 300 cities with more than 50,000 inhabitants, based on Rosstat population data as at 31 December 2016. We have stores in all of Russia's 20 largest cities and in seven cities in Kazakhstan.

In addition to our retail stores, we offer our products through our websites www.detmir.ru and www.elc-russia.ru. In 2011, we launched our online store, which has experienced significant growth since then in terms of sales, the number of SKUs and functionality (including the introduction of an "in-store pickup" service). We believe that our superior brand recognition and customer loyalty are particularly important in capturing market share in the fast developing online segment of the market. In 2015, we completed the roll-out of our "in-store pickup" service for goods ordered online throughout our retail network in Russia. We are continuously improving our online proposition by expanding our online product range and further integrating our online and offline platforms. In the nine months ended 30 September 2016, we recorded over 63 million visits in our online store, and the number of orders placed via our online store was over 1 million. We believe we are the market leader in terms of market share by revenue in online sales of children's goods in Russia with an estimated market share of 6% in the first half of 2016, according to Ipsos Comcon.

We have an established supply chain and IT platform which supports our nationwide retail chain and our growth strategy. We operate two distribution centres located in the Moscow region: our owned distribution centre in Bekasovo with approximately 70,000 square metres of usable area, and our leased distribution centre in Krekshino with approximately 20,000 square metres of usable area. To manage our inventory in the most efficient manner, we have customised warehouse management and automated stock replenishment systems based on the SAP platform. In line with our expansion strategy, in particular in the Urals and Siberian regions of Russia, we have made a preliminary decision to open a new distribution centre in the Urals in 2018.

In the nine months ended 30 September 2016, we had revenue of RUB54,226 million, representing a 35.7% increase from RUB39,967 million in the nine months ended 30 September 2015. In the nine months ended 30 September 2016, our like-for-like sales increased by 13.0% as compared to the nine months ended 30 September 2015. Our Adjusted EBITDA margin increased to 8.7% for the nine months ended 30 September 2016 from 7.4% for the nine months ended 30 September 2015. Our Adjusted Net Debt was RUB11,498 million as at 30 September 2016, representing an increase of 8.3% from RUB10,618 million as at 31 December 2015.

Competitive Strengths

We believe that the following strengths have contributed to our success and will continue to support our competitive position and strategy:

Large and growing consumer market segment that is resilient to economic cycles

We operate in a large addressable market segment that is highly resilient to economic downturn and is expected to grow in 2017, according to various sources. During 2015, there were 22.2 million children between 0-12 years of age in Russia (representing 15.2% of the total population), our target market, and the estimated size of the market for children's goods according to Ipsos Comcon was approximately RUB516 billion. Between 2008 and 2015, the population of children under 12 of age grew by 21.7% according to Rosstat, and this growth is expected to continue in the near term. This growth is underpinned by a significant increase in birth rates in Russia over the past decade from 10.2 births per 1,000 inhabitants in 2005 to 13.3 births per 1,000 inhabitants in 2014-2015. Sales of children's goods are highly resilient to economic conditions as compared to most other non-food retail market segments such as consumer electronics, DIY, furniture and fashion retail sales. For example, children's goods sales demonstrated strong resilience during the crisis of 2008/2009 with a year-on-year growth in Rouble terms of 9.0%, while most of other non-food market sales contracted (consumer electronics by 17.8%, DIY by 12.5%, furniture by 6.4%) or grew at a slower pace (fashion by 2.3%), according to Ipsos Comcon. During the 2014/2015 downturn, the children's goods market increased by 3.0% on a year-on-year basis in Rouble terms as compared to decrease in sales of consumer electronics by 14.1%, furniture by 10.0%, fashion by 5.6% and DIY by 4.9%, according to Ipsos Comcon. Between 2008 and 2015, the market for children's goods grew by 69.7% despite economic downturns in 2008/2009 and 2014/2015 according to Ipsos Comcon's estimates. In addition, Russian Government support and social benefits for families with two or more children has contributed to the economic resiliency of the market.

The undisputed market leader in the specialised children's goods retail market

We are the market leader in terms of the size of our store network and in terms of revenue in the highly fragmented market for children's goods in Russia. In 2015, we had an estimated market share of 32% of the specialised children's goods retail market and 13% of the total market of children's goods in Russia (including hyper- and supermarkets), according to Ipsos Comcon.

We have maintained and increased our leading market position despite competition from non-specialised retailers (primarily hyper- and supermarkets) as a result of our key competitive advantages such as strong brand awareness, the breadth of our product assortment, competitive pricing, our specific knowledge of our target customer group, the location of our stores in high traffic shopping malls and a superior customer shopping experience (as compared to general food retailers). Furthermore, according to Ipsos Comcon, the vast majority of customers in Russia prefer specialised children's goods retailers when shopping for children's products even though they may be available in hyper- or supermarkets, or non-organised retail markets, which further supports our growth plans.

We believe that our leading market position best enables us to capture growth opportunities in our target specialised children's goods retail market which is characterised by a relatively low concentration level in terms of other competitors' market shares. For example, in 2015 the next three largest specialised children's goods retailers after Detsky Mir collectively accounted for approximately 25% of the specialised children's goods market in Russia, according to Ipsos Comcon. In 2015, in terms of revenue, the second largest competitor in the specialised children's goods retail market in Russia had an estimated market share of 9% as compared to our market share of 32%.

The strength of our market position is underpinned by a number of advantages which also support our business model, allowing us to achieve superior financial performance and position us for growth in the future. These advantages include, among others, strong negotiating power in purchasing, the ability to enter into exclusive arrangements with our suppliers, enhanced flexibility in offering the lowest or competitive retail prices, as well as the ability to negotiate attractive lease agreements and attract skilled personnel.

Category-defining brand, highly popular customer proposition and longstanding presence in the market

The "Detsky mir" brand dates back to the opening of the first "Detsky mir" specialised children's goods store in central Moscow in 1947. Thereafter, during the Soviet period, all large children's stores or departments selling children's goods were named "Detsky mir". Accordingly, "Detsky mir" was closely associated with the entire children's goods retail industry in the Soviet Union and subsequently in Russia. More recently, we believe the "Detsky mir" brand has been further strengthened as a result of the expansion of our retail network nationwide since 2003. The iconic nature and unique strength of our brand is evidenced by high brand awareness. Based on the consumer survey conducted by Ipsos Comcon in 2016, the "Detsky mir" brand had 97% prompted awareness (as compared to 75% for one of our largest competitors).

We believe that our strong brand drives and supports our customer proposition, ultimately leading to strong customer traffic and sales. Our customer proposition is to offer one-stop shopping for children's goods with a comprehensive product assortment (up to 30,000 SKUs) across various product categories at affordable prices focused on middle and lower-middle income families, at conveniently located stores in modern shopping malls in densely populated residential areas. Also, our brand and our loyalty programme allow us to develop customer loyalty. This is a particularly important competitive advantage in the children's goods market because it generates repeat customer traffic. We have an industry-leading loyalty programme with over 14 million loyalty cards issued and a penetration ratio of 77% (share of sales made with a loyalty card) in the nine months ended 30 September 2016. At our stores, we offer an interactive and emotive shopping experience for children and parents with a focus on visual merchandising which further contributes to repeat traffic. Our strong ability to generate customer traffic also makes us very well positioned to secure attractive locations in shopping malls and other areas.

Highly diversified product selection that attracts customer traffic and supports growth and resilience of sales and profitability

We sell a broad variety of children's goods through our multi-category omni-channel one-stop shopping model. Although our primary target group is middle and lower-middle income young families with at least one child under 12 years of age, we believe that our diversified product selection and varied sales channels create a proposition that is attractive and accessible to a wider customer base. We are the retailer of choice for a broad range of children's goods, which allows us to develop strong customer loyalty.

We believe our diversified assortment including both staples and discretionary products also allows us to maintain a business that is highly resilient and profitable throughout the economic cycle, as the consumption of our staples categories remains highly robust in an economic downturn, whereas our high-margin discretionary product categories provide us with an opportunity to leverage economic recoveries and increases in consumer disposable incomes.

Within our product categories, we maintain a diversified mix of branded products comprising our own brands and leading international brands. Our own brand products primarily feature in fashion (apparel and footwear) merchandise, which accounts for approximately 76% of revenue in this category for the nine months ended 30 September 2016 and has the highest margin in our product assortment. We offer a wide selection of popular international brands such as Lego, Hasbro and Mattel, including many products that are exclusively offered or launched at our stores. Over the past few years, we have worked with key suppliers to obtain rights to exclusively offer their products and to expand our own brands enabling us to earn higher margins and offer products that our customers would not find elsewhere. Our market position also gives us access to products and promotion campaigns from leading international brands.

Depending on the size of a store, we offer from approximately 20,000 to 30,000 SKUs. Our highly diversified product selection and multiple categories enable us to reduce exposure to any one particular product category and the associated volatility in sales and earnings. In particular, we benefit from the substantial differences in market structures, competitive landscape, product flows, and growth and profitability drivers across categories such as fashion and footwear, toys, products for newborns, large items and stationery.

Having a broad assortment of products in a single store allows us to operate flexible product category management and pricing policies including the ability to cross-sell products to different types of customers, which further supports our like-for-like sales growth and gross profit per square metre. For example, our broad assortment allows us to introduce aggressive pricing for products for newborns which serve as the main traffic-generating category, ultimately leading to an increase in customer traffic, as well as growth in sales and profitability through increased sales of more profitable product categories such as fashion (apparel and footwear) and toys.

Rapidly growing e-commerce and omni-channel proposition underpin our growth

In addition to our retail stores, we offer our product portfolio through our websites www.detmir.ru and www.elc-russia.ru. In 2011, we launched our online store, which has experienced significant growth since then in terms of sales, the number of SKUs and functionality (including the introduction of an "in-store pickup" service). We believe that our superior brand recognition and customer loyalty are particularly important in capturing market share in the fast developing online segment of the market. In 2015, we completed the roll-out of our "in-store pickup" service throughout our retail network. We believe we are the market leader in terms of market share by revenue in online sales of children's goods in Russia with an estimated share of 6% in the first half of 2016, according to Ipsos Comcon. In the past several years, we have invested a considerable amount of managerial and financial resources in order to create an omni-channel platform and establish a customer proposition that has allowed us to achieve significant progress in developing our capabilities in the online segment of the market. In the nine months ended 30 September 2016, our online sales revenue (including sales via "in-store pickup" service) increased to RUB1,661 million, representing a 180.1% increase from RUB593 million in the nine months ended 30 September 2015. In 2015, our online sales revenue (including sales via "in-store pickup" service) increased to RUB1,260 million, representing a 455.1% increase from RUB227 million in 2013.

We have been successful in integrating our online and offline platforms drawing on the strengths of our offline retail operations. Our strong brand recognition underpins our online traffic and allows us to save on online marketing and advertising costs. Moreover, our country-wide offline footprint and offline purchasing volumes enable us to negotiate more attractive prices with suppliers than pure online players and offer lower prices for both our offline and online customers. Furthermore, our supply chain and nation-wide offline presence allow us to offer customers prompt and cost-efficient delivery solutions via our "in-store pickup" service that accounts for a substantial portion of online sales.

As at 31 December 2016, our online store offered approximately 40,000 SKUs which mainly included toys, large items, products for newborns and fashion (apparel and footwear). We intend to further expand our online product range to up to 50,000 SKUs primarily by increasing the range of apparel, footwear and products for newborns with a view to having a wider range of products offered online than in our offline stores.

Further integration of our online and offline platforms, where online sales serve as an additional channel to increase revenue at lower incremental costs, as well as expansion of our online store assortment, are among our primary strategic priorities in the coming years. We believe we are well positioned to compete successfully with pure e-commerce players primarily because of the strengths and scale of our offline operations and our high brand recognition.

We continue to invest in our online platform and omni-channel proposition, primarily focusing on implementation of the mobile version of our online store, implementation of SAP Hybris e-commerce platform, as well as in further enhancement of our delivery capabilities in the regions with no offline presence through partnerships with third party operators and the Russian Post.

Asset-light cash-generative business model providing strong returns on capital and enabling consistent dividend payments

Almost all of our stores are leased, with a majority of them located in modern shopping malls. We believe this model is best suited to achieving strong returns on capital due to its low capital requirements and provides us with flexibility to promptly reconfigure the locations of our stores as and when appropriate to respond to changes in demand and traffic in local markets. Our leased – store based model with relatively limited expansion capital expenditure per store has historically helped us run our business with generally positive operating cash flows, and, therefore, to finance our expansion plans primarily through internally generated funds.

We adhere to a disciplined set of investment criteria when opening new stores, focusing on a full set of investment return metrics, specifically an internal rate of return (rate of return that makes the net present value of all cash flows (both positive and negative) from a store equal to zero) ("**IRR**") of at least 40% over a 7-year cash flow profile without terminal value, store EBITDA (store operating income before depreciation and amortisation of store assets) break-even in four months after store opening, and a store maturity period (a period for achievement of planned performance targets such as customer traffic and revenue per square metre) of 18-24 months. Our site evaluation process also takes into account potential delays in the opening of a new store due to overall delays in the opening of a new shopping mall in which we expect to locate the store. Typically, we open new stores in the fourth quarter of a year to take advantage of the higher seasonal sales at year end. We continuously monitor the performance of each store in our retail chain. We will consider closing a store if it fails to meet key performance indicators over a period of time or if we can replace it with an adjacent or proximate location that can be secured on better lease terms or that offers higher customer traffic. However, we have historically closed or relocated only a very small number of stores.

Overall, we believe our focus on an asset-light business model and IRR targets leads to strong financial performance and returns on capital. In 2015, we achieved a pre-tax adjusted return on invested capital ("**Adjusted ROIC**") of 78.3% and a cash return on capital invested ("**CROCI**") of 58.0%. We believe that our Adjusted ROIC strongly compares to the respective metrics of the majority of Russian and international public retailers. See "*Presentation of Financial and Other Information—Non-IFRS and Non-US GAAP Financial Measures*" and "*Selected Consolidated Financial and Other Information.*"

Additionally, our strong cash generation profile has enabled us to pursue expansion while at the same time reducing leverage and offering consistent dividend payouts to our shareholders in recent years.

Scalable supply chain and infrastructure platform

We believe that, by virtue of our longstanding presence in the market and our extensive experience of operating a multi-store network across Russia and Kazakhstan, we have developed strong capabilities to address the logistical and other operational challenges associated with our business. We view our supply chain, IT and human resources as the principal infrastructural functions which support our nationwide retail chain and serve as the necessary platforms to facilitate its expansion. We believe all of these platforms are scalable to support the implementation of our expansion strategy.

We operate two distribution centres in the Moscow region: our owned distribution centre in Bekasovo with approximately 70,000 square metres of usable area, and our leased distribution centre in Krekshino with approximately 20,000 square metres of usable area dedicated to our online business and ELC stores. Our newly constructed distribution centre in Bekasovo, commissioned in 2015 has enabled us to improve our centralisation levels. Our centralisation level (purchase costs for goods that passed through our distribution centres, as a percentage of total purchase costs for goods) increased from 20% in 2013 to 65% in 2016, thus decreasing our logistics costs significantly. In 2015, we also implemented new warehouse management and automatic replenishment systems (SAP EWM), which have allowed us to increase the efficiency and reliability of our supply chain flows. We also have a fully-integrated enterprise resource planning (ERP) system based on the SAP platform, which is able to support up to 800 stores.

With respect to human resources, we have an established divisional structure to manage our store network and well-tested procedures to hire employees for new stores and to manage the store opening process. In addition, we have a dedicated team at the head office that continuously evaluates opportunities to open new stores in attractive locations.

Strong management team with track record of delivering business growth

We believe the members of our management team are among the leading industry professionals in their respective business areas. All key members of the management team have an extensive track record of operating in the Russian retail market.

Our management team has executed an aggressive expansion plan which has resulted in a significant improvement in our operating and financial performance since 2012. Our store network increased from 252 stores in 2013 to 464 stores in the nine months ended 30 September 2016 which contributed to revenue growth of 26.2% in 2014, 33.2% in 2015 and 35.7% in the nine months ended 30 September 2016. Like-for-like sales grew at 13.4% in 2013, 13.7% in 2014, 12.3% in 2015 and 13.0% in the nine months ended 30 September 2016 as compared to the same period in 2015. Our Adjusted EBITDA margin increased from 7.7% in 2013 to 9.8% in 2014 and 10.2% in 2015, as well as from 7.4% in the nine months ended 30 September 2015 to 8.7% in the nine months ended 30 September 2016, in each case as compared to the prior period. The management team has also shifted our focus and planning from margin maximisation to customer- and sales-driven performance. For example, new competitive pricing on "Key Value Items" and product mix strategies have been implemented to drive customer traffic and sales. We increased the share of higher margin own brands in the fashion segment. In relation to suppliers, we have been able to negotiate improved commercial terms such as pricing and payment terms. We obtained larger bonuses for generating higher volumes of sales of certain products of suppliers, as well as increases in reimbursements for the costs of our marketing and promotional activities. We also achieved cost reductions through optimisation of head office and in-store headcounts and tightened control over administrative costs.

We believe our strong market position, strong brand and ambitious growth strategy will enable us to continue to attract and develop high-calibre managers in the future. We also offer our senior management long- and short-term performance-linked incentives. See also "*Management and Corporate Governance—Long-Term Incentive Plan*".

Business Strategy

Using our competitive strengths, we intend to implement the following business strategies:

Sustainable expansion of the store network

We believe we are well positioned to increase our market share and grow our store network by taking advantage of opportunities in various regional markets and expanding our presence in cities where we are currently present by opening additional stores, also pre-empting competition.

Strategically, we target cities with a population of over 50,000 people. There are over 300 cities in Russia with populations of more than 50,000 and many of them still do not have specialised children's retailers or a sufficient number of such stores to meet local demand. We will continue to expand both in cities where we are already present, and new cities.

We principally focus on obtaining leases for selling space in existing shopping malls where we are not present. In 2015, we reviewed 330 locations of which 126 were approved as potential locations for our stores. Most shopping malls aim to have a children's retailer as an anchor tenant, therefore we primarily compete only with specialised children's retailers for such locations and are in most cases able to secure attractive locations and lease rates given our nationwide presence, exceptional brand awareness and leading market position. In the current environment, we have significant potential for expansion through existing shopping malls primarily by replacing competitors and entering underpenetrated local markets.

We estimate that there are over 600 existing shopping malls in Russia without a Detsky Mir store; within these 600 we have identified at least 90 which represent a very strong strategic fit meeting our store opening criteria without a meaningful cannibalisation impact on the existing chain. We continuously evaluate and monitor the availability and pipeline of shopping malls in Russia across regions and will be consistently pursuing openings in shopping malls meeting our criteria. See "*Business—Sales Channels—Retail Stores—Store Selection Process*" and "*Management's Discussion and Analysis of Financial Condition and Results of Operation—Liquidity and Capital Resources—Capital Expenditures*".

In addition to monitoring the shopping mall landscape, we assess the market opportunity in terms of saturation of regional markets and specific cities by specialised children's stores and modern retail channels overall. For example, we have identified over 130 cities with a population of 50,000-100,000 without any specialised children's stores which represent attractive new geographies for Detsky Mir.

From 2011 to 2016 (inclusive), we increased the number of Detsky Mir stores from 150 stores to 480 stores. We opened 103 Detsky Mir stores in 2015 and 100 Detsky Mir stores in 2016. We believe there is a market opportunity to target the roll-out of approximately 250 new Detsky Mir stores in 2017-2020, including approximately 70 new Detsky Mir stores in 2017, growing our footprint in Russia significantly while possibly doubling our store count in Kazakhstan. We believe we are uniquely positioned to capture the available growth opportunities in the Russian and Kazakhstani children's goods retailing segment, leveraging our unique brand strength, market leading position, omni-channel capabilities and long-term experience in the market. We have established processes and a dedicated team focusing solely on screening and evaluating potential opportunities for the new store openings on the basis of the economic development, consumers' disposable income, social and political environment in the respective regions and cities.

Continuous focus on measures to support further growth of like-for-like sales and gross profit per square metre

In recent years we have identified and realised significant improvements through the implementation of a comprehensive set of new policies, including significant revision of pricing and product assortment policies, as well as the elimination of supply chain difficulties to enhance availability of goods. Delivering further improvements (such as the development of a CRM system in order to better target our promotional activities), and adapting to changing customer preferences and sales channels to drive strong like-for-like sales growth and gross profit per square metre are the cornerstone of the strategy underpinning our growth plans.

In order to support gross profit, we invest in lowering prices to drive growth in the number of tickets primarily by keeping our assortment mix largely the same as in the past several years, with a shift in our product mix towards traffic-generating categories (such as products for newborns) and by seeking to improve commercial terms with our suppliers. While products for newborns have lower margins, they contribute significantly to generating traffic and therefore can increase gross profit per square metre. Our ability to lower prices for our customers is supported by our large purchasing volumes that enable us to negotiate attractive prices with suppliers. The decrease in revenue resulting from our investment in lowering prices has been offset by decreasing logistics costs due to higher level of centralisation as a result of a new distribution centre in Bekasovo (the Moscow region), the bonuses for advertising and the volume related discounts the we receive from suppliers, as well as our selling an increasing share of higher margin own brand merchandise. In line with this strategy, while our gross profit margin has been gradually decreasing from 38.6% in 2013 to 36.2% in 2015, and from 34.6% in the nine months ended 30 September 2015 to 33.3% in the nine months ended 30 September 2016, our gross profit per square metre increased from RUB46 thousand in 2013 to RUB50 thousand in 2015, and from RUB34 thousand in the nine months ended 30 September 2015 to RUB35 thousand in the nine months ended 30 September 2016.

Our store design concept has a highly interactive format that optimises selling space by way of integration of gaming and interactive zones with trading areas and product aisles. We consider our current store design concept launched in 2013 as one of our competitive advantages that allows us to obtain better lease terms from shopping malls and get higher traffic through customer loyalty.

In addition, we will continue to implement a series of ongoing measures such as price leadership on key value items, targeted promotion campaigns and fast reaction to prices set by competitors to support growth of like-for-like sales and growth in gross profit per square metre.

We will continue to seek additional ways of driving our like-for-like sales growth by entering into the exclusivity arrangements with our suppliers with respect to select innovative, high-demand products coming to the market.

Furthermore, we aim to maximise the impact of our industry-leading loyalty card programme on our sales growth. High loyalty card penetration ratio (77% of sales in the nine months ended 30 September 2016 were made using a loyalty card) provides us with unique data on our customers' purchasing behaviour and preferences. We are continuously working on improvements of information systems in order to better use such data for the purpose of direct marketing and refinement of our product offering.

Implementation of an omni-channel sales strategy addressing the development of the online market

Online sales of children's goods have experienced accelerated growth rates in recent years. According to Ipsos Comcon, the share of online sales in the total Russian market for children's goods was 9% in 2016 and is expected to expand further. Since the launch of our online platform in 2011, we have been focusing on adapting the "Detsky mir" brand and customer proposition, as well as integrating our offline advantages and online opportunities to extract the maximum benefit from the rapid growth of the online market.

We plan to continue the significant expansion of our online store assortment from 40,000 SKUs in 2016 to 50,000 SKUs in the medium term, with a view to having a wider range of products offered online than offline in our retail stores, development of our delivery capabilities, as well as the full integration with our retail store customer proposition and supply chain platform. In particular, the expansion of the online store assortment and further reduction of the average time between order confirmation and availability for in-store pickup will support further growth of our "in-store pickup" service and cross-selling opportunities. Moreover, we intend to generate higher online traffic by integrating it more with social media and by using multiple advertising channels to promote our online store. Furthermore, we expect to drive our online sales by expanding delivery geographies, in particular to cities where we do not currently have stores, as well as by collaborating with third parties. We also intend to implement SAP Hybris e-commerce platform in 2017, as well as the mobile version of our online sales platform.

Investment in our supply chain, supporting growth and enhancing scalability of the business model

Supply chain and related infrastructure are paramount to the retail proposition, and are of particular importance to a high-growth retailing company like Detsky Mir. We are focused on ensuring that our supply chain and related functions are scalable so that they can support the anticipated future growth of our business.

We seek to continue to utilise a flexible distribution model combining (i) a centralised platform based on our two distribution centres in the Moscow region (Bekasovo and Krekshino), and (ii) direct distribution by suppliers to the stores. We have increased the share of centralised deliveries that are processed through our distribution centres. Purchase costs for goods that passed through our distribution centres, as a percentage of total purchase costs for goods, increased from 20% in 2013 to 65% in 2016. We intend to further increase the share of centralised deliveries to 75-80% of purchase costs for goods passed through the warehouse by 2019, as we believe it will best address our needs and the specifics of delivery patterns from our suppliers and will ensure smooth deliveries of goods and minimise distribution costs. By increasing the share of centralised deliveries we specifically aim to reduce dependence on third party distributors, in particular with respect to domestically sourced products in the toys category, and internalise the respective profitability margins, as well as to work directly with large producers such as P&G who deal with high-volume wholesalers only.

To support our roll-out in the Ural and Siberian regions of Russia, we have made a preliminary decision to open a new distribution centre in the Urals with approximately 60,000 square meters of warehousing space in 2018. We intend to evaluate options, in particular with respect to owning as opposed to renting this new distribution centre, and make a final decision in the first half of 2017.

Ongoing improvements of our store operations and administrative functions enhancing efficiency and improving profitability

We are also improving our day-to-day operations, optimising our business processes and extracting additional optimisation opportunities from our significant scale. This relates to the entire spectrum of functions from sales to purchasing and head office operations. For example, we aim to further optimise our personnel structure, enhance automation and build on the optimisation initiatives we implemented in the course of the past four years. We expect the implementation of our initiatives in human resources to result in a decline in our payroll costs as a percentage of revenue. Furthermore, in addition to improving purchase prices and volume related discounts, we are also working on improving other commercial terms with our lessors and suppliers. For example, we are continuously seeking opportunities for exclusivity arrangements with our suppliers with respect to unique and high-demand products. As regards our lease agreements and rental rates, in the long-term we expect costs to increase in line with inflation, but to decrease as a percentage of revenue.

Summary Risk Factors

An investment in the Shares involves a high degree of risk. Among the risks relating to our business and the Shares are risks associated with the following matters:

Risks Relating to Demand and Competition

- General economic and demographic conditions in Russia may negatively affect consumer confidence and spending;
- Competition may affect our financial performance;
- We face challenges and competition in developing our online business;
- Failure to identify and satisfy consumer preferences could adversely affect our business;
- Our operations are subject to seasonality;

Risks Relating to our Business and Strategy

- A decrease in customer traffic at shopping malls where almost all of our stores are located could adversely affect our business;
- The failure of timely delivery of imported goods may impact our operations;
- We rely on third-party service providers, including merchandise suppliers and logistics companies;
- Failure to forecast demand or manage inventory levels and address seasonal fluctuations appropriately could adversely affect our business;
- We lease the premises for almost all of our stores and for our Krekshino distribution centre, and our failure to renew such leases on commercially acceptable terms, or at all, could affect our business;
- The anticipated adoption of IFRS 16 "Leases" may significantly impact our reported financial results and financial position;
- We may not be successful implementing our retail network expansion plans;
- A deterioration of the value of "Detsky mir" brand or infringement of the related trademarks could negatively impact our business;
- Implementation of our strategy depends on our senior management's experience and expertise, as well as our ability to recruit and retain experienced personnel;
- The sale of products for children exposes us to the risk of product liability claims and adverse publicity;
- We are exposed to the risk of theft, as well as employee misconduct and mistakes;
- Failures in our information technology systems could adversely affect our business and future growth;
- Our insurance policies may be insufficient to cover losses arising from business interruption, damage to our property or third-party liabilities;
- Failure to comply with existing laws or regulations or the directives of government inspections could result in the closure of certain of our stores, the imposition of substantial penalties, additional costs or slower growth of revenue;
- Competition laws enforced by the Russian Federal Antimonopoly Service may result in certain limitations being imposed on our activities, which may affect our business;
- Salary increases in Russia may adversely affect our results of operations;
- Information regarding our competitors and other market data and trends were not independently verified by us and may be inaccurate;

Risks Relating to our Financial Condition

- Our operations may be constrained if we cannot attract or service future debt financing;
- Fluctuations in the value of the Rouble against the U.S. Dollar could adversely affect our business;
- We do not have a fully automated information system for the preparation of IFRS financial statements;

Risks Relating to our Corporate Structure

- Sistema will continue to control us and its interests may differ from the interests of other shareholders;
- We have engaged in and will continue to engage in ordinary course commercial dealings with Sistema and its subsidiaries;

Risks Relating to the Political, Economic and Social Situation in Russia

- Emerging markets are subject to different risks as compared to more developed markets;
- Political risks could adversely affect the value of investments in Russia;
- Deterioration of Russia's relations with other countries could negatively affect the Russian economy and those of the nearby regions;
- The current political instability relating to Ukraine and related sanctions may affect our business;
- Crime and corruption, as well as social instability could adversely affect our business;
- The Russian banking system remains underdeveloped;
- If Russia were to return to high and sustained inflation, our results of operations could be adversely affected;
- Russian physical infrastructure is in poor condition and its further deterioration could have a material adverse effect on our business;

Risks Relating to the Russian Legal and Regulatory Environment

- Weaknesses relating to the Russian legal system and Russian law create an uncertain environment for investment and for business activity;
- Unlawful or arbitrary government action may have an adverse effect on our business;
- We may have difficulties in obtaining effective redress in court proceedings, including to protect our property rights;
- Shareholder liability provisions of Russian law could expose us to liability for our subsidiaries' obligations;
- Shareholder rights provisions of Russian law may impose additional costs on us, which could cause our financial results to suffer;
- Russia's developing securities laws and regulations may limit our ability to attract future investment and could subject us to fines or other enforcement measures despite our best efforts;
- Corporate governance standards in Russia differ from those in Western jurisdictions;
- Russian legal entities may be forced into liquidation on the basis of formal non-compliance with certain requirements of Russian law;

Risks Relating to Taxation in the Russian Federation

- The Russian taxation system is relatively underdeveloped;
- Russian anti-offshore measures may have adverse impact on our business decisions;
- The Russian thin capitalisation rules allow for different interpretations, which may affect our business, results of operations, financial condition or prospects;
- Repeated tax audits and extension of liability beyond the limitation period may result in additional tax liabilities;
- Russian transfer pricing rules may subject our transfer prices to challenge by the Russian tax authorities;
- We may encounter an increase in property taxes due to changes in the Russian system of property taxation;

- Payments of dividends (if any) on the Shares may be subject to Russian withholding tax;
- Capital gains from the sale of the Shares may be subject to Russian income tax;

Risks Relating to the Shares and the Trading Market

- There has been no prior public market for the Shares, and liquidity and the trading price of the Shares may be volatile;
- We may decide not to pay dividends in the future;
- It may not be possible to repatriate distributions made on the Shares at a favourable exchange rate, or at all;
- Holders of the Shares in certain jurisdictions may be subject to restrictions regarding the exercise of pre-emptive rights in future offerings;
- Future sales of Shares may adversely affect their market price;
- The Ordinary Shares may be delisted;
- Investors may have limited recourse against the Company, the Selling Shareholders and our directors and executive officers.

Summary Consolidated Financial and Operating Information

The following tables contain our selected historical consolidated financial and operating information as at the dates and for the periods indicated. The selected consolidated statement of profit and loss and other comprehensive income data and selected consolidated statement of cash flows data for the nine months ended 30 September 2016 and 2015, and the years ended 31 December 2015, 2014 and 2013, and selected consolidated statement of financial position data as at 30 September 2016 and 31 December 2015, 2014 and 2013 has been derived, without adjustments, from our (i) unaudited interim condensed consolidated financial information for the three months and the nine months ended 30 September 2016 prepared in accordance with IAS 34, Interim Financial Reporting (the "**Interim Financial Statements**"); (ii) audited consolidated financial statements for the year ended 31 December 2015 prepared in accordance with IFRS (the "**2015 Annual IFRS Financial Statements**"); and (iii) audited consolidated financial statements as at and for the year ended 31 December 2014 prepared in accordance with US GAAP (the "**2014 Annual US GAAP Financial Statements**", together with the Interim Financial Statements and the 2015 Annual IFRS Financial Statements, the "**Financial Statements**"), as set forth on pages F-2 through F-99 of this Offering Memorandum.

Historically, our consolidated financial statements were prepared in accordance with accounting principles generally accepted in the United States of America ("**US GAAP**"). We adopted International Financial Reporting Standards ("**IFRS**") as issued by the International Accounting Standards Board with effect from 1 January 2014, and the 2015 Annual IFRS Financial Statements were our first set of consolidated financial statements prepared in accordance with IFRS. As a result, the 2015 Annual IFRS Financial Statements (with the comparative consolidated financial information for 2014) and the Interim Financial Statements included herein were prepared in accordance with IFRS. As we had not yet adopted IFRS in 2013, we have included in this offering memorandum the 2014 Annual US GAAP Financial Statements (with the comparative consolidated financial information for 2013), which were prepared in accordance with US GAAP. See "*Presentation of Financial and Other Information*".

Prospective investors should read the following selected consolidated financial and operating information in conjunction with the information contained in "*Risk Factors*", "*Presentation of Financial and Other Information*", "*Capitalisation and Indebtedness*", "*Management's Discussion and Analysis of Financial Condition and Results of Operations*", and the Financial Statements included elsewhere in this Offering Memorandum.

Selected Consolidated Statement of Profit or Loss and Other Comprehensive Income (IFRS)

	Nine months ended 30 September		Year ended 31 December	
	2016	**2015**	**2015**	**2014**
	(unaudited)		*(audited)*	*(unaudited)*
		(in millions of Roubles)		
Revenue	54,226	39,967	60,544	45,446
Cost of sales	(36,151)	(26,125)	(38,640)	(28,183)
Gross profit	**18,075**	**13,842**	**21,904**	**17,263**
Selling, general and administrative expenses	(14,618)	(11,534)	(17,725)	(14,263)
Gain on sale of a building, net	—	—	—	1,164
Share of profit of associate, net of income tax	9	5	9	13
Other operating expenses, net	(19)	(11)	(20)	(7)
Operating profit	**3,447**	**2,302**	**4,168**	**4,170**
Finance income	148	535	723	56
Finance expense	(1,418)	(1,251)	(2,053)	(918)
Impairment of goodwill	—	—	(363)	—
Gain on acquisition of controlling interest in associate	16	—	—	—
Foreign exchange loss	(10)	(595)	(922)	(582)
Profit before tax	**2,183**	**991**	**1,554**	**2,727**
Income tax expense	(498)	(334)	(578)	(684)
Profit for the period	**1,685**	**657**	**976**	**2,043**

Selected Consolidated Statements of Operations and Comprehensive Income (US GAAP)

	Year ended 31 December	
	2014	2013
	(audited) *(in millions of Roubles)*	
Revenue	45,446	36,001
Cost of sales	(28,183)	(22,093)
Gross profit	**17,263**	**13,908**
Selling, general and administrative expenses	(13,523)	(11,155)
Gain on sale of a building, net	1,164	—
Depreciation and amortization	(740)	(634)
Interest in earnings of associates, net of tax	13	19
Other operating income and (expenses), net	(7)	(1)
Operating profit	**4,170**	**2,137**
Interest income	56	11
Interest expense	(918)	(518)
Foreign exchange loss	(582)	(58)
Income before income tax expense	**2,727**	**1,572**
Income tax expense	(684)	(419)
Net profit	**2,043**	**1,153**

Selected Consolidated Statement of Financial Position (IFRS)

	As at 30 September	As at 31 December		As at 1 January
	2016	2015	2014	2014
	(unaudited)	*(audited)* *(in millions of Roubles)*	*(unaudited)*	*(unaudited)*
Total non-current assets	10,457	15,352	10,335	3,704
Total current assets	26,011	23,842	16,509	11,721
Total assets	**36,468**	**39,194**	**26,843**	**15,424**
Total non-current liabilities	4,297	5,528	3,523	4,439
Total current liabilities	31,670	33,271	20,674	13,084
Total liabilities	**35,967**	**38,799**	**24,197**	**17,522**
Total equity/ (deficit)	**501**	**395**	**2,646**	**(2,098)**

Selected Consolidated Balance Sheets (US GAAP)

	As at 31 December	
	2014	2013
	(audited) *(in millions of Roubles)*	
Total non-current assets	9,634	3,194
Total current assets	16,310	11,190
Total assets	**25,944**	**14,383**
Total non-current liabilities	3,523	4,439
Total current liabilities	19,775	12,043
Total liabilities	**23,298**	**16,481**
Total shareholders' equity/ (deficit)	**2,646**	**(2,098)**

Selected Consolidated Statement of Cash Flows Data (IFRS)

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
	(unaudited)		*(audited)*	*(unaudited)*
	(in millions of Roubles)			
Net cash received from / (used in) operating activities	1,538	(3,058)	(679)	1,492
Net cash received from / (used in) investing activities	3,955	(4,355)	(5,217)	(2,646)
of which cash paid for capital expenditures[(1)]	(945)	(4,337)	(5,308)	(1,945)
Net cash (used in) / received from financing activities	(6,972)	7,556	6,160	1,963

(1) This represents the actual cash paid for capital expenditures (including purchases of property, plant and equipment, as well as intangible assets, which may relate to capital expenditures accrued in other periods).

Selected Consolidated Statement of Cash Flows Data (US GAAP)

	Year ended 31 December	
	2014	2013
	(audited)	
	(in millions of Roubles)	
Net cash provided by operating activities	1,492	2,025
Net cash used in investing activities	(2,646)	(750)
of which cash paid for capital expenditures[(1)]	(1,945)	(772)
Net cash generated by / (used in) / financing activities	1,963	(2,047)

(1) This represents the actual cash paid for capital expenditures (including purchases of property, plant and equipment, as well as intangible assets, which may relate to capital expenditures accrued in other periods).

Non-IFRS Measures

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
	(unaudited)			
EBITDA (in millions of Roubles)[(1)]	4,623	2,940	5,123	4,911
Adjusted EBITDA (in millions of Roubles)[(2)]	4,711	2,968	6,185	4,463
Adjusted EBITDA Margin[(3)]	8.7%	7.4%	10.2%	9.8%
Adjusted Net Profit[(4)]	1,755	679	2,189	1,685
CROCI[(5)]	29.1%	25.0%	58.0%	58.7%
ROIC[(6)]	30.0%	33.6%	65.0%	83.5%
Adjusted ROIC[(7)]	30.7%	29.1%	78.3%	88.4%

(1) EBITDA is calculated as profit for the period before income tax expense, foreign exchange loss, gain on acquisition of controlling interest in associate, finance expense, finance income, depreciation and amortisation;

(2) Adjusted EBITDA is calculated as EBITDA, adjusted for the one-off effect relating to disposal of the building occupied by the Yakimanka Gallery in 2014, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and *"Management and Corporate Governance—Share-based Compensation of the General Director"*) and additional cash bonuses under the LTI program;

(3) Adjusted EBITDA Margin is calculated as Adjusted EBITDA for a given period divided by revenue for such period expressed as a percentage;

(4) Adjusted Net Profit is calculated as profit for the period adjusted for the one-off effect relating to disposal of the building occupied by the Yakimanka Gallery in 2014 (together with related tax effects), impairment of goodwill in 2015, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and *"Management and Corporate Governance—Share-based Compensation of the General Director*) and additional cash bonuses under the LTI program;

(5) Cash Return on Capital Invested (CROCI) is calculated as Adjusted EBITDA divided by average gross capital invested (simple average of gross capital invested as at the respective dates). Gross capital invested is calculated as total assets (less amounts receivable under a loan granted to CJSC "DM-Finance", cash and cash equivalents and, for the nine months ended 30 September 2015 and the year ended 31 December 2015, the gross book value of the building occupied by the Bekasovo distribution centre and its equipment (which was completed in 2015, but was not operational for the most of 2015)) minus current liabilities (excluding short-term loans and borrowings and current portion of long-term loans and borrowings) plus accumulated depreciation and impairment in relation to property, plant and equipment and accumulated amortization in relation to other intangible assets;

(6) Return on Invested Capital (ROIC) is calculated as operating profit, adjusted for the effect of the disposal of Yakimanka building, divided by average capital invested (simple average of capital invested as at the respective dates). Capital invested is calculated as Net

Debt plus total equity/(deficit) minus amounts receivable under a loan granted to CJSC "DM-Finance", short term loan issued to the related party and, for the nine months ended 30 September 2015 and the year ended 31 December 2015, the net book value of the building occupied by the Bekasovo distribution centre (which was completed in 2015, but was not operational for the most of 2015); and

(7) Adjusted ROIC is calculated as operating profit, adjusted for the effect of the disposal of Yakimanka building, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and "*Management and Corporate Governance—Share-based Compensation of the General Director*") and additional cash bonuses under the LTI program divided by average capital invested (simple average of capital invested as at the respective dates). Capital invested is calculated as Net Debt plus total equity/(deficit) minus amounts receivable under a loan granted to CJSC "DM-Finance" and, for the nine months ended 30 September 2015 and the year ended 31 December 2015, the net book value of the building occupied by the Bekasovo distribution centre and its equipment (which was completed in 2015, but was not operational for e most of 2015).

The following table sets forth our Net Debt and Adjusted Net Debt as at the dates indicated:

	As at 30 September	As at 31 December		As at 1 January
	2016	2015	2014	2014
		(unaudited)		
Net Debt (in millions of Roubles)[8]	12,547	16,425	8,046	5,062
Adjusted Net Debt (in millions of Roubles)[9]	11,498	10,618	2,806	5,062

(8) Net Debt is calculated as total borrowings (long term loans and borrowings and short-term loans and borrowings and current portion of long-term loans and borrowings) less cash and cash equivalents; and

(9) Adjusted Net Debt is calculated as Net Debt adjusted for amounts receivable under the loan issued to CJSC "DM-Finance" (Sistema's subsidiary) in 2013.

The following table sets forth a reconciliation of our EBITDA and Adjusted EBITDA to our profit for the periods indicated:

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
		(unaudited) *(in millions of Roubles)*		
Profit for the period	1,685	657	976	2,043
Add / (deduct):				
Finance income	(148)	(535)	(723)	(56)
Finance expense	1,418	1,251	2,053	918
Gain on acquisition of controlling interest in associate	(16)			
Impairment of goodwill			363	
Foreign exchange loss	10	595	922	582
Income tax expense	498	334	578	684
Depreciation and amortisation	1,176	638	954	740
EBITDA	**4,623**	**2,940**	**5,123**	**4,911**
Reverse effect of:				
Additional bonus accruals under the LTI program	88	28	1,062	716
Effect of disposal of Yakimanka building	—	—	—	(1,164)
Adjusted EBITDA	**4,711**	**2,968**	**6,185**	**4,463**

The following table sets forth a reconciliation of our Adjusted Net Profit to our profit for the periods indicated:

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
		(unaudited) *(in millions of Roubles)*		
Profit for the period	1,685	657	976	2,043
Additional bonus accruals under the LTI program (with related tax effects)	70	22	850	573
Effect of disposal of Yakimanka building (with related tax effects)	—	—	—	(931)
Impairment of goodwill	—	—	363	—
Adjusted Net Profit	**1,755**	**679**	**2,189**	**1,685**

The following table sets forth a calculation of our CROCI for the periods indicated:

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
	(unaudited) *(in millions of Roubles)*			
Adjusted EBITDA	4,711	2,968	6,185	4,463
Divided by:				
Average gross capital invested	16,203	11,884	10,657	7,609
CROCI (%)	**29.1**	**25.0**	**58.0**	**58.7**

The following table sets forth a calculation of average gross capital invested as at the dates indicated:

	As at 30 September		As at 31 December		As at 1 January
	2016	2015	2015	2014	2014
	(unaudited) (*in millions of Roubles*)				
Total assets	36,468	37,177	39,194	26,843	15,424
Amounts receivable under a loan granted to CJSC "DM-Finance"	(1,049)	(5,674)	(5,807)	(5,239)	—
Gross book value of the building occupied by the Bekasovo distribution centre and its equipment	—	(2,789)	(3,183)	—	—
Cash and cash equivalents	(455)	(1,813)	(1,934)	(1,670)	(860)
Current liabilities	(31,670)	(28,653)	(33,271)	(20,674)	(13,084)
Short-term loans and borrowings and current portion of long-term loans and borrowings	8,737	12,382	12,894	6,228	1,572
Accumulated depreciation and impairment in relation to property, plant and equipment	4,097	3,562	3,803	3,042	2,744
Accumulated amortisation in relation to other intangible assets	803	553	595	493	398
Gross capital invested	**16,931**	**14,745**	**12,291**	**9,023**	**6,195**
Add:					
Gross capital invested at the beginning of the period (or, with respect to the capital invested as at 1 January 2014, as at the beginning of the previous period)	12,291	9,023	9,023	6,195	5,752
Gross book value of the building occupied by the Bekasovo distribution centre and its equipment	3,183	—	—	—	—
	32,405	**23,768**	**21,314**	**15,218**	**11,947**
Divided by 2:					
Average gross capital invested	**16,203**	**11,884**	**10,657**	**7,609**	**5,974**

The following table sets forth a calculation of our Adjusted ROIC for the periods indicated:

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
	(unaudited) *(in millions of Roubles)*			
Operating profit	3,447	2,302	4,168	4,170
Additional bonus accruals under the LTI program	88	28	1,062	716
Effect of disposal of Yakimanka building	—	—	—	(1,164)
Divided by:				
Average capital invested	11,506	8,001	6,682	4,208
Adjusted ROIC(%)	**30.7**	**29.1**	**78.3**	**88.4**

The following table sets forth a calculation of adjusted capital invested and average capital invested as at the dates indicated:

	As at 30 September		As at 31 December		As at 1 January
	2016	2015	2015	2014	2014
			(unaudited) (*in millions of Roubles*)		
Net debt	12,547	16,514	16,425	8,046	5,062
Total equity / (deficit)	501	2,481	395	2,646	(2,098)
Amounts receivable under a loan granted to CJSC "DM-Finance"	(1,049)	(5,674)	(5,807)	(5,240)	—
Net book value of the building occupied by the Bekasovo distribution centre and its equipment	—	(2,771)	(3,102)	—	—
Adjusted capital invested	**11,999**	**10,550**	**7,910**	**5,452**	**2,964**
Add:					
Capital invested at the beginning of the period (or, with respect to the capital invested as at 1 January 2014, as at the beginning of the previous period)	7,910	5,452	5,452	2,964	4,709
Net book value of the building occupied by the Bekasovo distribution centre and its equipment	3,102	—	—	—	—
	23,012	**16,002**	**13,363**	**8,416**	**7,673**
Divided by 2:					
Average capital invested	**11,506**	**8,001**	**6,682**	**4,208**	**3,837**

The following table sets forth a calculation of our Net Debt and Adjusted Net Debt for the periods indicated:

	As at 30 September	As at 31 December		1 January
	2016	2015	2014	2014
		(unaudited) (*in millions of Roubles*)		
Long-term loans and borrowings	4,265	5,465	3,488	4,350
Short-term loans and borrowings and current portion of long-term loans and borrowings	8,737	12,894	6,228	1,572
Cash and cash equivalents	(455)	(1,934)	(1,670)	(860)
Net Debt	**12,547**	**16,425**	**8,046**	**5,062**
Amounts receivable under a loan granted to CJSC "DM-Finance"	(1,049)	(5,807)	(5,240)	—
Adjusted Net Debt	**11,498**	**10,618**	**2,806**	**5,062**

Non-US GAAP Measures

	Year ended 31 December	
	2014	2013
	(unaudited)	
EBITDA (in millions of Roubles)(1)	4,911	2,771
Adjusted EBITDA (in millions of Roubles)(2)	4,463	2,771
Adjusted EBITDA Margin(3)	9.8%	7.7%
Adjusted Net Profit(4)	1,685	1,153
CROCI(5)	58.7%	46.4%
ROIC(6)	83.5%	55.7%
Adjusted ROIC(7)	88.4%	55.7%

(1) EBITDA is calculated as net profit before income tax expense, foreign exchange loss, gain on acquisition of controlling interest in associate, interest expense , interest income, depreciation and amortisation;

(2) Adjusted EBITDA is calculated as EBITDA, adjusted for the one-off effect relating to disposal of the building occupied by the Yakimanka Gallery in 2014, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and "*Management and Corporate Governance—Share-based Compensation of the General Director*") and additional cash bonuses under the LTI program;

(3) Adjusted EBITDA Margin is calculated as Adjusted EBITDA for a given period divided by revenue for such period expressed as a percentage;

(4) Adjusted Net Profit is calculated as net profit adjusted for the one-off effect relating to disposal of the building occupied by the Yakimanka Gallery in 2014 (together with related tax effects), as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and *"Management and Corporate Governance—Share-based Compensation of the General Director"*) and additional cash bonuses under the LTI program;

(5) Cash Return on Capital Invested (CROCI) is calculated as Adjusted EBITDA divided by average gross capital invested (simple average of gross capital invested as at the respective dates). Gross capital invested is calculated as total assets (less amounts receivable under a loan granted to CJSC "DM-Finance", cash and cash equivalents and for the nine months ended 30 September 2015 and the year ended 30 December 2015 the gross book value of the building occupied by the Bekasovo distribution centre and its equipment (which was completed in 2015, but was not operational for the most of 2015)) minus current liabilities (excluding short-term loans and borrowings and current portion of long-term loans and borrowings) plus accumulated depreciation and impairment in relation to property, plant and equipment and accumulated amortization in relation to other intangible assets;

(6) Return on Invested Capital (ROIC) is calculated as operating profit, adjusted for the effect of the disposal of Yakimanka building, divided by average capital invested (simple average of capital invested as at the respective dates). Capital invested is calculated as Net Debt plus total equity/(deficit) minus amounts receivable under a loan granted to CJSC "DM-Finance", short term loan issued to the related party and for the nine months ended 30 September 2015 and the year ended 30 December 2015 the net book value of the building occupied by the Bekasovo distribution centre (which was completed in 2015, but was not operational for the most of 2015); and

(7) Adjusted ROIC is calculated as operating profit, adjusted for the effect of the disposal of Yakimanka building, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan"* and *"Management and Corporate Governance—Share-based Compensation of the General Director*") and additional cash bonuses under the LTI program divided by average capital invested (simple average of capital invested as at the respective dates). Capital invested is calculated as Net Debt plus total equity/(deficit) minus amounts receivable under a loan granted to CJSC "DM-Finance" and for the nine months ended 30 September 2015 and the year ended 30 December 2015 the net book value of the building occupied by the Bekasovo distribution centre and its equipment (which was completed in 2015, but was not operational for the most of 2015).

The following table sets forth a reconciliation of our EBITDA and Adjusted EBITDA to our net profit for the periods indicated:

	Year ended 31 December	
	2014	**2013**
	(unaudited) (*in millions of Roubles*)	
Net profit	2,043	1,153
Add / (deduct):		
Interest income	(56)	(11)
Interest expense	918	518
Foreign exchange loss	582	58
Income tax expense	684	419
Depreciation and amortisation	740	634
EBITDA	**4,911**	**2,771**
Reverse effect of:		
Additional bonus accruals under the LTI program	716	—
Effect of disposal of Yakimanka building	(1,164)	—
Adjusted EBITDA	**4,463**	**2,771**

The following table sets forth a reconciliation of our Adjusted Net Profit to our Net Profit for the periods indicated:

	Year ended 31 December	
	2014	**2013**
	(unaudited) (*in millions of Roubles*)	
Net profit	2,043	1,153
Additional bonus accruals under the LTI program (with related tax effects)	573	—
Effect of disposal of Yakimanka building (with related tax effects)	(931)	—
Adjusted Net Profit	**1,685**	**1,153**

The following table sets forth a calculation of our CROCI for the periods indicated:

	Year ended 31 December	
	2014	**2013**
	(unaudited) (*in millions of Roubles*)	
Adjusted EBITDA	4,463	2,771
Divided by:		
Average gross capital invested	7,609	5,974
CROCI (%)	**58.7**	**46.4**

The following table sets forth a calculation of our Adjusted ROIC for the periods indicated:

	Year ended 31 December	
	2014	**2013**
	(unaudited) (*in millions of Roubles*)	
Operating profit	4,170	2,137
Additional bonus accruals under the LTI program	716	—
Effect of disposal of Yakimanka building	(1,164)	—
Divided by:		
Average capital invested	4,208	3,837
Adjusted ROIC(%)	**88.4**	**55.7**

Selected Operating Data

	Nine months ended 30 September		Year ended 31 December		
	2016	2015	2015	2014	2013
Number of stores (end of period)	464	370	425	322	252
Detsky Mir stores	420	326	381	278	224
ELC stores	44	44	44	43	27
Yakimanka Gallery	—	—	—	1	1
Selling space (in thousands of square metres, end of period)(1)	533	435	491	390	320
Detsky Mir stores	528	430	486	381	312
ELC stores	5	5	5	4	3
Yakimanka Gallery	—	—	—	1	1
Selling space (in thousands of square metres, end of period)(1)(2)					
Moscow and Moscow region	359	300	342	268	223
Other Russian regions	159	123	137	106	83
Gross profit per sq.m (in thousands of Roubles)(3)	35	34	50	48	46
Revenue per sq.m (in thousands of Roubles)(4)					
Moscow and Moscow region	118	110	159	149	147
Other Russian regions	98	90	127	119	107
Number of tickets (Detsky Mir stores in Russia only) (in thousands)(5)	47,442	37,206	53,137	42,787	35,517
Moscow and Moscow region	14,463	11,086	16,063	12,819	11,126
Other Russian regions	32,979	26,120	37,074	29,968	24,391
Average ticket (Detsky Mir stores in Russia only) (in Roubles)(6)	1,218	1,142	1,206	1,119	1,071
Moscow and Moscow region	1,348	1,264	1,327	1,217	1,170
Other Russian regions	1,164	1,090	1,153	1,077	1,026
Like-for-like average ticket growth (Detsky Mir stores in Russia only)(7)	8.1%	8.6%	8.2%	5.0%	4.8%
Moscow and Moscow region	9.2%	10.0%	9.9%	4.4%	4.7%
Other Russian regions	7.7%	8.0%	7.5%	5.4%	5.0%
Like-for-like number of tickets growth (Detsky Mir stores in Russia only)(7)	4.4%	4.7%	3.7%	8.3%	8.2%
Moscow and Moscow region	3.3%	4.0%	3.5%	5.6%	7.0%
Other Russian regions	4.9%	4.9%	3.9%	9.3%	8.8%
Like-for-like revenue growth (Detsky Mir stores in Russia only)(7)	13.0%	13.6%	12.3%	13.7%	13.4%
Moscow and Moscow region	12.8%	14.4%	13.8%	10.2%	12.0%
Other Russian regions	13.0%	13.3%	11.6%	15.2%	14.2%

(1) Selling space (in square metres) is an area inside Russian stores used to sell products, and excludes storage areas.

(2) Includes only Detsky Mir stores in Russia.

(3) Gross profit per sq.m. is calculated by dividing gross profit for the period by average selling space for the period (calculated in thousands of square metres as simple average of selling space as of the beginning and as of the end of the period).

(4) Data for the nine months ended 30 September 2016 and 2015 is not annualised and cannot be directly compared with the data for the years ended 31 December 2015, 2014 and 2013.

(5) Ticket is a receipt issued to a customer for its purchase (i.e. the amount in Roubles (including VAT) spent by a customer on a shopping trip) at a store in Russia only.

(6) Average ticket (expressed in Roubles) is calculated by dividing the total sales at Detsky Mir stores in Russia only during the relevant period by the number of tickets at such stores in that year.

(7) Like-for-like average growth, like-for-like number of tickets growth and like-for-like revenue growth as measures calculated on the basis of the operations of our Detsky Mir stores in Russia only. The Detsky Mir stores that are included in like-for-like comparisons are those stores that have been in operations for one full prior calendar year. For example, the like-for-like comparison of retail sales between 2014 and 2015 would include revenue of all Detsky Mir stores that were opened prior to 31 December 2013 and that were in operation during the entirety of 2014 and 2015. The like-for-like comparison of retail sales between the first nine months of 2016 and the first nine months of 2015 would include revenue of all Detsky Mir stores opened before 31 December 2014 (inclusive) that were in operation during the entirety of 2015 and nine months of 2016. Number of Detsky Mir stores included in the like-for-like revenue growth was as follows: 138 stores in 2013, 176 stores in 2014, 210 stores in 2015 and 272 stores in 2016. Like-for-like revenue is calculated on the basis of Russian store revenue (including VAT).

The Offering

Company	Public Joint Stock Company "Detsky mir", a company incorporated under the laws of the Russian Federation and registered in the Unified State Register of Legal Entities (Main State Registration Number 1027700047100). Its registered office is at 37 Prospect Vernadskogo, Building 3, Moscow 119415, Russian Federation.
The Selling Shareholders	(i) Sistema, (ii) FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED (acting jointly and in concert) and (iii) the other selling shareholders named herein under "*Principal and Selling Shareholders—Selling Shareholders*".
The Offering	The Selling Shareholders are offering an aggregate of up to 247,912,160 Shares (assuming the Over-Allotment Option is exercised in full). The Offering comprises an offering of Shares (i) outside the United States in reliance on Regulation S and (ii) within the United States to certain QIBs, as defined in, and in reliance on, Rule 144A of the Securities Act.
Offer Price Range	RUB85 to RUB105 per Share.
Share Capital	Our share capital currently consists of 739,000,000 issued, fully paid and outstanding ordinary shares, each with a nominal value of RUB0.0004. In addition, we are authorised by our Charter to issue an additional 14,250,000 Ordinary Shares. Our Ordinary Shares are subject to applicable provisions of Russian law and our Charter, and have the rights described under "*Description of Share Capital and Certain Requirements of Russian Law*".
Over-Allotment Option	In connection with the Offering, Sistema, FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED have granted the Joint Bookrunners the Over-Allotment Option to cover over-allotments in connection with the Offering, if any, and short positions resulting from any such over-allotments.
Share Delivery Date	The Shares are expected to be sold on or about 10 February 2017, and payment for them is expected to start on or about 10 February 2017.
Use of Proceeds	The gross proceeds from the Offering (assuming the Offer Price at the mid-point of the Offer Price Range and assuming all Shares are sold and the Over-Allotment Option is exercised in full) will be approximately RUB23,552 million. The net proceeds, after deduction of underwriting commissions, fees and expenses incurred by the Selling Shareholders in connection with the Offering (assuming the Offer Price at the mid-point of the Offer Price Range and assuming all Shares are sold and the Over-Allotment Option is exercised in full), will be approximately RUB22,576 million. We will not receive any proceeds from the sale of Shares by the Selling Shareholders.
Lock-up	The Company and the Selling Shareholders have each agreed in respect of themselves, their subsidiaries from time to time (in the case of the Company, Sistema, FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED) and any person acting on their behalf, for a period of 180 days, and members of management of the Company, including those participating in the Offering as Selling Shareholders, have each agreed in respect of themselves and any person acting on their behalf, for a period of 365 days, after the

	Share Delivery Date, not to, without the consent of the Joint Global Coordinators on behalf of the Joint Bookrunners (except in limited circumstances), issue, offer, sell or otherwise transfer any of their Ordinary Shares or securities convertible or exchangeable into or exercisable therefor. See "*Plan of Distribution—Lock-up Provisions*".
Dividend Policy	We have adopted a dividend policy to pay at least 50% of our annual net profit calculated based on IFRS accounts in dividends, subject to the Group's need for financial resources for capital expenditures and the Group's ability to meet its obligations as they fall due. The decision to pay a dividend must be approved by the General Shareholders' Meeting on a recommendation by the Board of Directors. Dividends may only be declared from accumulated undistributed and unreserved earnings, as shown in the Company's statutory financial statements prepared under RAS, and if certain other requirements of Russian legislation are met. See *"Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Dividends"* and *"Risk Factors—Risks Relating to the Shares and the Trading Market—We may decide not to pay dividends in the future"*.
Taxation	For a discussion of certain U.S. and Russian tax consequences of purchasing and holding the Shares, see "*Taxation*".
Transfer Restrictions	The Shares will be subject to certain restrictions on transfer as described under "*Selling and Transfer Restrictions*".
Listing and Trading	Our Ordinary Shares have been admitted to trading in the "Level 3" part of the List of Securities Admitted to Trading on Moscow Exchange with effect from 15 December 2016 under the symbol "DSKY". With effect from 8 February 2017, subject to compliance with the applicable minimum free float requirement, the Ordinary Shares will be transferred to the "Level 1" part of the List of Securities Admitted to Trading on Moscow Exchange. Trading in our Ordinary Shares on Moscow Exchange is expected to commence on or about the Share Delivery Date. Prior to the Offering, there has been no public market for the Shares.
Settlement Procedures	The Shares will be priced in Russian Roubles. It is expected that delivery of the Shares to purchasers thereof and payment for the Shares by the purchasers will commence on the Share Delivery Date. Potential purchasers of the Shares must indicate their payment currency at the time of placing an order with the Joint Bookrunners, which cannot be changed after the order book has been closed. Each purchaser of the Shares must pay for such Shares by the date agreed with the Joint Bookrunners. Subject to Russian currency control requirements, the Shares may be paid for in Russian Roubles or in US Dollars using the WM/Reuters closing spot rate at 16:00 London time effective on the day preceding the day on which the Offer Price is announced minus 15 kopecks. In order to take delivery of the Shares, an investor should have a direct depo account with NSD or with a custodian that has a depo account with NSD. Only if the Shares are deposited with NSD (or through a custodian having a depo account with NSD), can they be traded on Moscow Exchange. The security numbers for the Ordinary Shares are as follows: ISIN: RU000A0JSQ90

	CFI Code: ESVXXR
Risk Factors	Prospective investors should consider carefully certain risks discussed under "*Risk Factors*".

RISK FACTORS

An investment in the Shares involves a high degree of risk. Prospective investors should consider carefully, among other things, the risks set forth below and the other information contained in this Offering Memorandum prior to making any investment decision with respect to the Shares. The risks highlighted below could have a material adverse effect on our business, financial condition, results of operations or prospects, in which case the trading price of the Shares could decline and you could lose all or part of your investment. Prospective investors should note that the risks described below are not the only risks we face. We have described only the risks we consider to be material. However, there may be additional risks that we currently consider immaterial or of which we are currently unaware, and any of these risks could have the effects set forth above.

The risks below have been classified into the following categories: (i) Risks Relating to Demand and Competition, (ii) Risks Relating to our Business and Strategy, (iii) Risks Relating to our Financial Condition, (iv) Risks Relating to our Corporate Structure, (v) Risks Relating to the Political, Economic and Social Situation in Russia, (vi) Risks Relating to the Russian Legal and Regulatory Environment, (vii) Risks Relating to Taxation in the Russian Federation, and (viii) Risks Relating to the Shares and the Trading Market. This categorisation is provided for the convenience of the reader only, and any particular category should not be assumed to contain all the risks related to that category.

Risks Relating to Demand and Competition

General economic and demographic conditions in Russia may negatively affect consumer confidence and spending

As substantially all of our revenue is derived from Russia, purchases of our merchandise are dependent upon discretionary spending by our Russian customers, and our financial performance is sensitive to changes in macroeconomic conditions and other factors that affect consumer spending in Russia. These consumer spending habits are affected by, among other things, levels of employment, salaries and wage rates, consumer confidence and consumer perception of economic conditions, inflation, prevailing interest rates, income tax rates, consumer debt levels, housing and utilities costs, the availability of consumer credit, seasonal weather patterns and other changes in weather, changes in demographic profiles and consumers' aspirations.

General economic conditions and a decrease in consumer spending have had, and may continue to have, an adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares. During periods of economic stagnation or decline, consumers become more price-sensitive and in response we may be forced to offer lower priced and lower margin products in our product assortment, as well as more promotions, which may lead to reduced profitability. At present, the Russian economy is facing significant challenges, primarily due to the decline in prices for oil and other commodities which are Russia's principal exports and important drivers of Russia's economy, as well as the effects of economic sanctions imposed against certain Russian individuals and entities by the United States, the European Union and several other jurisdictions in connection with the Ukraine crisis. These factors have also contributed to the weakening of the Rouble, reduced access to financing for Russian borrowers and increased capital flight. According to Rosstat, Russia's nominal gross domestic product ("**GDP**") growth slowed from 1.3% in 2013 to 0.7% in 2014. In 2015, Russia's GDP declined by 3.7%. According to the Ministry of Economic Development of the Russian Federation, Russia's GDP is expected to have decreased by 0.6% in 2016 and to increase by 1.1% in 2017, assuming the current level of global oil prices remains constant. According to the Russian Consumer Confidence Overall Index reported by Rosstat, Russian consumer confidence was minus 19 in the third quarter of 2016 as compared to minus 32 in the first quarter of 2015. Generally, the Russian retail industry has been adversely impacted by the economic slowdown in Russia. Following the downturn in the Russian economy, consumers in Russia have become more cautious on non-discretionary purchases, although purchases of fast moving consumer goods and children's goods have not yet been similarly affected. During the economic downturn, consumers tend to reduce spending by reducing the volume of their purchases or by shifting their purchasing pattern towards cheaper products, with these trends being particularly pronounced with respect to discretionary products. While we were able to adapt our product mix and pricing policies during 2014 and 2015 to avoid a significant negative impact of these trends on our financial performance, there can be no assurance that we will be able to do so in future similar downturns. Deterioration of the Russian economy and economic uncertainty could further reduce consumer discretionary spending on the products we sell and could also cause a shift in consumer discretionary spending to products that are not currently in our product assortment.

Most of our end-customers are newborns and children and, as a result, our revenues are dependent on birth rates in Russia. While at present we are benefiting from positive demographic trends resulting from increasing birth rates over the last 10 years due to children being born to the Soviet baby boom generation of the early 1980s, in the future levels of demand for children's goods could be negatively impacted by lower birth rates. Any decline in the number of newborns and children in Russia in the future could have an adverse effect on demand for the products we sell.

There is no guarantee that consumer spending or demand for the products we sell will exceed or remain at current levels. Reduced consumer spending or demand for the products we sell could also result in excess inventories leading to increased merchandise markdowns and related costs which could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Competition may affect our financial performance

We operate in a competitive environment characterised by relatively low barriers to entry. We compete against a diverse group of competitors covering different product categories, including local and international players. Some of our competitors are general food retailers that compete with us in certain product categories, while others are specialised retailers focusing on particular segments of children's product offerings. Among specialist retailers, we compete with Russian specialised children's goods retailers such as Korablik and Dochki-Synochki and with international retailers with a presence in Russia such as Mothercare and Hamleys. In certain segments, we face competition from general food retailers (such as hyper- and supermarkets) and specialised retailers (such as monocategory retailers). We also compete with Russian and foreign Internet retailers. See "*—We face challenges and competition in developing our online retail business*". In 2015, we had an estimated market share of 32% of the specialised children's goods retail market in Russia (including hyper- and supermarkets) and 13% of the total market of children's goods in Russia, according to Ipsos Comcon.

Some of our competitors, particularly supermarket and hypermarket chains, have more retail space and stores, greater financial, marketing and other resources, greater purchasing economies of scale and lower cost bases in certain market segments. These retailers may be able to respond more swiftly to changes in market conditions and modify their product assortment or shelf space allocations, any of which could give them a competitive advantage over us. We cannot assure you that we will be able to compete successfully with such competitors in the future, particularly in geographic locations that represent new markets for us.

The Russian children's goods retail market is fragmented, with a large number of retailers (specialised and general food retailers) each holding a small market share. Mergers and acquisitions in the retail market may lead to industry consolidation.

According to Ipsos Comcon, in 2016, a number of Russian specialised children's goods retailers (such as Deti, Zdorovy Malysh and Mama) closed the majority of their stores while some of our competitors (such as Akademia and Nati) discontinued retail operations, reportedly due to financial difficulties. While we have been successful in recent years in capturing opportunities available due to the current downturn in the Russian economy, and have been able to increase our overall market share, if stronger operators emerge, we may lose market share and experience lower sales. Lower sales may lead to a reduction in our purchasing or negotiating power vis-à -vis suppliers or store lessors and in the recognition of our brand as compared to that of competitors.

Competitive pressures could lead to reduced sales and a decline in profitability and may have a material adverse effect on our business, financial position, results of operations, prospects and the trading price of the Shares.

We face challenges and competition in developing our online business

In addition to traditional store-based retailers, we compete with Internet-based retailers, including pure online retailers (such as esky.ru and akusherstvo.ru) and the online platforms of specialised children's goods retailers (such as Dochki-Synochki, Korablik and Mothercare). In recent years, Russian consumers have been increasingly using online platforms, including foreign retailers, mainly for price reasons and the typically wider assortment of merchandise offered online compared to in offline stores. According to AKIT, in the first half of 2016 the online sales market in Russia increased by 26% primarily due to a 37% growth of cross-border sales by foreign Internet retailers directly to Russian individuals as compared to the first half of 2015. Lower overhead costs, low barriers to entry, improving logistics and delivery, wider assortment of products, as well as a greater level of flexibility in responding to changing consumer preferences and demand allow online retailers to compete with traditional retailers.

According to Ipsos Comcon, we had a market share of 6% of the total online market of children's goods in Russia by revenue in the first half of 2016. In response to a rapid development of the online market, we intend to continue the implementation of an omni-channel sales strategy. Further integration of our online and offline platforms, where online sales serve as an additional channel to increase revenue with lower incremental costs, as well as expansion of our online store assortment, are among our primary strategic priorities. There can be no assurance, however, of how customer preferences will evolve with respect to the online market for children's goods, or that the online sales market in Russia will grow further or that Russian consumers will continue to use online platforms to buy children's goods at the same rate.

In order for us to compete successfully with other online retailers our online sales platform will need to provide our customers with a superior user experience in terms of convenience, design and functionality. There can be no assurance that our efforts in this respect will be successful. If we are unable to compete successfully with online retailers (both domestic and foreign), any loss of market share to Internet-based retailers may have a material adverse effect on our business, financial position, results of operations, prospects and the trading price of the Shares.

Failure to identify and satisfy consumer preferences could adversely affect our business

Consumer demand for our product assortment is directly affected by changes in consumer preferences. If consumer preferences in the markets in which we operate cease to favour our store format and/or the product assortment that we offer in our stores, and we are unable to identify and adapt to such changes in consumer preferences, store traffic and sales could decline, decreasing our revenue and profitability. For example, the emerging trend within children's play patterns towards game applications for electronic devices and online games may reduce demand for physical toys. Consumers in Russia may also increasingly favour shopping by Internet for convenience or price reasons in the future, as electronic payment, logistics and delivery methods improve and become more reliable and trusted by consumers. Furthermore, as we continue to expand into new cities, we may or may not be successful in adapting to local conditions and customer preferences that may vary from region to region. As a result of changes in customer preferences, traffic in our stores may decrease (or increase more slowly than in the past), and, the average ticket and the number of transactions at our stores may decrease.

Our success also depends significantly on our ability to anticipate, identify and effectively respond to changes in consumer demand and preferences. If we fail to anticipate and/or respond to the changes in a timely manner, we may have excess inventory which could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Our operations are subject to seasonality

We experience seasonal fluctuations in our operations, such as significant increases in volumes during the third and fourth quarters due to the back to school, as well as the winter and New Year seasons. Our revenue in the third quarter accounted for 37.8% of our total revenue in the nine months ended 30 September 2016. In 2015, our revenue in the third and fourth quarters accounted for 25.1% and 33.4%, respectively, of our total revenue. Retail sales of toys and expensive items of winter wear and footwear tend to peak at the end of the year due to the holidays season as well as the colder weather. Stationery sales peak in the third quarter at the time of the start of the school year. Seasonality also requires that we invest additional working capital to secure sufficient stock of products based on seasonal trends, as well as manage our inventory levels to minimise obsolescence. We purchase inventory for the December holiday season in October and November and make payments for these purchases in December, January, February and March. Poor trading performance in any single month or season, due to a failure to adjust the product mix for the relevant period or otherwise, can adversely affect full-year results and leave us with excess inventory that may be difficult to liquidate without price discounts, or at all, which in turn could have a material adverse effect on our business, financial condition, results of operations and prospects.

Risks Relating to our Business and Strategy

A decrease in customer traffic at shopping malls where almost all of our stores are located could adversely affect our business

Almost all of our stores are located in shopping malls. While we believe that our stores are destination locations for customers due to our brand and marketing efforts, we also rely heavily on the ability of the malls to attract customer traffic. Such customer traffic may not reach the levels that we originally expected due to various factors beyond our control. Mall customer traffic depends on the continuing popularity of a particular mall as a shopping destination, including its anchor tenants. While our stores tend to be the anchor tenant in the children's area of the mall, other anchor tenants (general food retailers, sporting goods hypermarkets, large electronics stores and entertainment zones) remain key drivers of mall customer traffic and we do not control the addition or loss of such anchors and co-tenants. Mall customer traffic also may be negatively impacted by poor accessibility, heavy traffic congestion, lack of sufficient or reliable electric supply chain, or other deficiencies in local transportation or utilities infrastructure, which are common in Russia. In addition, fewer people may visit shopping malls due to a loss of consumer confidence as a result of the downturn in the economy, terrorism or war. Moreover, as our stores are located in close proximity to other mall-based retailers (especially food hypermarkets and various apparel, footwear and specialty retailers) with whom we compete in certain product categories, we may lose some of the mall customer traffic to our competitors. Any decrease in shopping mall traffic or competition from other mall tenants could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

The failure of timely delivery of imported goods may impact our operations

In 2013-2015 and nine months ended 30 September 2016, over 80% of the goods sold were manufactured abroad, primarily in China, India, Bangladesh and Vietnam. Approximately 80% of the imported goods were purchased from distributors in Russia that import the product into Russia, with the remaining portion (primarily our private brand products) sourced directly from manufacturers from China, India, Vietnam and Bangladesh. As a result, we are subject to the risks associated with international trade (such as customs clearance, interruption in trade, force majeure) and other country specific factors, particularly those which may increase manufacturing cost or/and prevent the import of goods from such countries, as well as the availability and costs of transportation. The flow of merchandise could also be adversely affected by financial or political instability in any of the countries in which the merchandise is manufactured. Any event causing a disruption of imports, including the imposition of import restrictions, could adversely affect our business, financial condition, results of operations, prospects and the trading price of the Shares.

We rely on third-party service providers, including merchandise suppliers and logistics companies

We rely on a variety of third-party service providers in carrying out our retail operations. In particular, we rely on merchandise suppliers, logistics services providers and contractors engaged in construction works.

An efficient supply chain operation is critical to our business. In relation to the 80% of imported merchandise inventory which is purchased domestically from distributors in Russia, we rely on such distributors to deliver the merchandise directly to our stores. In relation to the 20% of merchandise inventory which we import ourselves (mostly our own brand products), we arrange for its transportation to Russia using third-party service providers and it is received by us at our distribution centres in Krekshino and Bekasovo located in the Moscow region. We also rely on third-party ground transportation companies to distribute merchandise from our distribution centres to stores in Russian regions and Kazakhstan. While we use a state-of-the-art inventory management system intended to ensure that our stores maintain sufficient inventory and engage a range of credible counterparties, our reliance on suppliers and third-party logistics services providers makes our supply chain operation subject to disruptions due to factors beyond our control. Road infrastructure in regions outside Moscow is underdeveloped and could adversely impact our supply chain in the regions. Any disruption in the operation of our supply chain could result in higher delivery costs, damage to products, insufficient stock levels at our stores (particularly, during high seasons) and lost revenue. In addition, we rely on contractors to carry out construction, maintenance or fit out works with regard to our stores. Accordingly, any such disruption to our supply chain system, product damage or failures in construction, maintenance or fit-out works could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Failure to forecast demand or manage inventory levels and address seasonal fluctuations appropriately could adversely affect our business

As a retailer of merchandise, we are exposed to the risk that we accumulate excess or have insufficient inventory as a result of seasonal peaks, unanticipated changes in consumer preferences and other supplier-related factors. To manage inventories effectively, we need to forecast consumer demand, which is uncertain by its nature. When we begin selling a new product, it is particularly difficult to forecast product demand accurately. There can be no assurance that we will be able to accurately predict these trends and events or that, if we do predict them, we will be able to respond adequately to avoid over-stocking or under-stocking inventory. In addition, demand for products could change significantly between the time an order is placed and the time the products are available for sale. Moreover, our inability to respond to seasonal peaks, including shifts in demand for certain products, could have a material adverse effect on our business. See "*Risks Relating to Demand and Competition—Our operations are subject to seasonality*".

As we carry a broad selection of products in 525 stores as at 31 December 2016, we maintain significant inventory levels. Carrying excess inventory increases requirements for warehousing and storage space, and may have a negative impact on cash flows and working capital, while failure to have a certain product in stock when a customer requests it could negatively affect revenue and lead to potential customer loss. Accordingly, any failure to manage inventory levels appropriately could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

We lease the premises for almost all of our stores and for our Krekshino distribution centre, and our failure to renew such leases on commercially acceptable terms, or at all, could affect our business

We lease the premises for almost all our stores and for our Krekshino distribution centre. As at 31 December 2016, the lease agreements for approximately 60% of our stores had a lease term of more than five years, approximately 31% had a lease term of one to five years and the remaining 9% had a lease term of less than one year. Most of our retail store lease agreements contain an automatic extension clause or provide that we have renewal rights exercisable subject to compliance with the lease terms and upon a written notice to the lessor. Approximately 82% of lease agreements allow early termination on our part following a three-to-five month notice. The lease term for our Krekshino distribution centre expires in 2019 and does not contain an automatic extension clause or a pre-emptive right to renew the lease. Most of our retail store lease agreements and the lease agreement for our Krekshino distribution centre provide the lessor with repudiation rights as a remedy for failure on our part to perform various types of obligations (including non-monetary obligations). Furthermore, some of our lease agreements allow the lessor to retain our property or to block access to our retail space in case we default on lease payment obligations. Most of our lease agreements with respect to stores located in Russia establish Rouble-denominated lease rates or a Rouble equivalent of foreign-currency lease rates at fixed Rouble/U.S. Dollar, Rouble/Euro or Rouble/U.S. Dollar-Euro exchange rates. Out of 466 Detsky mir store lease agreements as at 31 December 2016, 325 provided for Rouble-denominated lease rates, 114 provided for U.S. Dollar-denominated lease rates, 14 provided for EUR-denominated lease rates and 13 provided for dual U.S. Dollar/Euro lease rates. Out of 45 ELC store lease agreements as at 31 December 2016, 22 provided for Rouble-denominated lease rates, 19 provided for U.S. Dollar-denominated lease rates, two provided for EUR-denominated lease rates and two provided for dual U.S. Dollar/Euro lease rates. Due to the significant depreciation of the Rouble against the U.S. Dollar and the Euro in the end of 2014 and the subsequent volatility of the Rouble, we renegotiated lease agreements with lease rates established in U.S. Dollars and/or Euros, and introduced caps for Rouble/U.S. Dollar or Rouble/Euro exchange rates, as well as provisions to renegotiate these caps annually or establish caps for a certain period of time. As at 31 December 2016, the average exchange rates with respect to 56 agreements providing for an annual renegotiation of caps were RUB38 per U.S.$1, RUB53 per EUR1 and RUB46 for dual EUR/U.S.$ exchange rate, and the average exchange rates with respect to 85 Detsky Mir store lease agreements providing for longer-term fixed caps (in average, for not less than 4 years) were RUB38 per U.S.$1, RUB49 per EUR1 and RUB44 for dual EUR/U.S.$ exchange rate. As at 31 December 2016, 20 ELC store lease agreements provided for fixed Rouble/U.S. Dollar, Rouble/Euro or Rouble/U.S. Dollar-Euro exchange rates with average exchange rates of RUB48 per U.S.$1, RUB61 per EUR1 and RUB44 for dual EUR/U.S.$ exchange rate, while three ELC store lease agreements provided for rental payments based on the CBR's RUB/U.S.$ exchange rate. A predominant portion of our lease agreements entered into since 1 January 2016 are denominated in Roubles. All our twelve lease agreements with respect to stores located in Kazakhstan establish Tenge-denominated lease rates. There can be no assurance that we will continue to be able to renew leases on commercially acceptable terms, or at all, as they expire, or renegotiate commercial terms relating to lease rates established with reference to capped exchange rates.

We compete with other mall-based retailers for retail space in prime mall locations, including with various apparel, footwear and specialty retailers. If rent prices increase significantly, it may cease to be economically justifiable to lease stores and we may have to discontinue operations at some of our leased stores. If we are unable to maintain or renew leases for our stores or for the Krekshino distribution centre as they expire and on acceptable terms, or lease other suitable premises on acceptable terms, or if our existing leases are terminated for any reason (including in connection with a lessor's loss of its ownership rights to such premises), or if their terms (including rental charges) are revised to our detriment, such matters could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Furthermore, under Russian law, long-term leases (i.e., lease agreements entered into for a term of not less than one year) must be registered in the Real Estate Register maintained by Rosreestr. We have several lease agreements that were entered into for a term of not less than one year which have not been registered and/or which are in the process of registration. Russian statutory provisions are not entirely clear as to the status of such lease agreements and may be interpreted to the effect that non-registered lease agreements are deemed to be invalid (i.e. not binding for the parties to the agreement and creating no legal effect in respect to third parties). Pursuant to Russian case law, however, such lease agreements are binding on the parties (provided that the lessor and the tenant have agreed on all material terms of the lease and started performing the lease agreement), but create no legal effect in respect to third parties and cannot be enforced against any third parties. In particular, our pre-emptive right, if applicable, to enter into a lease agreement for a new term may not be enforceable in relation to such non-registered lease agreements. Moreover, if the lessor under these agreements transfers its ownership title to the leased property, then we may not be able to enforce such non-registered lease agreements against the new owner of the property. See "*Regulation of the Russian Retail Sector—Regulation of Real Estate—Regulation of Real Estate Sales and Leases*".

The anticipated adoption of IFRS 16 "Leases" may significantly impact our reported financial results and financial position

In January 2016, the International Accounting Standards Board issued IFRS 16, "Leases", which sets out a new model for lease accounting replacing IAS 17. The standard introduces a single lessee accounting model and requires a lessee to recognize assets and liabilities for all leases with a term of more than 12 months, unless the underlying asset is of low value. A lessee is required to recognize a right-of-use asset representing its right to use the underlying asset and a lease liability representing its obligation to make lease payments. Lessors continue to classify leases as finance and operating leases. Other areas of the lease accounting model have been impacted, including the definition of a lease. Transitional provisions have been provided. IFRS 16 is effective for accounting periods beginning on or after 1 January 2019, and is to be applied retroactively. Early adoption is permitted if IFRS 15, "Revenue from contracts with customers", has been adopted. We are currently evaluating the impact of IFRS 16 on our consolidated financial statements and expect IFRS 16 to have a significant negative impact on our consolidated statement of financial position and our non-IFRS measures such as EBITDA, Adjusted EBITDA and Net Debt due to recognition of right of use assets and lease liabilities for a substantial part of leases where the Group is a lessee. We expect to apply the standard in accordance with our future mandatory effective date (1 January 2019).

We may not be successful implementing our retail network expansion plans

Our business has recently expanded rapidly, and we anticipate further organic growth as we pursue our nationwide expansion. The number of our stores increased from 252 stores in 2013 to 322 stores in 2014, 425 stores in 2015 and 525 stores in 2016. We currently plan to open approximately 250 Detsky Mir stores in 2017-2020, including approximately 70 Detsky Mir stores in 2017. Our planned retail network expansion depends on our ability to locate and lease appropriate premises in mall locations with sufficiently high customer traffic on commercially acceptable terms; to open new stores in a timely manner; to employ, train and retain additional in-store and managerial personnel; and integrate the new stores into our existing operations on a profitable basis. Our growth plans also depend on, among other things, economic conditions, availability of funding, and the regulatory environment. There can be no assurance that our planned retail network growth will be achieved. Furthermore, any delays in opening new stores beyond original plans, particularly, outside the high season, will affect the maturation of these stores (i.e., the period of time by which they will achieve the performance targets set by us at the time of their opening). Even if we open new stores as anticipated, we may incur unforeseen costs and delays in new stores becoming profitable, or at all. Our failure to do any of the foregoing could have a material adverse effect on our business.

Opening new stores requires us to identify and lease premises that are suitable for our needs on commercially acceptable terms. During periods of economic growth, the market for property in large metropolitan areas in Russia and Kazakhstan, and particularly in Moscow, has been highly competitive and competition for, and therefore the cost of, premises may increase, as was the case in the past. While we have been successful in recent years in capturing current opportunities available due to the downturn in Russian economy, in the future, we may be unable to negotiate the same commercially favourable lease terms due to market conditions, and competition from other retailers. We compete with the mall-based retailers (including various apparel, footwear and specialty retailers) for prime mall locations. If we fail to identify and secure leases to premises on commercially acceptable terms and on a timely basis for any reason (including due to competition from other retailers seeking similar premises), our growth may be adversely affected.

Moreover, the actual operating and financial performance of new stores may prove to be worse than that of our existing stores or than forecasted. As the market may be becoming increasingly saturated and competitive, we may have to explore geographical expansion into areas that are not as attractive as the areas where we are already present, and our new stores may generate lower levels of customer traffic, sales density, total sales, profits or returns than levels we have achieved in our previously opened stores. Should demographic, economic, competitive or other operating conditions in our markets as a whole and in specific regions, cities or locations fail to meet our expectations, the performance of our new stores may end up being materially worse relative to our original plans, and this would have a material adverse effect on our business, financial results or prospects, and the trading price of the Shares.

If we decide to expand through selective acquisitions in the future, this strategy entails certain risks, including failure to conduct appropriate due diligence on the target's operations or financial condition, overvaluation of target and subsequent overpayment for the target, the incurrence of significantly higher than anticipated financing-related risks and operating expenses, and larger than anticipated liabilities. There can be no guarantee that diligence conducted by us will not identify material issues or that the acquired businesses will not negatively impact our performance. If any such risks materialise, our business could be adversely affected.

In addition, we may experience problems integrating new stores into our business and managing them successfully, in particular, in new regions and locations. These risks include failing to effectively assimilate and integrate the operations and personnel into our business, and failing to install and integrate all necessary systems and controls, including financial reporting systems. The failure to implement our expansion plans could have a material adverse effect on our business, financial condition, results of operations or prospects, and the trading price of the Shares.

A deterioration of the value of "Detsky mir" brand or infringement of the related trademarks could negatively impact our business

As our business depends on our "Detsky mir" brand and the goodwill associated with it, the "Detsky mir" brand name and related trademarks are key assets of our business. In Russia, we registered our current "Detsky mir" logo as a well-known trademark in 2007. In Kazakhstan, we currently operate our stores under a licensing agreement with the Company and our operating subsidiary in Kazakhstan. In October 2016, we filed an application with the respective authorities in Kazakhstan to register "Detsky mir" logo as a trademark.

Russia generally offers a lower level of intellectual property rights protection and enforcement than countries in Western jurisdictions. The use of trademarks is a relatively developing area of Russian law, and accordingly conflicts between registrations may arise. While no intellectual property claims are currently ongoing or pending, a third party may claim to have rights superior to our registration or our registration may prove vulnerable on other grounds. Since we registered the current "Detsky mir" logo, we have constantly monitored any potential infringements of our trademark rights and, when third parties used the "Detsky mir" name and trademark in violation of our rights, have protected our rights through notices to infringers and court proceedings, and we will continue to do so. Although we believe that we have been taking appropriate steps to protect our trademarks and other intellectual property rights, such steps may not prove sufficient and third parties may infringe or challenge our rights. If we are unable to protect existing intellectual property rights against infringement or misappropriation, this could impact our ability to develop business. In addition, we may need to engage in litigation in order to enforce our intellectual property rights. A failure to protect these rights could have a material adverse effect on our business, financial condition, results of operations or prospects, and the trading price of the Shares.

Implementation of our strategy depends on our senior management's experience and expertise, as well as our ability to recruit and retain experienced personnel

Our ability to implement our business strategy is dependent, to a large extent, on the services of senior management personnel, in particular Mr. Vladimir Chirakhov, our General Director. We also depend on our ability to continue to attract, retain and motivate qualified personnel, particularly store managers and store personnel. The loss or diminution in the services of one or more of our senior management personnel or a failure to attract and retain qualified personnel could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

The sale of products for children exposes us to the risk of product liability claims and adverse publicity

The marketing and sale of toys, children's apparel, products for newborns and other products for children entail an inherent risk of product liability claims, product recall and adverse publicity as a result. In addition, such products may, in certain cases, result in personal injury or even death. Even though in recent years we have not received any product liability claims or notifications, there can be no assurance that such claims do not arise against us in the future. If we fail to secure adequate insurance or contractual indemnification from the relevant supplier, product liability claims relating to defective products could have a material adverse effect on our ability to successfully market similar products in the future and more generally, on our business. In addition, even if a product liability claim is not successful or is not fully pursued, the negative publicity surrounding any assertion that the products we sell cause injury or death could harm our reputation with existing and potential customers. Any product liability claim brought against us whether or not successful, could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

We are exposed to the risk of theft, as well as employee misconduct and mistakes

We are exposed to the risk of product and cash theft, as well as employee misconduct and mistakes. Although we have put in place various security and surveillance measures, we are unable to completely prevent product thefts or employee misconduct occurring from time to time at our stores. For example, the majority of customer tickets are paid in cash. Therefore, we are exposed to minor cash shortages as a result of employee misconduct (such as theft) or mistakes (such as errors in giving change to customers). We take various precautions to prevent and detect product theft, employee misconduct or mistakes; however, these may not be effective in all cases. Significant losses arising from or costs incurred to prevent product thefts, employee misconduct or mistakes could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Failures in our information technology systems could adversely affect our business and future growth

We record our sales and costs and manage our inventory through a variety of information technology systems, including systems which communicate over the Internet. In addition, we have an online sales platform. Our information technology systems may be vulnerable to damage or interruption from human error, data inconsistency, Internet slowdowns or unavailability, natural disasters, power loss, computer viruses, intentional acts of vandalism, breaches of security (including with regard to online payments and consumer data) and similar events. In addition, third parties may attempt to gain access to our systems to our detriment, and we may not be able to protect our systems from all attacks. If such attacks occur, some of the problems we may encounter include theft or destruction of data, including commercial, customer, financial and product information, to our commercial detriment or damage to our reputation. We have contingency plans in place to deal with such events which, however in spite of such plans, we may not be able to prevent our systems from suffering failures or delays that might cause significant data loss or other disruptions to our business. System or equipment failures may also result in significant sales losses if store trading software or our online sales platform is rendered inoperable. Other significant systems failures could cause delays in the delivery of products to our stores, decreased customer service and customer satisfaction, and harm to our reputation. Insufficient capacity of our information technology systems may cause slowdown of our operations. Accordingly, any of the foregoing failures in our information technology systems could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Our insurance policies may be insufficient to cover losses arising from business interruption, damage to our property or third-party liabilities

We believe that our current insurance arrangements comply with insurance requirements under Russian law. However, the insurance industry is not yet fully developed in Russia, and many forms of insurance protection common in more developed countries are not yet available in Russia or are not available on comparable or commercially acceptable terms, including coverage for business interruption. We currently maintain inventory insurance, insurance of cash in cash registers and certain types of third-party liability insurance. In certain cases, however, we may not be insured for the full replacement value of the insured property. We have also insured our own distribution centre in Bekasovo (in the Moscow region) against damage caused by fire and water, natural disasters, theft and third-party wrongdoing and we are in the process of negotiating third-party liability insurance for this distribution centre. There can be no assurance that if we incur significant liability, our insurance will be sufficient to cover such liability. We do not currently maintain insurance coverage for business interruption, product liability or loss of key management personnel, as these are not industry practice in our sector.

If we experience a major accident or if a significant event such as fire, explosion or flood were to affect one or several of our core properties or facilities or a substantial number of our stores, we could experience substantial property and equipment loss and disruption in operations. Moreover, depending on the severity of the damage, we may not be able to rebuild such damaged property or restore operations in a timely fashion, or at all, or prevent such damage from negatively impacting our reputation or customer relationships. Our insurance policies may not cover all cases of loss of material property. For example, we will not be able to recover loss in the event of an act of terrorism. For a number of our stores, we do not currently maintain insurance coverage against damage caused by fire, water, natural disasters, theft and third-party wrongdoing. We also do not have third-party liability insurance coverage in place for a number of our stores. Accordingly, any such event could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Failure to comply with existing laws or regulations or the directives of government inspections could result in the closure of certain of our stores, the imposition of substantial penalties, additional costs or slower growth of revenue

As a retailer of merchandise and baby food products, our business and particularly our stores must comply with various laws, regulations and rules with respect to, among other things, quality standards, health and safety, sanitary rules and consumer protection. This includes obtaining and renewing various permits concerning, for example, health and safety and environmental standards. Regulatory authorities exercise considerable discretion in matters of enforcement and interpretation of applicable laws, regulations and rules, the issuance and renewal of permits and in monitoring compliance with the terms thereof. Compliance with the requirements imposed by these authorities may be costly and time-consuming and may result in delays in the commencement of our operations, the imposition of penalties and suspension of operations at our stores.

Federal Law No. 381-FZ "On the Fundamentals of State Regulation of Trading Activities in the Russian Federation" dated 28 December 2009, as amended (the "**Federal Trading Law**"), regulates retail trade and trade of food products and therefore impacts our retail operations, in particular, retail sale of baby food products. For example, as of 1 January 2017, new amendments to the Federal Trading Law came into force restricting the mark-up a Russian food retailer may apply to certain products, imposing certain minimum periods for payments to suppliers and prohibiting the inclusion of certain terms in supply contracts. The Federal Trading Law also provides limitations on volume-based bonuses paid by suppliers to retailers for supplied food products, e.g. a volume-based bonus cannot be included into supplied food price and shall not exceed 5% of total price of supplied food products. The Federal Trading Law also restricts the placement of non-stationary retail facilities on state and municipal land, despite such placement being subject to regulation by state and municipal authorities.

In addition, Russian trade and consumer protection rules and regulations can change rapidly, which may adversely affect our ability to conduct business. Certain fundamental amendments to existing law and regulations have recently been proposed, but have not yet been adopted, by regulatory authorities of the Russian Federation and Eurasian Economic Union ("**EEU**"). For example, in June 2016 Kazakhstan authorities proposed an initiative to implement a psychological and pedagogical expert evaluation of children's goods imported into the EEU. The proposal, which is expected to be finalised in mid-2017, would enable EEU members to limit the importation of children's goods that are found by experts to have the potential to provoke aggression or to otherwise have a negative impact on the development of a child's personality. It is not yet clear how the proposed expert evaluations would be conducted or who is to be included in the expert panels. Furthermore, in December 2016, Ministry of Industry and Trade of the Russian Federation proposed to introduce amendments to the Russian Federal Law "On the Main Guarantees of Children's Rights", which provides, *inter alia*, for the inclusion of certain children's goods on the list of "essential goods" maintained by the Russian Government. Should children's goods be classified as "essential goods", the Russian government will have the authority to establish limits on retail prices in respect of such products, which could have a material adverse effect on our pricing practices. Should either or both of the above regulations be enacted, this could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Failure to comply with existing or new laws, regulations and rules may result in the imposition of sanctions, including civil and administrative penalties applicable to us and criminal and administrative penalties applicable to our officers. Specifically, we may be required to cease certain of our business activities and/or to remedy past infringements. Decisions, requirements or sanctions taken and imposed by relevant authorities may restrict our ability to conduct our operations or to do so profitably and, as a result, could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Competition laws enforced by the Russian Federal Antimonopoly Service may result in certain limitations being imposed on our activities, which may affect our business

Federal Law No. 135-FZ "On Protection of Competition" dated 26 July 2006, as amended (the "**Competition Law**"), generally prohibits any concerted action, agreement or coordination of business activity that results or may result in, among other matters, (a) price fixing, discounts, extra charges or margins; (b) coordination of auctions and tenders; (c) allocation of a market by territory, volume of sales or purchases, types of products, customers or suppliers; (d) refusal by suppliers to enter into contracts with customers; (e) imposing unfavourable contractual terms; (f) fixing disparate prices for the same products, for unjustified reasons (g) restriction of competition in any other way. Courts interpret these concepts of concerted actions or coordination of business activity inconsistently. As a result, there is significant uncertainty as to what actions may be viewed as violations of the Competition Law. In a number of precedents, Russian courts found concerted actions where market participants acted in a similar way within the same period of time, although, arguably, there have been legitimate economic reasons for such behaviour and the behaviour was not aimed at restricting competition. While we are not aware of any allegation that we have violated the Competition Law, there is a risk that we may be found to have violated the law if our market behaviour towards our customers or suppliers is viewed as being similar to the behaviour of our competitors, and perceived by the Russian Federal Antimonopoly Service (the "**FAS**") as restricting competition. Such broad interpretations of the Competition Law may result in the FAS imposing substantial limitations on our activities, may limit our operational flexibility and may result in civil, administrative or criminal liability.

The FAS, which has power to investigate perceived violations of the Competition Law, has reviewed the marketing, sales and supply strategies of major participants in the Russian retail industry in recent years and has brought charges against certain market participants alleging concerted actions in violation of the Competition Law. If our activities are found to have violated the Competition Law, we could be subject to penalties or ordered to change our business operations in a manner that increases costs or reduces revenue and profit margin. Despite our best efforts to comply with the Competition Law, there can be no assurance that the FAS will not inspect our activities in the future and find us liable for breaches of the Competition Law. Should this happen, this could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

In addition, while we are not aware of having such position in any market, if we are found to hold a market share of over 35% or a dominant position within a certain market with respect to our retail operations or a specific product or service, or products or services, we will become subject to increased scrutiny by the FAS. For example, we may be required to submit for regulatory review our agreements with suppliers, and any failure to obtain such consent may adversely affect our business, financial condition, results of operations, prospects and the trading price of the Shares. See "*Regulation of the Russian Retail Sector—Russian Antimonopoly Regulation*".

Salary increases in Russia may adversely affect our results of operations

Salaries and our other personnel costs are one of the key components of selling, general and administrative expenses. If salaries and, consequently, our personnel costs increase at a higher pace than our sales, our profitability could be adversely affected. Unless we are able to continue to increase the efficiency and productivity of our employees, wage cost increases exceeding sales growth that are not offset by such increases of efficiency could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Information regarding our competitors and other market data and trends were not independently verified by us and may be inaccurate

Information regarding our competitors and other market data and trends has been sourced from third-party independent agencies such as Ipsos Comcon, as well as from Russian government agencies, and such information has not been independently verified by us. The process of estimating market data and trends requires interpretations of available data which may be incomplete and many assumptions to be made, including assumptions relating to current and future economic conditions and customers' preferences. We cannot give any assurance that such estimates have been made with a high degree of accuracy. Nevertheless, we confirm that such information has been accurately reproduced and, as far as we are aware and are able to ascertain from information published by third parties that no facts have been omitted which would render the reproduced information inaccurate or misleading. Moreover, the official data published by Russian government agencies is substantially less complete or detailed than those of Western countries. Official statistics may also be produced on different bases than those used in Western countries. Any statistical information relating to the Russian Federation and the retail market in this Offering Memorandum is therefore subject to uncertainty due to concerns about the completeness or reliability of available official and public information. The lack of accurate statistical information may also adversely affect our business planning capacity, which in turn could have a material adverse effect on our business, financial condition, results of operations and prospects.

Risks Relating to our Financial Condition

Our operations may be constrained if we cannot attract or service future debt financing.

We seek to maintain a strong capital position and prudent approach to leverage. As at 30 September 2016, we had indebtedness (total long-term and short-term loans and borrowings) in the amount of RUB13,002 million, and short-term debt (short-term loans and borrowings and current portion of long-term loans and borrowings) comprised 67.2% of our indebtedness. As at 31 December 2015 Adjusted Net Debt to Adjusted EBITDA for the year ended 31 December 2015 was 1.7x. As at 30 September 2016 Adjusted Net Debt to Adjusted EBITDA for the twelve months ended 30 September 2016 was 1.5x. See "*Presentation of Financial and Other Information—Non-IFRS and Non-US GAAP Financial Measures* ".

We have entered into short- and long-term financing arrangements with several banks, including Sberbank, VTB, Raiffeisenbank, Alfa Bank and UniCredit, some of which contain covenants requiring us to meet certain financial ratios. In addition, our ability to make payments on our debt depends upon our ability to maintain our operating performance at a satisfactory level, which is subject to general economic and market conditions and to financial, business and other factors, many of which are beyond our control. Any breach of our financing arrangements or the inability to service our debt through internally generated cash flow or other sources of liquidity would lead to default, which could have a material adverse effect on our business.

Furthermore, our planned growth requires expansion capital expenditure. Cash flows from our operations and borrowings from financial institutions are expected to be the primary sources of funding for our planned growth, although we may consider issuing Rouble-denominated bonds in the domestic capital markets. Funding on favourable terms may become increasingly difficult to obtain during times of liquidity constrains on the financial markets. In addition, covenants in our existing financing arrangements may restrict our ability to raise additional debt funding. If we do not generate sufficient operating cash flow or obtain sufficient financing to fund our planned expansion capital expenditures, we may need to curtail or discontinue our growth plans, which could have a material adverse effect on our future development and, in turn, have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Fluctuations in the value of the Rouble against the U.S. Dollar could adversely affect our business

We earn our revenues in Roubles whereas some of our costs are denominated in foreign currencies, primarily the U.S. Dollar and the Euro. Over 80% of the merchandise we sell is manufactured outside of Russia. Of this merchandise, approximately 20% is priced in non-Rouble denominated currencies. Moreover, rental payments for certain of our store premises are linked to the U.S. Dollar or Euro. See "*—Risks Relating to Business and Strategy—We lease the premises for almost all of our stores and for our Krekshino distribution centre, and failure to renew such leases on commercially acceptable terms could affect our business*". The RUB/U.S.$ exchange rate fluctuated significantly in 2013-2016 ranging from RUB32.73 per U.S.$1.00 at the end of 2013 to RUB67.03 per U.S.$1.00 at the end of 2016, and continues to be volatile. As a result of various factors, including a sharp decline in global oil prices, the Rouble depreciated materially against the U.S. Dollar and other foreign currencies during 2014 and 2015. When the Rouble depreciates against the U.S. Dollar or any other foreign currency, our costs generally increase and if we are not be able to pass these cost increases on to our customers by increasing the Rouble price of our merchandise, our margins will decrease.

In addition, our primary functional and reporting currency is the Rouble. For the nine months ended 30 September 2016, we had a foreign exchange loss of RUB10 million as compared to RUB595 million for the nine months ended 30 September 2015. For 2015, we had a foreign exchange loss of RUB922 million as compared to RUB582 million for 2014 and RUB58 million for 2013. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Results of Operations*". As a result of volatility, changes in currency exchange rates between the U.S. dollar and the Rouble have affected and will continue to affect non-cash foreign exchange gains and losses which are recorded in our consolidated statement of profit or loss which, in turn, has impacted and will continue to impact our profit for the period.

We do not have a fully automated information system for the preparation of IFRS financial statements

We depend on information systems for our operations (including financial reporting) which have been customised to meet the needs of our business. In 2015, we completed the implementation of the new enterprise resource planning system on the basis of SAP platform and migrated from our legacy systems. The new system is intended, among other things, to improve controls over financial reporting process and reduce timing for preparation of IFRS financial statements. However, the preparation of our IFRS financial statements continues to involve manual processing that comprises the conversion of local statutory accounts of our subsidiaries into IFRS schedules through accounting adjustments, followed by the consolidation of these financial statements. This process is complex and time-consuming, and requires significant attention from senior accounting personnel. We believe our current information system is sufficient to permit the preparation of our IFRS financial statements on a timely and accurate basis; however, if we are unable to adjust our information system to increase the level of automation, the risk of misstatements in our financial statements remaining undetected may not be entirely ruled out, which could have a material adverse effect on our business, reputation and the trading price of the Shares.

Risks Relating to our Corporate Structure

Sistema will continue to control us and its interests may differ from the interests of other shareholders

Immediately prior to the Offering, Sistema was our controlling shareholder, with 72.6% of our share capital. Following completion of the Offering, Sistema will own 50% and 1 Ordinary Share in our share capital (assuming all Shares are sold and the Over-Allotment Option is exercised in full). As the controlling shareholder, Sistema exercises significant influence over our business strategy, corporate affairs, management and policies, including decisions on acquisitions and disposals of businesses. We believe that such influence has been, and will continue to be, important in the pursuit and implementation of our strategy. However, there can be no assurance that Sistema's interests, views or strategy in relation to us will always coincide with those of other shareholders. Sistema will possess sufficient votes to pass most shareholder resolutions without regard to the votes of other shareholders. Potential conflicts may arise where Sistema may choose not to approve matters which are otherwise in the interest of the remaining shareholders. In addition, transactions with Sistema may in certain circumstances qualify as interested party transactions under Russian law that require approval of a majority of our shareholders that do not have an interest in such transactions. As a result, we may be prevented from completing certain transactions, which could have a material adverse effect on our business.

In addition, Sistema may act in concert with our other significant shareholders, such as FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED, that may have similar interests and views on many matters submitted to a vote of shareholders or to the Board of Directors. Taken together, these shareholders will be able to control the outcome of virtually all shareholder votes and the deliberations of the Board of Directors.

We have engaged in and will continue to engage in ordinary course commercial dealings with Sistema and its subsidiaries

In the ordinary course of business, we have commercial dealings with Sistema and its subsidiaries. Our commercial dealings with Sistema and other related parties are concluded on an arm's-length basis, nevertheless, transactions with related parties pose the risk of us entering into transactions on terms less favourable than could be obtained in arm's length transactions with unrelated parties. If any such risk materialises, it could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares. See also "*Transactions with Related Parties*".

Risks Relating to the Political, Economic and Social Situation in Russia

Substantially all of our revenues are derived from within the Russian Federation and substantially all of our fixed assets are located in the Russian Federation. Investments in the Russian Federation, such as the Shares, carry certain country-specific risks.

Emerging markets are subject to different risks as compared to more developed markets

Emerging markets such as Russia are subject to different risks as compared to more developed markets, including, in some cases, increased political, economic and legal risks. Emerging market governments and judiciaries often exercise broad, unchecked discretion and are susceptible to abuse and corruption. Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved in, and are familiar with, investing in emerging markets. Emerging markets such as the Russian Federation are subject to rapid change, and the information set out herein may become quickly outdated.

Moreover, financial turmoil in any emerging market country tends to adversely affect the value of investments in all emerging market countries as investors move their money to more stable, developed markets. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in the Russian Federation and adversely affect its economy. In addition, during such times, companies in emerging markets can face severe liquidity constraints as foreign funding sources are withdrawn.

Political risks could adversely affect the value of investments in Russia

While the political situation in the Russian Federation has been relatively stable since 2000, future policy and regulation may be less predictable than in less volatile markets. Any future political instability could result in a worsening overall economic situation, including capital flight and a slowdown of investment and business activity. In addition, any change in the Russian Government or its programme of reform or lack of consensus between the Russian President, the Prime Minister, the Russian Government, the Parliament and powerful economic groups could lead to political instability and a deterioration in Russia's investment climate that could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

According to some commentators, politically motivated actions, including claims brought by the Russian authorities against several major Russian companies, have called into question the security of property and contractual rights, progress of the market and political reforms, the independence of the judiciary and the certainty of legislation. This has, in turn, resulted in significant fluctuations in the market price of Russian securities and had a negative impact on foreign investments in the Russian economy, over and above the general market turmoil recently. Any similar actions by the Russian authorities which result in a further negative effect on investor confidence in Russia's business and legal environment could have a further material adverse effect on the Russian securities market and prices of Russian securities, including the Shares.

Russia is a federative state consisting of 85 constituent entities, or "subjects". The Russian Constitution reserves some governmental powers for the Russian Government, some for the subjects and some for areas of joint competence. In addition, eight "federal districts" ("*federal'nye okruga*"), which are overseen by a plenipotentiary representative of the President, supplement the country's federal system. The delineation of authority among and within the subjects is, in many instances, unclear and contested, particularly with respect to the division of tax revenues and authority over regulatory matters. Subjects have enacted conflicting laws in areas such as privatisation, land ownership and licensing. For these reasons, the Russian political system is vulnerable to tension and conflict between federal, subject and local authorities. This tension creates uncertainties in the operating environment in Russia, which may prevent businesses from carrying out their strategy effectively.

In addition, ethnic, religious, historical and other divisions have on occasion given rise to tensions and, in certain cases, military conflict. Moreover, various acts of terrorism have been committed within the Russian Federation. The risks associated with these events or potential events could materially and adversely affect the investment environment and overall consumer and entrepreneurial confidence in the Russian Federation, which in turn could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Deterioration of Russia's relations with other countries could negatively affect the Russian economy and those of the nearby regions

Over the past several years, Russia has been involved in conflicts, both economic and military, involving neighbouring states. On several occasions, this has resulted in the deterioration of Russia's relations with other members of the international community, including the United States and various countries in Europe. Many of these jurisdictions are home to financial institutions and corporations that are significant investors in Russia and whose investment strategies and decisions may be affected by such conflicts and by worsening relations between Russia and its immediate neighbours. For example, political instability and deteriorating economic conditions led to a wide-scale crisis in Ukraine in late 2013 and the beginning of 2014. As a result of these events, in March 2014, following a public referendum, the Crimean peninsula and the city of Sevastopol became new separate constituents of the Russian Federation. The events relating to Ukraine and Crimea have prompted condemnation by members of the international community and have been strongly opposed by the EU and the United States, with a resulting material negative impact on their relationships with Russia.

In addition, Russia's involvement in the armed conflict in Syria since September 2015 may put further pressure on the international relations between Russia and other countries. In particular, on November 24, 2015, a Turkish fighter jet shot down a Russian bomber aircraft near the Turkish-Syrian border. The incident resulted in a bilateral crisis, with Russia imposing economic sanctions against Turkey. This has led to a decrease in export-import and investment activity between the countries. Russia's involvement in the conflict in Syria could further lead to an escalation of geopolitical tensions, the possible introduction or expansion of international sanctions against Russia by other countries and an increased risk of terrorist attacks.

In December 2016, the President of the United States issued an executive order providing for the imposition of sanctions on individuals and entities determined to be responsible for tampering, altering, or causing the misappropriation of information with the purpose or effect of interfering with or undermining election processes or institutions in the United States. In accordance with the executive order, the U.S. Office of Foreign Assets Control (OFAC) extended its list of sanctioned Russian entities and individuals to include persons believed to be involved in the alleged hacker attacks on the servers of the U.S. political parties during the 2016 presidential election.

The emergence of new or escalated tensions between Russia and neighbouring states or other states could negatively affect the Russian economy. This, in turn, may result in a general lack of confidence among international investors in the region's economic and political stability and in Russian investments generally. Such lack of confidence may result in reduced liquidity, trading volatility and significant declines in the price of listed securities, including the Shares.

The current political instability relating to Ukraine and related sanctions may affect our business

The political instability and conflict in Ukraine, heightened levels of tension between Russia and other states, the imposition by the United States, the European Union and other countries of sanctions and other restrictive measures, and the imposition by Russia of sanctions, including import and travel restrictions, has had in the past, and may continue to have in the future, an adverse effect on the Russian economy.

The United States, the European Union and a number of other jurisdictions and authorities have imposed sanctions on a number of Russian officials and individuals, former Ukrainian officials, and several Russian companies and banks with the consequence that entities and individuals in the United States and European Union cannot do business with them or provide funds or economic resources to them, with assets in the relevant sanctioning jurisdictions subject to seizure and the individuals to visa bans. In addition, the United States and European Union have applied "sectoral" sanctions, whose principal consequences are that several leading Russian banks have been restricted from accessing international capital markets. These sanctions have adversely affected the Russian economy and Russia's financial markets, increased the cost of capital and capital outflows, and worsened the investment climate in Russia. If Russia were barred from using the international SWIFT payment system, ordinary banking services in Russia and cross-border trade would be disrupted. An introduction of sanctions targeting a broader segment of the Russian economy could interfere with our operations, which would have a material adverse effect on our ability to conduct business with suppliers, agents and other third parties.

Furthermore, although none of our subsidiaries is currently subject to any US or EU sanctions, should any of our subsidiaries become subject to such sanctions, there may be significant restrictions or bans imposed on dealings with us, which may also restrict or prohibit dealings with the Shares, including their sale, purchase or transfer, which could negatively affect our shareholders. Any non-compliance with US, EU and other sanctions programmes could expose us to significant fines and penalties and to enforcement measures, which in turn could adversely impact our business, financial condition, results of operations or prospects. See "*Principal and Selling Shareholders*".

Crime and corruption, as well as social instability could adversely affect our business

Emerging markets such as the Russian Federation are prone to social risks. High levels of corruption reportedly exist in Russia, including the bribing of officials for the purpose of initiating investigations by government agencies. Corruption and other illegal activities could disrupt our ability to conduct business effectively, and claims that we were involved in such corruption or illegal activities could generate negative publicity, either of which could harm our business.

In addition, rising unemployment, forced unpaid leave, wages in arrears and weakening economies have in some cases in the past led to and could in the future lead again to labour and social unrest. Such labour and social unrest could disrupt ordinary business operations, which also could materially adversely affect our business, financial condition, results of operations, prospects and the trading price of the Shares.

The Russian banking system remains underdeveloped

Russia's banking and other financial systems are not well developed or regulated. There are currently a limited number of creditworthy Russian banks, most of which are headquartered in Moscow. Although the CBR has the mandate and authority to suspend banking licences of insolvent banks, many insolvent banks still operate. Many Russian banks also do not meet international banking standards, and the transparency of the Russian banking sector still does not meet internationally accepted norms.

The serious deficiencies in the Russian banking sector, combined with the deterioration in the credit portfolios of Russian banks, may result in the banking sector being more susceptible to the current worldwide credit market downturn and economic slowdown. A prolonged or serious banking crisis or the bankruptcy of a number of large Russian banks could, should they occur in the future, have a material adverse effect on our business.

Further, we rely on debt financing from Russian banks. Accordingly, if a prolonged or serious banking crisis were to occur in Russia, our ability to access this source of financing may be limited, which in turn could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

If Russia were to return to high and sustained inflation, our results of operations could be adversely affected

During the period of 2010-2015, the consumer price index in Russia measured by Rosstat was 8.8% in 2010, 6.1% in 2011, 6.6% in 2012, 6.5% in 2013, 11.4% in 2014, 12.9% in 2015, and is forecast to be 5.4% in 2016 and 5.2% in 2017. A return to high and sustained inflation could lead to market instability, new financial crises, reductions in consumer purchasing power and the erosion of consumer confidence. Certain of our costs such as rent and utilities costs, as well as payroll costs, are sensitive to rises in inflation in Russia. Due to competitive pressures in the future, we may be unable to raise prices sufficiently to cover such costs and to maintain or increase our profit margins. Furthermore, even if we are able to increase prices to cover such increased costs, such price increases may result in decreased demand for our merchandise and a decrease in sales, which could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Russian physical infrastructure is in poor condition and its further deterioration could have a material adverse effect on our business

Russia's physical infrastructure largely dates back to Soviet times and has not been adequately funded and maintained in recent years. Particularly affected are the rail and road networks, power generation and transmission facilities, communications systems, and building stock. The Russian Government is actively pursuing plans to re-organise the national rail, electricity and telephone systems, as well as public utilities. Any such re-organisation may result in increased charges and tariffs, potentially adding costs to our business, while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems. The deterioration of Russian physical infrastructure harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business in the Russian Federation and can interrupt business operations. Further deterioration in Russia's physical infrastructure could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Risks Relating to the Russian Legal and Regulatory Environment

Weaknesses relating to the Russian legal system and Russian law create an uncertain environment for investment and for business activity

The Russian Federation is still developing the legal framework required by a market economy. Our business is subject to the rules of federal laws and decrees, orders and regulations issued by the President, the Russian Government, the federal ministries and regulatory authorities, which are, in turn, complemented by regional and local rules and regulations. These legal norms at times overlap or contradict one another. Several fundamental Russian laws have only become effective within the past five to ten years, and many have recently been amended. The recent nature of many Russian laws and the rapid evolution of the Russian legal system place the enforceability and underlying constitutionality of laws in doubt and result in ambiguities, inconsistencies and anomalies. Many new laws remain untested. In addition, Russian law sometimes leaves substantial gaps in regulatory infrastructure. Among the risks of the current Russian legal system, to varying degrees, are: inconsistencies among federal laws, among decrees, orders and regulations issued by the President, the Russian Government, federal ministries and regulatory authorities and among regional and local laws, rules and regulations; limited judicial and administrative guidance on interpreting Russian law; the possibility of undue influence on or manipulation of judges and the judicial system; substantial gaps in the regulatory structure due to delay or absence of implementing legislation; a high degree of discretion on the part of governmental authorities; and bankruptcy procedures that can be subject to abuse.

All of these weaknesses could affect our ability to enforce our rights under contracts, or to defend against claims by others under Russian jurisdiction, which in turn could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Unlawful or arbitrary government action may have an adverse effect on our business

Governmental authorities have a high degree of discretion in the Russian Federation and have in the past exercised their discretion arbitrarily, without due process or prior notice, and sometimes in a manner contrary to law. Moreover, the Russian Government also has the power, in certain circumstances, by regulation or governmental act, to interfere with the performance of, nullify or possibly terminate contracts. Unlawful or arbitrary governmental actions have reportedly included withdrawal of licences, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local governmental entities have also used common defects in share issuances and registration as pretexts for court claims and other demands to invalidate such issuances and registrations and/or to void transactions, often for political purposes. Unlawful or arbitrary governmental action, if directed at us, could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

We may have difficulties in obtaining effective redress in court proceedings, including to protect our property rights

The Russian judicial system is not immune from economic and political influences. The Russian court system is understaffed and underfunded, and the quality of justice, duration of legal proceedings, performance of courts and enforcement of judgments remain problematic. Under Russian legislation, judicial precedents generally have no binding effect on subsequent decisions and are not recognised as a source of law. However, in practice, courts usually consider judicial precedents in their decisions. Enforcement of court judgments can in practice be very difficult and time-consuming in Russia. Additionally, court claims are sometimes used in furtherance of political and commercial aims. All of these factors can make judicial decisions in Russia difficult to predict and make effective redress problematic in certain instances.

There are also legal uncertainties relating to property rights. During its transformation from a centrally planned economy to a market economy, the Russian Federation enacted laws to protect private property against expropriation and nationalisation and to provide for fair compensation to be paid if such events were to occur. However, it is possible that due to lack of experience in enforcing these provisions or to political pressure, Russian courts would not enforce these laws in the event of an attempted expropriation, nationalisation or re-nationalisation. Such expropriation, nationalisation or re-nationalisation could potentially bring little or no compensation and could have a material adverse effect on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Shareholder liability provisions of Russian law could expose us to liability for our subsidiaries' obligations

Although a substantial majority of our business is conducted by our parent company, we have certain Russian subsidiaries. Under Russian law, in certain cases, we may be jointly and severally liable for the obligations of a subsidiary. Furthermore, we may also bear contingent liability for the obligations of a subsidiary that becomes insolvent or bankrupt if this is shown to be our company's fault.

If we knew that the action taken pursuant to our instructions would result in losses, then the subsidiary's shareholders would be able to seek compensation from us for such losses. Although we currently own 100% of each of our operating subsidiaries, in any case where the future we were to become less than a 100% owner, these shareholder liability provisions of Russian law could result in significant liabilities for us and adversely affect our business, financial condition, results of operations, prospects and the trading price of the Shares.

Shareholder rights provisions of Russian law may impose additional costs on us, which could cause our financial results to suffer

Under Russian law, shareholders that vote against or abstain from voting on some decisions may demand repurchase of all or some of their shares so long as the shareholder demanding repurchase voted against or did not participate in the voting on certain decisions as determined in accordance with Russian law. See "*Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Share Capital Decrease and Share Repurchases*".

Although our obligation to purchase shares, as well as similar obligations of our subsidiaries that have minority shareholders, in these circumstances will be limited to 10% of our or their net assets as calculated under Russian Accounting Standards ("**RAS**") at the time the matter at issue is voted upon, any such repurchase requirements, if triggered, could have a material adverse effect on our cash flow, as well as on our business, financial condition, results of operations, prospects and the trading price of the Shares.

Russia's developing securities laws and regulations may limit our ability to attract future investment and could subject us to fines or other enforcement measures despite our best efforts

The regulation and supervision of the securities market, financial intermediaries and issuers are considerably less developed in the Russian Federation than in the Western jurisdictions. Disclosure and reporting requirements, anti-fraud safeguards, insider trading restrictions and duties of the directors to the company are relatively new concepts in the Russian Federation and are unfamiliar to many Russian companies and managers.

In addition, Russian securities rules and regulations can change rapidly, which may adversely affect our ability to conduct securities-related transactions. While some important transactions are subject to little or no oversight in the Russian Federation, other transactions are subject to requirements not found in other jurisdictions, resulting in delays in conducting securities offerings and accessing the capital markets. It is often unclear whether certain regulations, decisions and letters issued by the various regulatory authorities apply to us. Violation of reporting and other securities regulation requirements can result in the imposition of fines or difficulties in registering subsequent share issuances. We may be subject to fines or other enforcement measures despite our best efforts at compliance, which could adversely affect our business, financial condition, results of operations, prospects and the trading price of the Shares.

Corporate governance standards in Russia differ from those in Western jurisdictions

We comply with corporate governance standards applicable to publicly listed Russian companies, which are not of the same standard as those in Western jurisdictions. Accordingly, there are fewer protections for investors than would otherwise be the case if we were required to comply with corporate governance principles or standards applicable to public companies in the United Kingdom or the United States.

Russian legal entities may be forced into liquidation on the basis of formal non-compliance with certain requirements of Russian law

Certain provisions of Russian law may allow a court to order liquidation of a Russian legal entity on the basis of its formal non-compliance with certain requirements during formation, re-organisation or operation. There have been cases in the past in which formal deficiencies in the establishment process of a Russian legal entity or non-compliance with provisions of Russian law have been used by Russian courts as a basis for the liquidation of that entity. Some Russian courts, in deciding whether to order the liquidation of a company, have looked beyond the fact that the company failed to comply fully with all applicable legal requirements and have taken into account other factors, such as the financial standing of the company and its ability to meet its tax obligations, as well as the economic and social consequences of its liquidation.

Under Russian legislation, if the net assets of a Russian joint stock company (determined in accordance with the RAS) fall below its charter capital at the end of its third year following incorporation or any subsequent financial year where they were also below the charter capital at the end of the previous financial year, the company is required to voluntarily liquidate itself or decrease its charter capital to match its net assets. In addition, if the net assets of a Russian joint-stock company at the end of its second or any subsequent financial year fall below the statutory minimum share capital requirement, the company must liquidate. If a company fails to comply with either of the requirements stated above within six months after the end of the relevant financial year, the company's creditors may accelerate their claims and require the company to perform its obligations early and pay damages, and governmental authorities may seek the involuntary liquidation of the company. Substantially similar rules apply if net assets of a limited liability company fall below the charter capital. Courts have on occasion ordered the involuntary liquidation of a company for having insufficient net assets, even if the company continued to fulfil its obligations and had net assets in excess of the minimum amount at the time of liquidation.

Also, if the net assets of a joint stock company (as stated in its RAS statutory accounting reports) fall below its charter capital by more than 25% at the end of each quarter in a financial year following its second (or each subsequent) financial year, the company is required to make two publications to that effect. Creditors whose rights of claim arose before such publication may require the company to perform its obligations early and pay damages. A court may refuse to satisfy a creditor's claim if the company establishes that: (i) a decrease in the net assets does not violate the creditor's rights; or (ii) the obligation is adequately secured.

Many Russian companies have negative net assets due to very low historical asset values reflected on their RAS balance sheets; however, their solvency is not adversely affected by such negative net assets. "Cub-Market", LLC, our subsidiary that owns and operates the ELC stores in Russia, had net assets below the statutory minimum charter capital for 2015, the first three quarters of 2016 and is expected to have net assets below the statutory minimum charter capital for 2016. As part of our strategy with respect to ELC stores, we intend to increase operational efficiency of this chain on a stand-alone basis and relocate a number of unprofitable stores. These measures are expected to increase the profitability of "Cub-Market", LLC, which in turn should improve its level of net assets. If we fail to achieve the expected results and consequently an involuntary liquidation or claims for early repayment of obligations were to occur in respect of "Cub-Market", LLC or any of our other subsidiaries, we would be forced to reorganise our operations we conduct through such subsidiaries, which could have a material adverse effect on our business, results of operations, financial condition, prospects and the trading price of the Shares.

Risks Relating to Taxation in the Russian Federation

The Russian taxation system is relatively underdeveloped

The Russian government is constantly reforming the tax system by redrafting parts of the Tax Code of the Russian Federation (the "**Russian Tax Code**"). As of 1 January 2009 the corporate profits tax rate was reduced to 20%. For individuals who are tax residents in the Russian Federation the current personal income tax rate is 13%. The general rate of VAT is 18%. As of 1 January 2010, the Unified Social Tax has been replaced by social security charges payable to the Russian pension, social security and medical insurance funds. Since 1 January 2012 a basic security charge of 30% applies to annual salary within certain limits. An additional 10% charge is imposed on annual salary in excess of those limits. Since 1 January 2012 the new Russian transfer pricing legislation is in force. Starting from 2014, the property tax on certain real estate (including business centres, offices, shopping centres and retail outlets) is paid on their cadastral value, rather than net book value. Starting from 2016, maximum tax rate applicable to real estate taxable at cadastral value is 2%.

As of 1 January 2015 a number of amendments have been made to the Russian legislation introducing, among others, the concepts of controlled foreign companies, corporate tax residency and beneficial ownership (see also "*—Russian anti-offshore measures may have adverse impact on our business decision*"). Due to the relative lack of court and administrative practice, no assurance can be currently given as to how these amendments will be applied in practice and their exact nature, their potential interpretation by the tax authorities and the possible impact on the taxpayers.

In addition, in September 2016 a draft law introducing country-by-country reporting ("**CbCR**") requirements has been published. Introducing mandatory filing of CbCR is in general in line with the Organisation for Economic Co-operation and Development ("**OECD**") recommendations within the Base Erosion and Profit Shifting ("**BEPS**") initiative.

The proposed amendments would require multinational corporate enterprise groups with consolidated revenues of over certain threshold to submit annual CbCR on revenues (including separate data on independent and related entities), profits, taxes, number of employees, assets, and other items, broken down by the jurisdictions where they have presence and Russia. In addition to that, certain other reporting forms would need to be submitted locally ("local file") and on a global level ("master file"), both detailing multinational corporate enterprises groups operations (locally and globally, respectively), as well as transfer pricing methodologies applied to intra-group transactions. CbCR will need to be submitted for financial years starting from 1 January 2017. Reports for prior years may be submitted on a voluntary basis. It is at the moment unclear how the above measures will be applied in practice by the Russian tax authorities and courts.

Russian tax laws, regulations and court practice are subject to frequent change, varying interpretations and inconsistent and selective enforcement. Different interpretations of tax regulations exist both among and within government bodies at the federal, regional and local levels which creates uncertainties and inconsistent enforcement. The current practice is that private clarifications to specific taxpayers' queries with respect to particular situations issued by the Russian Ministry of Finance are not binding on the Russian tax authorities and there can be no assurance that the Russian tax authorities will not take positions contrary to those set out in such clarifications. During the past several years the Russian tax authorities have shown a tendency to take more assertive positions in their interpretation of tax legislation which has led to an increased number of material tax assessments issued by them as a result of tax audits. In practice, the Russian tax authorities generally interpret the tax laws in ways that do not favour taxpayers. In some instances the Russian tax authorities have applied new interpretations of tax laws retroactively. There is no established precedent or consistent court practice in respect of these issues. For instance, the Russian tax authorities have started specifically targeting structures that they perceive as aimed at abusing double tax treaties relieves, especially where recipient of Russian source income is argued not to be a beneficial owner of such income, which may be viewed as retroactive enforcement of recent amendments to the Tax Code. In a number of cases such approach was supported by courts. Furthermore, in the absence of binding precedent, court rulings on tax or other related matters by different courts relating to the same or similar circumstances may also be inconsistent or contradictory. Taxpayers often have to resort to court proceedings to defend their position against the tax authorities.

Despite intention declared by the Russian government to reduce the overall tax burden in recent years, there is a possibility that the Russian Federation would impose arbitrary or onerous taxes and penalties in the future, which could have a material adverse effect on our business, financial condition, results of operations and prospects.

The Russian tax authorities are increasingly taking a "substance over form" approach. Russian tax legislation is becoming increasingly technical and complex. Certain new revenue raising measures have been introduced lately, as discussed below, and it is expected that additional such measures may be introduced. Although it is unclear how any new measures would operate, the introduction of such measures may affect our overall tax efficiency and may result in significant additional taxes becoming payable. We cannot offer prospective investors any assurance that additional tax exposures will not arise. Additional tax exposures could have a material adverse effect on our business, results of operations, financial condition or prospects. In October 2006, the Plenum of the Supreme Arbitration Court of the Russian Federation issued Ruling No. 53, formulating a concept of "unjustified tax benefit", which is defined in the Ruling by reference to specific examples of such tax benefits (e.g., tax benefits obtained as a result of a transaction that has no reasonable business purpose), which may lead to the disallowance of their application. There is a growing practice on the interpretation of this concept by the tax authorities or the courts and it is apparent that the tax authorities actively seek to apply this concept when challenging tax positions taken by taxpayers. The tax authorities have actively sought to apply this concept when challenging tax positions taken by taxpayers in court, and this trend is anticipated to continue in the future. Although the intention of this Ruling was to combat tax law abuses, the tax authorities have started applying the "unjustified tax benefit" concept in a broader sense than may have been intended by the Supreme Arbitration Court. Court rulings on such cases to date have been both in favour of taxpayers and tax authorities, but it is not possible to determine which direction the court practice will take in the future in this respect.

The Ministry of Finance in its "Main Directions of Russian Tax policy for 2017 and the Planning Period of 2018 and 2019" outlined a number of initiatives. Among others, the following changes were put in force as a legislative implementation of those initiatives:

- Starting from 2017 and continuing through 2020, the amount of loss carried forward will be limited to 50% of the tax base for the relevant period. Starting from 2021, recognition of the entire amount of losses should become possible again. With that, the 10-year limitation period is currently abolished (which means that losses incurred since 2007 will be carried forward until fully utilised).
- Starting from 1 October 2017, the penalties for overdue tax payments are increased. For individual entrepreneurs and legal entities, the penalty rate would be 1/300 of the Central Bank of Russia's key rate per day during the first 30 days of delay, and would then double to 1/150 of the key rate. Thus, based on the current Central Bank of Russia's key rate (10%), the penalty for tax payment delays would cost companies around 23% per annum.
- Starting from 2017 any guarantees between Russian non-banking organizations, as well as interest-free loans between Russian related parties will not be treated as controlled transactions under TP rules.

It is expected that other initiatives of the Ministry of Finance, such as acceding to the OECD Multilateral Agreement for amending double tax treaties, and automatic information exchange with foreign tax authorities, will also be adopted in the near time.

Russian anti-offshore measures may have adverse impact on our business decisions

The Russian Federation, like a number of other countries in the world, is actively involved in discussion of measures against tax evasion through the use of low tax jurisdictions as well as aggressive tax planning structures. Initiatives such as the incorporation into Russian law of the concept of beneficial ownership, tax residency of legal entities, taxation of controlled foreign companies, conclusion of multilateral agreements for the exchange of information between the tax authorities of different countries were first raised by the Government in the Main Directions of Russian Tax Policy for 2013 and the planned period of 2014-2015. The Russian President's address to the Federal Assembly of the Russian Federation on December 12, 2013 was focused extensively on the proposed anti-offshore measures in the Russian economy.

As a response to this address, the Federal Law No. 376-FZ was signed by the Russian President on November 24, 2014 with its provisions applicable starting from January 1, 2015. This law introduced the following concepts into Russian tax legislation:

- The concept of "controlled foreign companies" (the "**CFC Rules**"). Under the Russian CFC Rules, in certain circumstances, undistributed profits of foreign companies and non-corporate structures (e.g., trusts, funds or partnerships) domiciled in foreign jurisdictions, which are ultimately owned and/ or controlled by Russian tax residents (legal entities and individuals), are subject to taxation in Russia. The Russian CFC Rules were further developed. In particular, in June 2015, the President of the Russian Federation signed a federal law introducing technical amendments to the Russian CFC Rules, and another federal law amending the CFC rules was signed in February 2016. In the meantime, certain provisions of the Russian CFC Rules are still ambiguous and may be subject to arbitrary interpretation by the Russian tax authorities. We believe these rules should not affect us, however there is no assurance on this;
- The concept of "corporate tax residency". Under this concept, a foreign legal entity may be recognized as a Russian tax resident if such entity is in fact managed from Russia. When an entity is recognized as Russian tax resident it is obligated to register with the Russian tax authorities, calculate and pay Russian tax on its worldwide income and comply with other tax-related rules established for Russian entities. The new rules set principal and secondary criteria for determining the place of management (among other things, the place where the company's executive body operates). However, it is unclear how these criteria will be applied by the Russian tax authorities in practice. We believe these rules should not affect us, however there is no assurance on this;
- The concept of "beneficial ownership". Under Federal Law No. 376-FZ, a beneficial owner is defined as a person holding directly, through its direct and/or indirect participation in other organizations or otherwise, the right to own, use or dispose of income, or the person on whose behalf another person is authorized to use and/or dispose of such income. When determining the beneficial owner, the functions of a foreign person that is claiming the application of reduced tax rates under a double tax treaty and the risks that such person takes should be analyzed. In accordance with Federal Law No. 376-FZ, the benefits of a double tax treaty will not apply if a foreign person claiming such benefits has limited powers to dispose of the relevant income, fulfills intermediary functions without performing any other duties or taking any risks and paying such income (partially or in full) directly or indirectly to another person who would not be entitled to the same benefits should it have received the income in question directly from Russia. Federal Law No. 376-FZ gives right to the tax agent (i.e., the payer of income) to require, in addition to a certificate of tax residency, a confirmation from the recipient of income that it is the beneficial owner of such income, however, at the moment it is still not clear what should be the form of such confirmation. Starting 1 January 2017 this right of the tax agent becomes an obligation.

It is currently unclear how the Russian tax authorities will interpret and apply the new tax provisions regarding the CFC rules and the concept of corporate tax residency and what will be the possible impact on us.

As to the beneficial ownership concept, according to the existing court practice, the tax authorities successfully applied this concept retroactively in respect to payments made before 2015 (i.e. prior to the date when the Russian beneficial ownership concept have come into force). Herewith, the tax authorities were unable to refer to the new rules enacted by the Federal Law No. 376-FZ for the period prior to 2015, so they referred to an applicable double tax treaty and the Commentaries to the OECD Model Tax Convention. Starting from 2015 the tax authorities may refer to specific provision of the Tax Code when they challenge the beneficial ownership of the recipient and charge additional tax. Moreover, starting from 2017, obtaining a confirmation that the income recipient is its beneficial owner will become an obligatory procedure (rather than a right of a tax agent) for applying a reduced withholding tax rate.

Taking the above into account, it cannot be excluded that we might be subject to additional tax liabilities because of these changes being introduced and applied to transactions carried out by us, which could have a material adverse effect on our business, financial condition and results of operations.

On November 4, 2014 the Russian President also signed Federal Law No. 325-FZ ratifying the multilateral Convention on Mutual Administrative Assistance in Tax Matters developed by the Council of Europe and the OECD, which the Russian Federation signed in 2011. Ratification of this Convention will enable the Russian Federation to receive tax information from all participating countries which include, among others, a number of offshore jurisdictions. The provisions of the Convention came into force for Russia starting from 1 July 2015.

No assurance can be given as to the potential interpretation of the abovementioned changes to Russian tax legislation by the Russian tax authorities and the possible impact on us. These developments could complicate tax planning as well as related business decisions, and could possibly expose us to significant fines and penalties and to enforcement measures, despite our best efforts at compliance, and could result in a greater than expected tax burden.

The Russian thin capitalisation rules allow for different interpretations, which may affect our business, results of operations, financial condition or prospects

Russian tax legislation includes thin capitalisation rules which limit the amount of interest that could be deducted by the Russian subsidiaries of the Company for corporate income tax purposes on "controlled" debts. In accordance with amendments to the Russian thin capitalisation rules coming into effect starting from 2017, a controlled debt is defined as a loan or other indebtedness (i) obtained by a Russian company from a foreign related person which (a) owns, directly or indirectly, more than 25% of such Russian company's share capital; or (b) owns a share in such Russian company's capital through a chain of entities, in which each subsequent person directly owns more than 50% of the previous entity; (ii) obtained by a Russian company from another company affiliated (including by means of common ownership as defined by the Tax Code) to such foreign related person; or (iii) that is guaranteed or otherwise secured by such foreign parent or its affiliates. The deductibility of interest is restricted to the extent that the controlled debt of a Russian company exceeds its net assets by more than 3 times. Interest on excess debt is non-deductible and treated as a dividend subject to withholding tax.

Our Russian subsidiaries may be affected by the Russian Federation's thin capitalisation rules if at any time they receive loans from or have loans guaranteed by foreign or Russian related parties.

It is currently unclear how the Russian tax authorities will interpret and apply the amended thin capitalization rules. Therefore, it cannot be ruled out that we might be subject to additional tax liabilities, which could have a material adverse effect on our business.

Repeated tax audits and extension of liability beyond the limitation period may result in additional tax liabilities

Generally, taxpayers are subject to tax audits for a period of three calendar years immediately preceding the year in which the decision to conduct an audit is taken. The tax authorities are entitled to conduct tax audits for the year in which the decision to conduct the audit is taken and the three calendar years immediately preceding that year. However, the fact that a particular tax period has been reviewed does not automatically rule out the possibility of an additional review of the same period by the same or a higher tax authority (where such audit is carried out in connection with the restructuring/liquidation of a taxpayer, or as a result of filing by such taxpayer of an amended tax return decreasing the tax payable, or by a higher-level tax authority for the purpose of reviewing the work of lower-level tax authorities). In addition, on 14 July 2005, the Constitutional Court issued a decision that allows the statute of limitations for tax penalties to be extended beyond the three-year term set forth in the Russian Tax Code if a court determines that a taxpayer has obstructed or hindered a field tax audit. Moreover, the first part of the Russian Tax Code provides for the extension of the three year statute of limitations for tax liabilities if the actions of the taxpayer create insurmountable obstacles for the tax audit. Because none of the relevant terms is defined in Russian law, the tax authorities may have broad discretion to argue that a taxpayer has "obstructed" or "hindered" or "created insurmountable obstacles" in respect of an inspection, effectively linking any difficulty experienced in the course of their tax audit with obstruction by the taxpayer and use that as a basis to seek tax adjustments and penalties beyond the three-year term. Therefore, the statute of limitations is not entirely effective.

Tax audits or inspections may result in additional costs to us, in particular if the relevant tax authorities conclude that we did not satisfy our tax obligations in any given year. Such audits or inspections may also impose additional burdens on us by diverting management resources. The outcome of these audits or inspections could have a material adverse effect on our business, financial condition, results of operations and prospects.

Russian transfer pricing rules may subject our transfer prices to challenge by the Russian tax authorities

The transfer pricing rules contained in the Russian Tax Code are to a great extent aligned with the international transfer pricing principles developed by Organisation for Economic Co-operation and Development (OECD). According to these rules, transactions of the companies of the group may fall into the scope of "controlled transactions" if they are performed with Russian related companies (under certain thresholds and conditions), non-Russian related companies (with no thresholds) or non-Russian companies that are resident in certain offshore zones (currently under certain thresholds).

The Russian transfer pricing rules require taxpayers to notify the Russian tax authorities of “controlled transactions”. Taxpayers could also be required to present to the Russian tax authorities transfer pricing documentation related to “controlled transactions” upon their request.

The Russian transfer pricing rules may have a potential impact on our tax costs arising from the pricing mechanisms used in controlled transactions and, in particular, transactions with related parties in and outside of the Russian Federation. The Russian tax authorities will be entitled to accrue additional tax liabilities if prices of the “controlled transactions” differ from those which independent counterparties in similar conditions would have applied. The Russian tax authorities have conducted a number of transfer pricing audits and accrued additional taxes to the relevant taxpayers. Moreover, in certain instances the Russian tax authorities have applied the transfer pricing rules and methods in cases, where the rules have formally not been applicable, claiming additional tax charges calculated using the transfer pricing rules but based on other tax concepts (e.g. unjustified tax benefit, lack of economic justification of expenses, etc.).

As a result, due to the uncertainties in the interpretations of transfer pricing legislation, no assurance can be given that the tax authorities will not challenge the prices applied by us and make adjustments, which could affect our tax position. Unless such tax adjustments are successfully contested in court, we could become liable for increases in our taxes payable. The Russian transfer pricing law, including the possible tax adjustments outlined above, could have a material adverse effect on our business, results of operations and financial condition.

We may encounter an increase in property taxes due to changes in the Russian system of property taxation

Effective from 1 January 2014, amendments to the provisions of the Russian Tax Code regulating property tax came into force. Nevertheless, application of the new property tax regime introduced by these amendments should start only after the regional legislatures have approved the final cadastral value of real estate objects and have passed corresponding regional tax laws. Under the new property tax regime, certain real estate, including business centres, offices, shopping centres and retail outlets, should be subject to property tax at their cadastral value, rather than net book value. Cadastral values are expected to be set at a level that approximates fair market value. Starting from 2016 property tax rates applicable to real estate taxable at cadastral value would be limited to a maximum of 2%, with specific rates being set by each region. This may lead to an overall increase of tax burden on the owners of the relevant real estate property, negatively affecting their profitability. As a result, this may have a material effect on our business financial condition, results of operations and prospects.

Payments of dividends (if any) on the Shares may be subject to Russian withholding tax

Payments of dividends by a Russian entity to non-resident legal persons and non-resident individuals are subject to Russian withholding tax at a rate of 15%. Such Russian withholding tax may generally be subject to reduction pursuant to the terms of an applicable double tax treaty between the Russian Federation and the country of tax residence of non-resident investors to the extent that such non-resident investors are entitled to benefit from this double tax treaty, provided the Russian tax documentation requirements or other conditions as described below are satisfied.

Starting from 1 January 2015 there is an explicit requirement in the Russian Tax Code, that in order to enjoy benefits under an applicable double tax treaty, the person claiming such benefits must be the beneficial owner of the relevant income. Starting from 1 January 2017, in addition to a certificate of tax residency, the Russian Tax Code requires the tax agent to obtain a confirmation from the non-resident holder – legal entity that it is the beneficial owner of the relevant income. There has been no guidance on the form of such confirmation yet. Due to introduction of these changes, there can be no assurance that treaty relief at source will be available in practice.

Starting from 1 January 2014 the new tax rules introduced by Federal Law of 2 November 2013 No. 306-FZ came into force. These rules introduce a new regime of taxation of income on securities issued by Russian issuers and held in certain types of accounts with Russian custodians. This new regime, inter alia, introduces the new information disclosure requirement in respect of persons executing rights attached to the shares issued by Russian issuers registered in Russian custodians in foreign nominal holder depo accounts, foreign authorised holder depo accounts and foreign depositary receipt programme depo accounts. When a Russian custodian transfers dividends on the Shares registered in the above accounts opened with such Russian custodian, Russian withholding tax is calculated and withheld by such Russian custodian based on the disclosure of the summarised information about the persons executing rights attached to relevant Shares and information about the persons in whose interests a foreign asset manager exercises the rights attached to the Shares, unless the exercise of rights attached to such Shares is performed by such asset manager on behalf of a foreign investment fund which is in accordance with its bylaws is classified as a mutual collective scheme.

If the required information is properly disclosed in accordance with the Russian Tax Code, the Russian custodian should withhold Russian withholding tax at a tax rate envisaged either by the Russian Tax Code or by the relevant double tax treaty, provided that application of such rate is not subject to conditions connected with ownership interest, or (and) amount of investment, or (and) period of owning a share in the capital of a Russian issuer (the reduced tax rate that is subject to the said conditions will only be available in the form of a tax refund). Since the Russian custodian should rely on the disclosed aggregated information on the above persons as required by the Russian Tax Code and described above, in the absence of proper disclosure, the Russian custodian has to withhold a standard 15% tax on the distributable dividends (i.e. relevant double tax treaty reliefs would not apply).

The recipient of dividend income who is entitled to the reduced tax rates on dividends attached to the Shares under either the Russian Tax Code or relevant double tax treaty may apply for a refund in accordance with the general tax refund procedure envisaged by the Russian Tax Code.

It is unclear whether for non-resident individual investors a reduction of withholding income tax provided by a respective double tax treaty between the Russian Federation and the country of the tax residence of such non-resident individual investors could be obtained before dividends are paid. If non-resident individual investors do not obtain double tax treaty relief at the time the dividend income related to the Shares is paid to such non-resident individual investors and income tax is withheld by a Russian income payer, such non-resident individual investors may apply for a refund within three years from the end of the tax period in which the tax was withheld. The documentation requirements to obtain such a refund are prescribed by the Russian Tax Code. However, there can be no assurance that such double tax treaty relief (or refund of any taxes withheld) will be available for such non-resident individual investor.

Since the above rules were introduced relatively recently, they are largely untested in practice. These rules contain some unclear provisions which could be interpreted in a way that is unfavourable for investors into the Shares. For example, new provisions of the Russian Tax Code are not clear on how the requirement to disclose information on the persons exercising rights attached to the Shares correspond to the general requirement of Russian double tax treaties in respect of "beneficial ownership right" to income or "actual right of ownership" as a condition to the application of the double tax treaty relief as well as on how the procedures of collection information on such persons and its aggregation will work in practice. The above requirements impose a risk of additional tax liabilities in the Russian Federation for the holders of the Shares, which could adversely affect the value of the Shares.

Payments of dividends by a Russian entity to a Russian resident investor who is an individual or a legal entity or organisation resident in the Russian Federation for tax purposes should generally be subject to Russian withholding income tax and such tax should not exceed 13% of the gross dividend amount payable to such Russian resident investor.

Capital gains from the sale of the Shares may be subject to Russian income tax

In accordance with the Russian Tax Code if a non-resident holder that is a legal entity disposes of the shares and such shares are recognised as quoted securities under the Russian Tax Code, the proceeds from such disposal (other than through a permanent establishment in the Russian Federation) should not be subject to withholding tax in the Russian Federation. Consequently, no Russian withholding income tax should be imposed on the proceeds from disposal of the Shares to be received by a non-resident holder to the extent the Shares would be recognised as quoted securities under the requirements of the Russian Tax Code.

Russian withholding tax could potentially arise if a non-resident holder that is a legal entity disposes of the Shares (other than through a permanent establishment in the Russian Federation), should such Shares be not recognised as quoted as defined by the Russian Tax Code and should more than 50% of our gross assets consist of immovable property located in the Russian Federation. In such case the gross proceeds of such disposal may be subject to withholding tax in the Russian Federation at a rate of 20%. Alternatively, the capital gains from the disposal may be subject to a 20% withholding tax provided certain requirements are made. The capital gain is the excess, if any, of the sales price over the sum of the acquisition and disposal costs (which need to be evidenced by proper supporting documents) of the Shares.

A resident investor that is a legal entity should generally be subject to Russian profits tax at a rate of 20% of the capital gain. A resident investor who is an individual should generally be subject to income tax at a rate of 13% on the gross proceeds from a disposal of the Shares less any available cost deduction.

The imposition or risk of the imposition of the above tax liabilities in the Russian Federation could adversely affect the value of the Shares.

Risks Relating to the Shares and the Trading Market

There has been no prior public market for the Shares, and liquidity and the trading price of the Shares may be volatile

Prior to the Offering, there has been no public trading market for the Shares. There can be no assurance that, after completion of the Offering, a liquid market will develop for the Shares. Although the Shares will be traded on Moscow Exchange, an active liquid trading market may not develop or be sustained after the Offering. The lack of an active market may impair investors' ability to sell their Shares at the time they wish to sell them or at a price they consider reasonable. The lack of an active market may also reduce the market value of the Shares. Active liquid trading markets generally result in lower price volatility and more efficient execution of buy and sell orders for investors.

The Russian stock markets have experienced and may continue to experience extreme price and volume volatility. A material adverse effect on the value of the Shares could arise from many factors, including: variations in our operating results and those of other Russian companies including our competitors; securities analysts' or investors' expectations that such operating results will not be met by us; variations in national and industry growth rates; changes in governmental legislation or regulation; regulatory actions that affect our business; depth and liquidity of the market for the Shares; general economic conditions within the business sector where we operate or in the Russian Federation; or extreme price and volume fluctuations on the Russian or other emerging market stock exchanges. Any of these events could have a material adverse effect on the trading price of the Shares.

We may decide not to pay dividends in the future

We may be unable or elect not to declare any dividends in the future. The payment of dividends, if any, by us to holders of the Shares will depend (in addition to applicable regulatory requirements) on, among other things, our future profits, financial position and capital requirements, general economic conditions, and other factors that the members of the Board of Directors deem to be important from time to time. See "*Dividend Policy*". Should the Board of Directors and/or our shareholders decide in the future against declaring dividends on the Shares, their trading price may be adversely affected.

It may not be possible to repatriate distributions made on the Shares at a favourable exchange rate, or at all

We intend to pay dividends, if any, on the Shares in Russian Roubles. Currently, Russian currency control legislation pertaining to the payment of dividends does not prohibit payment of Rouble dividends on shares to non-Russian residents. However, there can be no assurance that it will not be reversed in the future. The ability to convert Roubles into U.S. dollars or other foreign currencies is subject to the availability of U.S. dollars or such other foreign currencies on Russia's currency markets. Although there is an existing market within Russia for the conversion of Roubles into U.S. dollars or other foreign currencies, including the interbank currency exchange and OTC and currency future markets, the market for the conversion of Roubles into foreign currencies outside Russia is limited and, therefore, non-Russian holders of the Shares wishing to convert Rouble dividends paid on the Shares into local currencies outside Russia may not be able to do so at a favourable exchange rate, or at all.

Holders of the Shares in certain jurisdictions may be subject to restrictions regarding the exercise of pre-emptive rights in future offerings

In order to raise funding in the future, we may issue additional Shares. Generally, existing holders of shares in Russian public joint stock companies (such as the Company) are in certain circumstances entitled to pre-emptive rights on the issue of new shares in that company as described in "*Description of Share Capital and Certain Requirements of Russian Legislation—Description of Share Capital—Rights Attaching to Ordinary Shares—Pre-emptive Rights*". However, holders of Shares in certain jurisdictions (including the United States) may not be able to exercise pre-emptive rights with respect to any new equity issuances by us unless the applicable securities law requirements in such jurisdiction (including, in the United States, in some circumstances the filing of a registration statement under the Securities Act) are adhered to or an exemption from such requirements is available. We are unlikely to adhere to such requirements and an exemption from such requirements may not be available. Accordingly, such holders may not be able to exercise their pre-emptive rights on future issuances of Ordinary Shares and, as a result, their percentage ownership in the Company would be reduced.

Future sales of Shares may adversely affect their market price

Sales, or the possibility of sales, of substantial numbers of Shares following the Offering could have an adverse effect on the trading price of the Shares or impair our ability to raise equity capital in the future. The Company and the Selling Shareholders have each agreed in respect of themselves, their subsidiaries from time to time, and any person acting on its or their behalf, for a period of 365 days (for members of management of the Company, including those participating in the Offering as Selling Shareholders) and 180 days (for the Company and the Selling Shareholders, other than the members of management of the Company) after the Share Delivery Date, not to, without the consent of the Joint Global Coordinators on behalf of the Joint Bookrunners (except in limited circumstances), issue, offer, sell or otherwise transfer any of their Ordinary Shares or securities convertible or exchangeable into or exercisable therefor. See "*Plan of Distribution—Lock-up Provisions*". Sales, or the possibility of sales, of substantial numbers of Shares by any of these persons following the end of this period, waiver of lock-up restrictions or other sales made could have an adverse effect on the trading price of the Shares following the Offering or impair our ability to raise equity capital in the future. Moreover, we may in the future issue additional Shares or any other securities convertible or exchangeable into Shares. Any such issue could result in an effective dilution for investors purchasing the Shares in the Offering and adversely affect the trading price of the Shares.

The Ordinary Shares may be delisted

In order to maintain its listing on Moscow Exchange, the Company is required to comply with listing requirements, including, among others, compliance with Russian securities laws and the CBR regulations, and with certain minimum corporate governance requirements, as well as maintaining minimum trading volumes. A material failure to comply with the listing rules and requirements may constitute grounds for delisting of the Ordinary Shares. A delisting would likely to have a material adverse effect on the trading price of the Shares.

Investors may have limited recourse against the Company, the Selling Shareholders and our directors and executive officers

Judgments rendered by a court in any jurisdiction outside the Russian Federation will generally be recognised by courts in the Russian Federation only if an international treaty providing for recognition and enforcement of judgments in civil or commercial cases exists between the Russian Federation and the country where the judgment is rendered, or if a federal law is adopted in the Russian Federation providing for the recognition and enforcement of foreign court judgments.

As at the date of the Offering Memorandum, there is no treaty between the United States or the United Kingdom and the Russian Federation providing for reciprocal recognition and enforcement of court judgments in civil and commercial matters, and no relevant federal law on enforcement of foreign court judgments has been adopted in the Russian Federation. In the absence of an applicable treaty, enforcement of a final judgment rendered by a foreign court may still be recognised by a Russian court on the basis of reciprocity, if courts of the country where the foreign judgment is rendered have previously enforced judgments issued by Russian courts. While Russian courts have recently recognised and enforced English court judgments on these grounds, the existence of reciprocity must be established at the time the recognition and enforcement of a foreign judgment is sought, and it is not possible to predict whether a Russian court will in the future recognise and enforce on the basis of reciprocity a judgment issued by a foreign court, including an English court. These limitations may deprive investors of effective legal recourse for claims related to their investment in the Shares. The Company's presence outside the United Kingdom and the United States may limit the legal recourse of the investors against the Company and its directors and executive officers. The Company is incorporated under Russian laws. The majority of its directors and executive officers reside outside the United Kingdom and the United States. As a result, investors may not be able to effect service of process within the United Kingdom and the United States upon the Company or its directors and executive officers. Furthermore, the majority of our assets are located outside the United Kingdom and the United States, principally in the Russian Federation. We believe that the majority of the assets of its directors and executive officers are located outside the United Kingdom and the United States. As a result, investors may not be able to enforce United Kingdom and United States court judgments obtained against the Company or its directors and executive officers in jurisdictions outside the United Kingdom and the United States. In addition, it may be difficult for investors to enforce, in original actions brought in courts in jurisdictions outside the United Kingdom and the United States, judgments obtained under U.K. and U.S. securities laws.

IMPORTANT INFORMATION ABOUT THIS OFFERING MEMORANDUM

Each prospective investor, by accepting delivery of this Offering Memorandum, agrees that this Offering Memorandum is being furnished by the Company for the purpose of enabling a prospective investor to consider the purchase of the Shares. Any reproduction or distribution of this Offering Memorandum, in whole or in part, any disclosure of its contents or use of any information herein for any purpose other than considering an investment in the Shares is prohibited, except to the extent that such information is otherwise publicly available.

None of Credit Suisse (Securities) Europe Limited, Goldman Sachs International, Morgan Stanley & Co. International plc, JSC Sberbank CIB, SIB (Cyprus) Limited or UBS Limited (the "**Joint Bookrunners**") makes any representation or warranty, express or implied, nor accepts any responsibility, as to the accuracy or completeness of any of the information in this Offering Memorandum. This Offering Memorandum is not intended to provide the basis of any credit or other evaluation and should not be considered as a recommendation by any of the Company, the Selling Shareholders or the Joint Bookrunners that any recipient of this Offering Memorandum should purchase the Shares. Each potential purchaser of Shares should determine for itself the relevance of the information contained in this Offering Memorandum, and its purchase of Shares should be based upon such investigation, as it deems necessary.

The Company accepts responsibility for the information contained in this Offering Memorandum, and having taken all reasonable care to ensure that such is the case, the information contained in this Offering Memorandum is, to the best of the Company's knowledge, in accordance with the facts and contains no omissions likely to affect its import.

This Offering Memorandum does not constitute an offer to the public to purchase or otherwise acquire the Shares. In making an investment decision regarding the Shares, you must rely on your own examination of us and the terms of the Offering, including the merits and risks involved. You should rely only on the information contained in this Offering Memorandum. None of the Company, the Selling Shareholders or the Joint Bookrunners has authorised any other person to provide you with different information. If anyone provides you with different or inconsistent information, you should not rely on it. You should assume that the information appearing in this Offering Memorandum is accurate only as of its date. Our business, financial condition, results of operations, prospects and the information set forth in this Offering Memorandum may have changed since the date hereof.

We have included our own estimates, assessments, adjustments and judgments in preparing some market information, which has not been verified by an independent third party. Market information included herein is, therefore, unless otherwise attributed to a third party source, to a certain degree, subjective. While we believe that our own estimates, assessments, adjustments and judgments are reasonable and that the market information prepared by us approximately reflects the industry and the markets in which we operate, there is no assurance that our own estimates, assessments, adjustments and judgments are the most appropriate for making determinations relating to market information or that market information prepared by other sources will not differ materially from the market information included herein.

The contents of the Company's or Sistema's websites (or the websites of the Russia-China Investment Fund, the Russian Direct Investment Fund or China Investment Corporation) do not form any part of this Offering Memorandum.

You should not consider any information in this Offering Memorandum to be investment, legal or tax advice. You should consult your own counsel, accountant and other advisors for legal, tax, business, financial and related advice regarding purchasing the Shares. None of the Company, the Selling Shareholders or the Joint Bookrunners makes any representation to any offeree or purchaser of the Shares regarding the legality of an investment in the Shares by such offeree or purchaser under appropriate investment or similar laws.

The Joint Bookrunners are acting exclusively for the Company and the Selling Shareholders and no one else in connection with the Offering and will not be responsible to any other person for providing the protections afforded to their respective clients or for providing advice in relation to the Offering. To the fullest extent permitted by applicable law, none of the Joint Bookrunners accepts any responsibility whatsoever for the contents of this Offering Memorandum or for any other statement made or purported to be made by it or any of them or on its or their behalf in connection with the Company or the Offering. Each of the Joint Bookrunners accordingly disclaims, to the fullest extent permitted by applicable law, all and any liability whether arising in tort or contract or otherwise (save referred to above) which it might otherwise have in respect of this Offering Memorandum or any such statement.

In connection with the Offering, the Joint Bookrunners and any of their respective affiliates acting as an investor for its or their own account or accounts may subscribe for or purchase, as the case may be, Shares and, in that capacity, may retain, purchase, sell, offer to sell or otherwise deal for its or their own account or accounts in such Shares, any other securities of the Company or other related investments in connection with the Offering or otherwise. Accordingly, references in this Offering Memorandum to the Shares being issued, offered, subscribed or otherwise dealt with should be read as including any issue or offer to, or subscription or dealing by, the Joint Bookrunners and any of their respective affiliates acting as an investor for its or their own account or accounts. The Joint Bookrunners do not intend to disclose the extent of any such investment or transactions otherwise than in accordance with any legal or regulatory obligation to do so.

The Company and the Selling Shareholders may withdraw the Offering at any time before the Share Delivery Date, and the Company, the Selling Shareholders and the Joint Bookrunners reserve the right to reject any offer to purchase the Shares, in whole or in part, and to sell to any prospective investor less than the full amount of the Shares sought by such investor.

The distribution of this Offering Memorandum and the offer and sale of the Shares may be restricted by law in certain jurisdictions. You must inform yourself about, and observe any such restrictions. See "*Selling and Transfer Restrictions*" and "*Plan of Distribution*" elsewhere in this Offering Memorandum. You must comply with all applicable laws and regulations in force in any jurisdiction in which you purchase, offer or sell the Shares or possess or distribute this Offering Memorandum and you must obtain any consent, approval or permission required for your purchase, offer or sale of the Shares under the laws and regulations in force in any jurisdiction to which you are subject or in which you make such purchases, offers or sales. None of the Company, the Selling Shareholders or the Joint Bookrunners is making an offer to sell the Shares or a solicitation of an offer to buy any of the Shares to any person in any jurisdiction except where such an offer or solicitation is permitted or accepts any legal responsibility for any violation by any person, whether or not an investor, of applicable restrictions.

NOTICE TO CERTAIN INVESTORS

Notice to U.K. and other EEA Investors

This Offering Memorandum and the Offering are only addressed to and directed at persons in member states of the European Economic Area (the "**EEA**"), who are "qualified investors" ("**Qualified Investors**") within the meaning of Article 2(1)(e) of the Prospectus Directive. In addition, in the United Kingdom, this Offering Memorandum is only being distributed to and is only directed at (1) Qualified Investors who are investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2005 (the "**Order**") or high net worth entities falling within Article 49(2)(a)-(d) of the Order or (2) persons to whom it may otherwise lawfully be communicated (all such persons together being referred to as "**relevant persons**"). The Shares are only available to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such Shares will be engaged in only with, (1) in the United Kingdom, relevant persons and (2) in any member state of the EEA other than the United Kingdom, Qualified Investors. This Offering Memorandum and its contents should not be acted upon or relied upon (1) in the United Kingdom, by persons who are not relevant persons or (2) in any member state of the EEA other than the United Kingdom, by persons who are not Qualified Investors.

This Offering Memorandum has been prepared on the basis that all offers of the Shares will be made pursuant to an exemption under the Prospectus Directive from the requirement to produce a prospectus for offers of the Shares. Accordingly, any person making or intending to make any offer within the EEA of the Shares should only do so in circumstances in which no obligation arises for the Company, the Selling Shareholders or any of the Joint Bookrunners to produce a prospectus for such offer. None of the Company, the Selling Shareholders or the Joint Bookrunners has authorised or authorises the making of any offer of the Shares through any financial intermediary, other than offers made by the Joint Bookrunners which constitute the final placement of the Shares contemplated in this Offering Memorandum.

For the purposes of this provision, the expression "Prospectus Directive" means Directive 2003/71/EC (and amendments thereto, including the 2010 PD Amending Directive, to the extent implemented in each relevant member state of the EEA), and includes any relevant implementing measure in each relevant member state of the EEA and the expression "**2010 PD Amending Directive**" means Directive 2010/73/EU.

Notice to United States Investors

Because of the following restrictions, purchasers in the United States are advised to consult legal counsel prior to making any offer, resale, pledge or transfer of Shares.

The Shares have not been and will not be registered under the Securities Act or with any securities regulatory authority of any state or other jurisdiction in the United States and may not be offered or sold in the United States, except to persons reasonably believed to be QIBs or outside the United States in offshore transactions in reliance on Regulation S. Prospective investors are hereby notified that sellers of the Shares may be relying on the exemption from the registration requirements of Section 5 of the Securities Act provided by Rule 144A.

Any resale or other transfer, or attempted resale or other transfer, of such Shares, made other than in compliance with the above stated restriction, shall not be recognised by the Company. In addition, until 40 days after the commencement of the Offering of the Shares, an offer or sale of Shares within the United States by a dealer (whether or not participating in the Offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

NEITHER THE U.S. SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION IN THE UNITED STATES NOR ANY OTHER U.S. REGULATORY AUTHORITY HAS APPROVED OR DISAPPROVED OF THE SHARES OR PASSED UPON OR ENDORSED THE MERITS OF THE OFFERING OF THE SHARES OR THE ACCURACY OR ADEQUACY OF THIS OFFERING MEMORANDUM. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENCE IN THE UNITED STATES.

Japan

The Shares have not been and will not be registered under the Final Instruments and Exchange Law, as amended (the "**FIEL**"). This Offering Memorandum is not an offer of securities for sale, directly or indirectly, in Japan or to or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or entity organised under the laws of Japan) or to others for reoffer or resale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan, except pursuant to an exception from the registration requirements under the FIEL, and otherwise in compliance with, the FIEL and other relevant laws and otherwise in compliance with such law and any other applicable laws, regulations or ministerial guidelines of Japan.

Australia

No prospectus or other disclosure document has been lodged with, or registered by the Australian Securities and Investments Commission in relation to the offering of the Shares. This Offering Memorandum does not constitute a prospectus or other disclosure document under the Corporations Act 2001 (the "**Corporations Act**") and does not purport to include the information required for a prospectus or other disclosure document under the Corporations Act.

This document is being distributed in Australia by the Joint Bookrunners to persons (the "**Exempt Investors**") who are "sophisticated investors" (within the meaning of section 708(8) of the Corporations Act, to "professional investors" (within the meaning of section 708(11) of the Corporations Act) and/or otherwise pursuant to one of more exemptions contained in section 708 of the Corporations Act. The entity receiving this document represents and warrants that if it is in Australia, it is either a professional or a sophisticated investor or a person to whom it is lawful to offer the Shares without disclosure to investors under Chapter 6D of the Corporations Act and that it will not distribute this document to any other person.

Any Shares applied for by Exempt Investors in Australia must not be offered for sale in Australia for 12 months from the date of issue, except in circumstances where disclosure to investors under Chapter 6D of the Corporations Act would not be required pursuant to an exemption under section 708 or 708A of the Corporations Act. This document is not supplied in connection with any offering or proposed offering of securities or financial products that require disclosure in accordance with Chapter 6D or Part 7.9 of the Corporations Act. Chapters 6D and 7 of the Corporations Act are complex. Any person acquiring the Shares must observe such Australian on-sale restrictions and if in any doubt as to the application or effect of this legislation, should confer with its professional advisors.

Canada

The Shares may be sold in Canada only to purchasers resident or located in the Provinces of Ontario, Québec, Alberta and British Columbia, purchasing, or deemed to be purchasing, as principal that are accredited investors, as defined in National Instrument 45-106 Prospectus Exemptions or subsection 73.3(1) of the Securities Act (Ontario), and are permitted clients, as defined in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations. Any resale of the Shares must be made in accordance with an exemption from, or in a transaction not subject to, the prospectus requirements of applicable securities laws.

Securities legislation in certain provinces or territories of Canada may provide a purchaser with remedies for rescission or damages if this offering memorandum (including any amendment thereto) contains a misrepresentation, provided that the remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province or territory. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's province or territory for particulars of these rights or consult with a legal advisor.

Pursuant to section 3A.3 (or, in the case of securities issued or guaranteed by the government of a non-Canadian jurisdiction, section 3A.4) of National Instrument 33-105 Underwriting Conflicts ("NI 33-105"), the Joint Bookrunners are not required to comply with the disclosure requirements of NI 33-105 regarding underwriter conflicts of interest in connection with this offering.

PRESENTATION OF FINANCIAL AND OTHER INFORMATION

Presentation of Financial Information

Our financial information set forth herein has, unless otherwise indicated and as discussed below, been extracted without material adjustment from our Financial Statements, which are included elsewhere in this Offering Memorandum.

Historically, our consolidated financial statements were prepared in accordance with US GAAP. We adopted IFRS with effect from 1 January 2014 and the 2015 Annual Financial Statements were our first set of consolidated financial statements prepared in accordance with IFRS. As a result, the 2015 Annual IFRS Financial Statements (with the comparative consolidated financial information for 2014) and the Interim Financial Statements included herein have been prepared in accordance with IFRS. Separately included herein are the 2014 Annual US GAAP Financial Statements (with the comparative consolidated financial information for 2013), which have been prepared in accordance with US GAAP.

As part of the transition, we made certain adjustments to our consolidated financial statements, which were necessary to prepare the 2015 Annual IFRS Financial Statements in accordance with IFRS 1 "First time adoption of International Financial Reporting Standards" ("**IFRS 1**"). We applied IFRS 1 in the preparation of the consolidated statement of financial position as at 1 January 2014, the transition date to IFRS, with certain exceptions relating to the opening consolidated statement of financial position, as described in detail in Note 6 to the 2015 Annual IFRS Financial Statements.

IFRS 1 requires us to disclose reconciliations of our equity reported in accordance with US GAAP to our equity in accordance with IFRS at the date of transition to IFRS and at the end of the latest period presented in our most recent annual financial statements in accordance with US GAAP, as well as reconciliation of our total comprehensive income in accordance with IFRS for the latest period in our most recent annual financial statements with total comprehensive income in accordance with US GAAP for the same period. However, we decided not to present these reconciliations in the 2015 Annual IFRS Financial Statements because transition to IFRS has impacted neither equity at the respective dates nor total comprehensive income for the respective periods.

Nevertheless, due to differences between the accounting principles of US GAAP and the accounting principles of IFRS, statements made under differing accounting principles are not directly comparable.

Non-IFRS and Non-US GAAP Financial Measures

This Offering Memorandum includes certain financial measures that are not measures of performance specifically defined by IFRS or US GAAP. These include EBITDA, Adjusted EBITDA, Adjusted EBITDA Margin, Net Debt, Adjusted Net Debt, Adjusted Net Profit, CROCI, ROIC and Adjusted ROIC.

We define:

- EBITDA: (i) as a non-US GAAP measure for the years ended 31 December 2013 and 2014, as net profit before income tax expense, foreign exchange loss, gain on acquisition of controlling interest in associate, interest expense, interest income, depreciation and amortisation; and (ii) as a non-IFRS measure for the years ended 31 December 2014 and 2015 and the nine months ended 30 September 2015 and 2016, as profit for the period before income tax expense, foreign exchange loss, gain on acquisition of controlling interest in associate, finance expense, finance income, depreciation and amortisation;
- Adjusted EBITDA as EBITDA, adjusted for the one-off effect relating to disposal of the building occupied by the Yakimanka Gallery in 2014, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and *"Management and Corporate Governance—Share-based Compensation of the Chief Executive Officer"*) and additional cash bonuses under the LTI program;
- Adjusted EBITDA Margin as Adjusted EBITDA for a given period divided by revenue for such period expressed as a percentage;

- Adjusted EBITDA for the twelve months ended 30 September 2016 is computed as Adjusted EBITDA for the nine-month period ended 30 September 2016 plus Adjusted EBITDA for the twelve months ended 31 December 2015 less Adjusted EBITDA for the nine-month period ended 30 September 2015, with all such figures disclosed in "*Selected Consolidated Financial And Other Information*";
- Net Debt as total borrowings (long term loans and borrowings and short-term loans and borrowings and current portion of long-term loans and borrowings) less cash and cash equivalents;
- Adjusted Net Debt as Net Debt adjusted for amounts receivable under the loan issued to CJSC "DM-Finance" (Sistema's subsidiary) in 2013. See "*Transactions with Related Parties*";
- Adjusted Net Profit is calculated as profit for the period adjusted for the one-off effect relating to disposal of the building occupied by the Yakimanka Gallery in 2014 (together with related tax effects), impairment of goodwill in 2015, as well as additional share-based compensation expense (together with related tax effects) (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and "*Management and Corporate Governance—Share-based Compensation of the General Director*") and additional cash bonuses under the LTI program;
- Cash Return on Capital Invested (CROCI) is calculated as Adjusted EBITDA divided by average gross capital invested (simple average of gross capital invested as at the respective dates). Gross capital invested is calculated as total assets (less amounts receivable under a loan granted to CJSC "DM-Finance", cash and cash equivalents and for the nine months ended 30 September 2015 and the year ended 31 December 2015 the gross book value of the building occupied by the Bekasovo distribution centre and its equipment (which was completed in 2015, but was not operational for the most of 2015)) minus current liabilities (excluding short-term loans and borrowings and current portion of long-term loans and borrowings) plus accumulated depreciation and impairment in relation to property, plant and equipment and accumulated amortization in relation to other intangible assets;
- Return on Invested Capital (ROIC) is calculated as operating profit, adjusted for the effect of the disposal of Yakimanka building, divided by average capital invested (simple average of capital invested as at the respective dates). Capital invested is calculated as Net Debt plus total equity/(deficit) minus amounts receivable under a loan granted to CJSC "DM-Finance", short term loan issued to the related party and for the nine months ended 30 September 2015 and the year ended 31 December 2015 the net book value of the building occupied by the Bekasovo distribution centre (which was completed in 2015, but was not operational for the most of 2015); and
- Adjusted ROIC is calculated as operating profit, adjusted for the effect of the disposal of Yakimanka building, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and *"Management and Corporate Governance—Share-based Compensation of the General Director*") and additional cash bonuses under the LTI program divided by average capital invested (simple average of capital invested as at the respective dates). Capital invested is calculated as Net Debt plus total equity/(deficit) minus amounts receivable under a loan granted to CJSC "DM-Finance" and for the nine months ended 30 September 2015 and the year ended 31 December 2015 the net book value of the building occupied by the Bekasovo distribution centre and its equipment (which was completed in 2015, but was not operational for the most of 2015).

We have included these measures because we believe that they enhance an investor's understanding of our financial performance. Further, we use the non-IFRS and non-US GAAP measures disclosed in the Offering Memorandum in our business operations to, among other things, evaluate the performance of our operations, develop budgets and measure our performance against those budgets. We also believe that these non-IFRS and non-US GAAP are commonly reported by comparable businesses and used by investors in comparing the performance of businesses. In addition, certain of our financing facilities contain financial covenants that are based on certain of these measures. See "*Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Indebtedness.*"

The non-IFRS and non-US GAAP measures disclosed in this Offering Memorandum are unaudited supplementary measures of our performance and liquidity that are not required by, or presented in accordance with, IFRS or US GAAP. These measures are not defined by IFRS or US GAAP and our use and definition of these metrics may vary from other companies in our industry due to differences in accounting policies or differences in the calculation methodology. These non-IFRS and non-US GAAP financial measures have limitations and should not be considered in isolation, or as substitutes for financial information as reported under

IFRS or US GAAP. Accordingly, undue reliance should not be placed on the non-IFRS and non-US GAAP measures presented in this Offering Memorandum. For a reconciliation of our EBITDA and Adjusted EBITDA to our profit for the period and for calculations of Adjusted EBITDA margin, Net Debt, Adjusted Net Debt, CROCI, ROIC and Adjusted ROIC, see "*Selected Consolidated Financial and Other Information—Key Financial Ratios and Other Information*".

Presentation of Operating Information

In this Offering Memorandum, we present certain operating information regarding our stores such as selling space, average ticket, like-for-like average ticket and like-for-like number of tickets and like-for-like revenue growth. We calculate this operating information on the basis of certain assumptions made by us. As a result, this operating information may not be comparable to similar operating information reported by other companies.

We define:

- average ticket (expressed in Roubles) as dividing the total sales at Detsky Mir stores in Russia only during the relevant period by the number of tickets at such stores in that year;
- like-for-like average ticket growth, like-for-like number of tickets growth and like-for-like revenue growth as measures calculated on the basis of the operations of our Detsky Mir stores in Russia only. The Detsky Mir stores that are included in like-for-like comparisons are those stores that have been in operations for one full prior calendar year. For example, the like-for-like comparison of retail sales between 2014 and 2015 would include revenue of all Detsky Mir stores that were opened before 31 December 2013 (inclusive) and that were in operation during the entirety of 2014 and 2015. The like-for-like comparison of retail sales between the first nine months of 2016 and the first nine months of 2015 would include revenue of all Detsky Mir stores opened before 31 December 2014 (inclusive) that were in operation during the entirety of 2015 and nine months of 2016. The number of Detsky Mir stores included in the like-for-like revenue growth was as follows: 138 stores in 2013, 176 stores in 2014, 210 stores in 2015 and 272 stores in 2016. Like-for-like revenue is calculated on the basis of Russian store revenue (including VAT);
- selling space (in square metres) as the area inside Russian stores used to sell products, and excludes storage areas;
- Gross profit per square metre is calculated by dividing gross profit for the period by average selling space for the period (calculated in thousands of square metres as simple average of selling space as of the beginning and as of the end of the period);
- SKU (stock keeping unit) as a number assigned to a particular product to identify the price, product options and manufacturer of the merchandise; and
- ticket as a receipt issued to a customer for its purchase (i.e. the amount in Roubles (including VAT) spent by a customer on a shopping trip) at a store in Russia only.

Most of the above operating information is provided only with respect to our operations in Russia. We also have a presence in Kazakhstan, however, our operations there are not material. Revenue from our Kazakhstan stores was RUB494 million, or 0.9% of our total revenue, in the nine months ended 30 September 2016 and RUB669 million, or 1% of our total revenue, in 2015.

Currency

In this Offering Memorandum, the following currency terms are used:

- "**RUB**", "**Rouble**" or "**rouble**" means the lawful currency of the Russian Federation;
- "**U.S.$**", "**U.S. dollar**" or "**USD**" means the lawful currency of the United States of America (the "**United States**" or the "**U.S.**");
- "**KZT**", "**Kazakh tenge**" or "**Tenge**" means the lawful currency of the Republic of Kazakhstan;
- "**EUR**" or "**euro**" means the lawful currency of the participating Member States in the third stage of the European and Economic Monetary Union pursuant to the Treaty establishing the European Community, as amended from time to time.

Functional currency is determined separately for each of the Group's entities. For all of the Group's Russian entities the functional currency is Russian Rouble. The functional currency of the Group's Kazakh entities is the Kazakh tenge. The reporting currency is Russian Rouble.

This Offering Memorandum contains conversions of certain amounts relating to particular transactions from the currency in which the transaction was effected into U.S. dollars. These conversions were effected at the relevant foreign currency to U.S. dollar rate in effect as at the date of the transaction unless otherwise stated. No representation is made that the rouble or U.S. dollar amounts referred to herein could have been or could be converted into roubles or U.S. dollars, as the case may be, at these rates, at any particular rate or at all.

The table below sets forth, for the periods and dates indicated, the high, low, period end and period average exchange rate between the Rouble and the U.S. dollar, based on the official exchange rate quoted by the CBR for the relevant year. Fluctuations in the exchange rate between the Rouble and the U.S. dollar in the past are not necessarily indicative of fluctuations that may occur in the future. These rates may also differ from the actual rates used in the preparation of the Financial Statements and other financial information presented in this Offering Memorandum.

	RUB per U.S.$1.00			
	High	**Low**	**Period average**(1)	**Period end**
Year				
2012	34.04	28.95	31.09	30.37
2013	33.47	29.93	31.85	32.73
2014	67.79	32.66	38.42	56.26
2015	72.88	49.18	60.96	60.96
2016	83.59	60.27	67.19	60.66
July 2016	67.05	62.99	64.34	67.05
August 2016	67.05	63.55	64.94	65.08
September 2016	65.87	63.16	64.56	63.16
October 2016	63.40	62.05	62.62	62.90
November 2016	65.86	63.20	64.31	64.94
December 2016	65.24	60.27	62.09	60.66
January 2017 (through 26 January 2017)	60.16	59.15	59.53	59.15

Source: www.cbr.ru (CBR)

Note:

(1) The average rates are calculated as the average of the daily exchange rates on each business day (which rate is announced by the CBR for each such business day) and on each non-business day (which rate is equal to the exchange rate on the previous business day).

References to the Company

In this Offering Memorandum, references to “Group”, “we”, “us”, “ourselves”, “ours”, and “our” mean the Company and its consolidated subsidiaries, unless the context requires otherwise. References to the Company are to “Detsky mir” PJSC only.

Rounding

Some numerical figures included in this Offering Memorandum have been subject to rounding adjustments. Accordingly, numerical figures shown for the same category presented in different tables may vary slightly and numerical figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that preceded them.

Presentation of Third-Party Statistical and Other Information

We have derived certain information and statistics in this Offering Memorandum, including certain information and statistics concerning the Russian retail sector and our competitors, from private and publicly available information, including principally annual reports, industry publications, market research, press releases, filings under various securities laws, official data published by certain Russian government agencies, such as the CBR, the Federal Service for State Statistics of the Russian Federation (“**Rosstat**”), National Bank of Kazakhstan, U.S. Census Bureau, and data published by the International Monetary Fund (the “**IMF**”), and data published by private agencies such as Ipsos Comcon, AC Nielsen, Statista, Masmi, AKIT and Ebeltorf Russia—IRG. Information sourced from Ipsos Comcon, AC Nielsen, Statista, Masmi, AKIT and Ebeltorf Russia—IRG should not be considered as their opinion as to the value of Shares or the advisability of investing in the Shares. Such information and statistics have not been independently verified. Such information is contained in this Offering

Memorandum under the captions "*Summary*", "*Risk Factors*", "*Management's Discussion and Analysis of Financial Condition and Results of Operations*", "*The Russian Children's Goods Retail Sector*" and "*Business*". Where third-party information is set out, it has been sourced. Such information has been accurately reproduced and, as far as we are aware and are able to ascertain from information published by third parties that no facts have been omitted which would render the reproduced information inaccurate or misleading. None of the Joint Bookrunners, Ipsos Comcon, AC Nielsen, Statista, Masmi, AKIT and Ebeltorf Russia—IRG accepts liability for the accuracy of any such information and prospective investors are advised to use such information with caution.

LIMITATION ON ENFORCEMENT OF CIVIL LIABILITIES

The Company is incorporated under the laws of the Russian Federation and the Selling Shareholders are incorporated under the laws of the Russian Federation/Cyprus or residents of the Russian Federation, as applicable. Their presence outside the United States and the United Kingdom may limit your legal recourse against them. The majority of our directors and executive officers named in this Offering Memorandum reside outside the United States and the United Kingdom. Moreover, substantially all of the Company's and the Selling Shareholders' assets and substantially all of the assets of their respective directors and executive officers are located outside the United States and the United Kingdom.

As a result, it may not be possible for you to:

- effect service of process within the United States or the United Kingdom upon the Company, the Selling Shareholders or their respective directors and executive officers; or
- enforce, in the English or U.S. courts, judgments obtained outside English or U.S. courts against the Company, the Selling Shareholders or their respective directors and executive officers, including actions under the civil liability provisions of U.S. securities laws or any state or territory of the United States.

In addition, it may be difficult for you to enforce, in original actions brought in courts in jurisdictions located outside the United Kingdom and the United States, liabilities predicated upon English laws or U.S. federal securities laws.

Courts in the Russian Federation will generally recognise judgments rendered by a court in any jurisdiction outside the Russian Federation only if:

- an international treaty providing for the recognition and enforcement of judgments in civil cases exists between the Russian Federation and the country where the judgment is rendered; and/or
- a federal law of the Russian Federation provides for the recognition and enforcement of foreign court judgements.

No such federal law has been passed and no such treaty for the reciprocal recognition and enforcement of foreign court judgments in civil and commercial matters exists between the Russian Federation and certain other jurisdictions (including the United Kingdom and the United States), as a result of which new proceedings may have to be brought in the Russian Federation in respect of a judgment already obtained in any such jurisdiction against the Company, the Selling Shareholders or, as applicable, their respective directors and executive officers.

Even if an applicable international treaty is in effect or a foreign judgment might otherwise be recognised and enforced on the basis of reciprocity, the recognition and enforcement of a foreign judgment will in all events be subject to exceptions and limitations provided for in Russian law. For example, a Russian court may refuse to recognise or enforce a foreign judgment if its recognition or enforcement would contradict Russian public policy.

In addition, Russian courts have limited experience in the enforcement of foreign court judgments. The limitations described above, including the general procedural grounds set out in Russian legislation for the refusal to recognise and enforce foreign court judgments in the Russian Federation, may limit or delay, perhaps significantly, the enforcement of such judgment and thereby deprive the holders of the Shares of effective legal recourse against the Company, the Selling Shareholders and, as applicable, their respective directors and executive officers.

In the absence of an applicable treaty, enforcement of a final judgment rendered by a foreign court may still be recognised by a Russian court on the basis of reciprocity, if courts of the country where the foreign judgment is rendered have previously enforced judgments issued by Russian courts. While Russian courts have recently recognised and enforced English court judgments on these grounds, the existence of reciprocity must be established at the time the recognition and enforcement of a foreign judgment is sought, and it is not possible to predict whether a Russian court will in the future recognise and enforce on the basis of reciprocity a judgment issued by a foreign court, including an English court.

The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards, but it may be difficult to enforce arbitral awards in the Russian Federation due to a number of factors, including compliance with the procedure for the recognition and enforcement of foreign arbitral awards by Russian courts established by the Arbitrazh Procedural Code of the Russian Federation, limited experience of Russian courts in international commercial transactions, official and unofficial political resistance to enforcement of awards against Russian companies in favour of foreign investors, Russian courts' inability to enforce such orders and corruption. Furthermore, enforcement of any arbitral award pursuant to arbitration proceedings may be limited by the mandatory provisions of Russian laws relating to categories of non-arbitrable disputes and the exclusive jurisdiction of Russian courts, and specific requirements to arbitrability of certain categories of disputes (including, specific requirements in relation to a type of an arbitral institution, arbitration rules, seat of arbitration and parties to an arbitration agreement for consideration of corporate disputes in relation to Russian companies) and the application of Russian laws with respect to bankruptcy, winding up or liquidation of Russian companies. The possible need to re-litigate in the Russian Federation a judgment obtained in a foreign court on the merits may also significantly delay the enforcement of such judgment. Under Russian law, certain amounts may be payable by the claimant upon the initiation of any action or proceeding in any Russian court. These amounts in many instances depend on the amount of the relevant claim.

See "*Risk Factors—Risks Relating to the Shares and the Trading Market—Investors may have limited recourse against the Company, the Selling Shareholders and our directors and executive officers because they generally conduct their operations outside the United States and the United Kingdom and all of our current directors and executive officers reside outside the United States and the United Kingdom*".

AVAILABLE INFORMATION

For so long as any the Shares are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act, we will, during any period in which we are neither subject to Section 13 or Section 15(d) of the Exchange Act, nor exempt from reporting pursuant to Rule 12g3-2(b) thereunder, provide to any holder or beneficial owner of such restricted Shares, or to any prospective purchaser of such restricted Shares designated by such holder or beneficial owner upon the request of such holder, beneficial owner or prospective purchaser, the information required to be delivered to such persons pursuant to Rule 144A(d)(4) under the Securities Act (or any successor provision thereto).

FORWARD-LOOKING STATEMENTS

Certain statements in this Offering Memorandum are not historical facts and constitute "forward-looking statements" within the meaning of Section 27A of the Securities Act and section 21E of the U.S. Securities Exchange Act of 1934, as amended. Forward-looking statements are identified by words such as "believes", "anticipates", "expects", "estimates", "intends", "plans", "will", "may" and similar expressions, but these expressions are not the exclusive means of identifying such statements. Forward-looking statements appear, without limitation, under the headings "*Risk Factors*", "*Management's Discussion and Analysis of Financial Condition and Results of Operations*" and "*Business*". We may from time to time make written or oral forward-looking statements in reports to shareholders and in other communications. Examples of such forward-looking statements include, but are not limited to:

- statements of our plans, objectives or goals, including those related to our strategy, products or services;
- statements of future economic performance; and
- statements of assumptions underlying such statements.

Forward-looking statements that we may make from time to time (but are not included in this Offering Memorandum) may also include projections or expectations of revenues, income (or loss), earnings (or loss) per share, dividends, capital structure or other financial items or ratios.

By their very nature, forward-looking statements involve inherent risks and uncertainties, both general and specific, and risks exist that the predictions, forecasts, projections and other forward-looking statements will not be achieved. Prospective investors should be aware that a number of important factors could cause actual results to differ materially from the plans, objectives, expectations, estimates and intentions expressed in such forward-looking statements. These factors include:

- the prevailing global and domestic economic environment;
- inflation, interest rate and exchange rate fluctuations;
- the health of the Russian economy;
- the effects of, and changes in, the policy of the Russian federal government (the "**Russian Government**");
- our ability to finance our anticipated capital expenditures at least in part through revenue from operations or otherwise;
- the effects of, and changes in, the policies of the Russian Government;
- the effects of changes in laws, regulations, taxation or accounting standards or practices;
- the effects of competition in the geographic and business areas in which we conduct our operations;
- our ability to control expenses;
- acquisitions or divestitures;
- our expansion;
- changes in consumer preferences; and
- our success at managing the risks associated with the aforementioned factors.

This list of important factors is not exhaustive. When relying on forward-looking statements, prospective investors should carefully consider the foregoing factors and other uncertainties and events, especially in light of the political, economic, social and legal environment in which we operate. Such forward-looking statements speak only as of the date on which they are made. Accordingly, we do not undertake any obligation to update or revise any of them, whether as a result of new information, future events or otherwise. We do not make any representation, warranty or prediction that the results anticipated by such forward-looking statements will be achieved, and such forward-looking statements represent, in each case, only one of many possible scenarios and should not be viewed as the most likely or standard scenario.

USE OF PROCEEDS

The gross proceeds from the Offering (assuming the Offer Price at the mid-point of the Offer Price Range and assuming all Shares are sold and the Over-Allotment Option is exercised in full) will be approximately RUB23,552 million. The net proceeds (assuming the Offer Price at the mid-point of the Offer Price Range and assuming all Shares are sold and the Over-Allotment Option is exercised in full), and after deduction of underwriting commissions, fees and expenses incurred by the Selling Shareholders in connection with the Offering, will be approximately RUB22,576 million. The Company will not receive any proceeds from the sale of Shares by the Selling Shareholders. The total Offering-related expenses payable by the Company are estimated to be approximately RUB13.5 million.

DIVIDEND POLICY

We have adopted a dividend policy to pay at least 50% of our annual net profit calculated based on IFRS accounts in dividends, subject to the Group's need for financial resources for capital expenditures and the Group's ability to meet its obligations as they fall due. The decision to pay a dividend must be approved by the General Shareholders' Meeting on a recommendation by the Board of Directors.

Dividends may only be declared from accumulated undistributed and unreserved earnings, as shown in the Company's statutory financial statements prepared under RAS, and if certain other requirements of Russian legislation are met. If statutory undistributed earnings are negative as of the beginning of a fiscal year, then dividends may only be declared from net profit earned in that fiscal year, as shown in the Company's statutory financial statements prepared under RAS. As at 31 December 2015, the Company's statutory undistributed earnings were negative, while statutory net profit for the year ended 31 December 2015 was RUB2,731 million. For a description of other conditions that must be satisfied before dividends may be declared, see "*Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Dividends*". In particular, the decision to pay dividends and the amount thereof must be recommended by our Board of Directors and approved by our shareholders. The amount of dividends, if any, approved by the shareholders may not be higher than the amount proposed by the Board of Directors. We anticipate that dividends will be declared and paid to our shareholders in Roubles. We may distribute dividends on the Ordinary Shares based on our three-month, six-month, nine-month and/or annual statutory results under RAS. For the years ended 31 December 2014, 2015 and 2016, the Company paid dividends based on nine-month and annual statutory results under RAS. In the future, we intend to continue to declare and pay dividends based on interim and annual statutory results under RAS.

See *"Risk Factors—Risks Relating to the Shares and the Trading Market—We may decide not to pay dividends in the future"* and *"—It may not be possible to repatriate distributions made on the Shares at a favourable exchange rate or at all."*

CAPITALISATION AND INDEBTEDNESS

The following table shows our consolidated capitalisation, comprising total non-current debt and total equity as at 30 September 2016. For further information regarding our financial condition, see "Selected Consolidated Financial and Other Information", "Management's Discussion and Analysis of Financial Condition and Results of Operations" and the Financial Statements included elsewhere in this Offering Memorandum.

	As at 30 September 2016
	(unaudited) *(in millions of Roubles)*
Non-current debt	
Long-term loans and borrowings, net of current portion	4,265
Total non-current debt	**4,265**
Equity	
Share capital	1
Additional paid-in capital	5,793
Accumulated deficit	(5,378)
Currency translation reserve	85
Total equity	**501**
Total capitalisation (1)	**4,766**

(1) Total capitalisation is the sum of total non-current debt and total equity.

In the fourth quarter of 2016, we opened additional and extended existing credit lines in the aggregate amount of RUB3.2 billion.

In December 2016, our General Shareholders' Meeting approved the payment of interim dividends for the nine months ended 30 September 2016 in the aggregate amount of RUB3,119 million, which were paid in full in December 2016.

Except as described above, there have been no material changes in the consolidated capitalisation of the Group since 30 September 2016.

SELECTED CONSOLIDATED FINANCIAL AND OTHER INFORMATION

The following tables contain our selected historical consolidated financial and operating information as at the dates and for the periods indicated. The selected consolidated statement of profit and loss and other comprehensive income data and selected consolidated statement of cash flows data for the nine months ended 30 September 2016 and 2015, and the years ended 31 December 2015, 2014 and 2013, and selected consolidated statement of financial position data as at 30 September 2016 and 31 December 2015, 2014 and 2013 has been derived, without adjustments, from the Financial Statements, which are included elsewhere in this Offering Memorandum.

Historically, our consolidated financial statements were prepared in accordance with US GAAP. We adopted International Financial Reporting Standards as issued by the IFRS with effect from 1 January 2014, and the 2015 Annual IFRS Financial Statements were our first set of consolidated financial statements prepared in accordance with IFRS. As a result, the 2015 Annual IFRS Financial Statements (with the comparative consolidated financial information for 2014) and the Interim Financial Statements included herein were prepared in accordance with IFRS. As we had not yet adopted IFRS in 2013, we have included in this offering memorandum the 2014 Annual US GAAP Financial Statements (with the comparative consolidated financial information for 2013), which were prepared in accordance with US GAAP. See "*Presentation of Financial and Other Information*".

Prospective investors should read the following selected consolidated financial and operating information in conjunction with the information contained in "*Risk Factors*", "*Presentation of Financial and Other Information*", "*Capitalisation and Indebtedness*", "*Management's Discussion and Analysis of Financial Condition and Results of Operations*", and the Financial Statements included elsewhere in this Offering Memorandum.

Selected Consolidated Statement of Profit or Loss and Other Comprehensive Income (IFRS)

	Nine months ended 30 September		Year ended 31 December	
	2016	**2015**	**2015**	**2014**
	(unaudited)		*(audited)*	*(unaudited)*
	(in millions of Roubles)			
Revenue	54,226	39,967	60,544	45,446
Cost of sales	(36,151)	(26,125)	(38,640)	(28,183)
Gross profit	**18,075**	**13,842**	**21,904**	**17,263**
Selling, general and administrative expenses	(14,618)	(11,534)	(17,725)	(14,263)
Gain on sale of a building, net	—	—	—	1,164
Share of profit of associate, net of income tax	9	5	9	13
Other operating expenses, net	(19)	(11)	(20)	(7)
Operating profit	**3,447**	**2,302**	**4,168**	**4,170**
Finance income	148	535	723	56
Finance expense	(1,418)	(1,251)	(2,053)	(918)
Impairment of goodwill	—	—	(363)	—
Gain on acquisition of controlling interest in associate	16	—	—	—
Foreign exchange loss	(10)	(595)	(922)	(582)
Profit before tax	**2,183**	**991**	**1,554**	**2,727**
Income tax expense	(498)	(334)	(578)	(684)
Profit for the period	**1,685**	**657**	**976**	**2,043**

Selected Consolidated Statements of Operations and Comprehensive Income (US GAAP)

	Year ended 31 December	
	2014	**2013**
	(audited) (*in millions of Roubles*)	
Revenue	45,446	36,001
Cost of sales	(28,183)	(22,093)
Gross profit	**17,263**	**13,908**
Selling, general and administrative expenses	(13,523)	(11,155)
Gain on sale of a building, net	1,164	—
Depreciation and amortization	(740)	(634)
Interest in earnings of associates, net of tax	13	19
Other operating income and (expenses), net	(7)	(1)
Operating profit	**4,170**	**2,137**
Interest income	56	11
Interest expense	(918)	(518)
Foreign exchange loss	(582)	(58)
Income before income tax expense	**2,727**	**1,572**
Income tax expense	(684)	(419)
Net profit	**2,043**	**1,153**

Selected Consolidated Statement of Financial Position (IFRS)

	As at 30 September	As at 31 December		As at 1 January
	2016	**2015**	**2014**	**2014**
	(unaudited)	*(audited)* (*in millions of Roubles*)	*(unaudited)*	*(unaudited)*
Total non-current assets	10,457	15,352	10,335	3,704
Total current assets	26,011	23,842	16,509	11,721
Total assets	**36,468**	**39,194**	**26,843**	**15,424**
Total non-current liabilities	4,297	5,528	3,523	4,439
Total current liabilities	31,670	33,271	20,674	13,084
Total liabilities	**35,967**	**38,799**	**24,197**	**17,522**
Total equity/ (deficit)	**501**	**395**	**2,646**	**(2,098)**

Selected Consolidated Balance Sheets (US GAAP)

	As at 31 December	
	2014	**2013**
	(audited) (*in millions of Roubles*)	
Total non-current assets	9,634	3,194
Total current assets	16,310	11,190
Total assets	**25,944**	**14,383**
Total non-current liabilities	3,523	4,439
Total current liabilities	19,775	12,043
Total liabilities	**23,298**	**16,481**
Total shareholders' equity/ (deficit)	**2,646**	**(2,098)**

Selected Consolidated Statement of Cash Flows Data (IFRS)

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
	(unaudited)		*(audited)*	*(unaudited)*
	(in millions of Roubles)			
Net cash received from / (used in) operating activities	1,538	(3,058)	(679)	1,492
Net cash received from / (used in) investing activities	3,955	(4,355)	(5,217)	(2,646)
of which cash paid for capital expenditures[(1)]	(945)	(4,337)	(5,308)	(1,945)
Net cash (used in) / received from financing activities	(6,972)	7,556	6,160	1,963

(1) This represents the actual cash paid for capital expenditures (including purchases of property, plant and equipment, as well as intangible assets, which may relate to capital expenditures accrued in other periods).

Selected Consolidated Statement of Cash Flows Data (US GAAP)

	Year ended 31 December	
	2014	2013
	(audited)	
	(in millions of Roubles)	
Net cash provided by operating activities	1,492	2,025
Net cash used in investing activities	(2,646)	(750)
of which cash paid for capital expenditures[(1)]	(1,945)	(772)
Net cash generated by / (used in) / financing activities	1,963	(2,047)

(1) This represents the actual cash paid for capital expenditures (including purchases of property, plant and equipment, as well as intangible assets, which may relate to capital expenditures accrued in other periods).

Non-IFRS Measures

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
	(unaudited)			
EBITDA (in millions of Roubles)[(1)]	4,623	2,940	5,123	4,911
Adjusted EBITDA (in millions of Roubles)[(2)]	4,711	2,968	6,185	4,463
Adjusted EBITDA Margin[(3)]	8.7%	7.4%	10.2%	9.8%
Adjusted Net Profit[(4)]	1,755	679	2,189	1,685
CROCI[(5)]	29.1%	25.0%	58.0%	58.7%
ROIC[(6)]	30.0%	33.6%	65.0%	83.5%
Adjusted ROIC[(7)]	30.7%	29.1%	78.3%	88.4%

(1) EBITDA is calculated as profit for the period before income tax expense, foreign exchange loss, gain on acquisition of controlling interest in associate, finance expense, finance income, depreciation and amortisation;

(2) Adjusted EBITDA is calculated as EBITDA, adjusted for the one-off effect relating to disposal of the building occupied by the Yakimanka Gallery in 2014, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and *"Management and Corporate Governance—Share-based Compensation of the General Director"*) and additional cash bonuses under the LTI program;

(3) Adjusted EBITDA Margin is calculated as Adjusted EBITDA for a given period divided by revenue for such period expressed as a percentage;

(4) Adjusted Net Profit is calculated as profit for the period adjusted for the one-off effect relating to disposal of the building occupied by the Yakimanka Gallery in 2014 (together with related tax effects), impairment of goodwill in 2015, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and *"Management and Corporate Governance—Share-based Compensation of the General Director"*) and additional cash bonuses under the LTI program;

(5) Cash Return on Capital Invested (CROCI) is calculated as Adjusted EBITDA divided by average gross capital invested (simple average of gross capital invested as at the respective dates). Gross capital invested is calculated as total assets (less amounts receivable under a loan granted to CJSC "DM-Finance", cash and cash equivalents and, for the nine months ended 30 September 2015 and the year ended 31 December 2015, the gross book value of the building occupied by the Bekasovo distribution centre and its equipment (which was completed in 2015, but was not operational for the most of 2015)) minus current liabilities (excluding short-term loans and borrowings and current portion of long-term loans and borrowings) plus accumulated depreciation and impairment in relation to property, plant and equipment and accumulated amortization in relation to other intangible assets;

(6) Return on Invested Capital (ROIC) is calculated as operating profit, adjusted for the effect of the disposal of Yakimanka building, divided by average capital invested (simple average of capital invested as at the respective dates). Capital invested is calculated as Net Debt plus total equity/(deficit) minus amounts receivable under a loan granted to CJSC "DM-Finance", short term loan issued to the related party and, for the nine months ended 30 September 2015 and the year ended 31 December 2015, the net book value of the building occupied by the Bekasovo distribution centre (which was completed in 2015, but was not operational for the most of 2015); and

(7) Adjusted ROIC is calculated as operating profit, adjusted for the effect of the disposal of Yakimanka building, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and "*Management and Corporate Governance—Share-based Compensation of the General Director*") and additional cash bonuses under the LTI program divided by average capital invested (simple average of capital invested as at the respective dates). Capital invested is calculated as Net Debt plus total equity/(deficit) minus amounts receivable under a loan granted to CJSC "DM-Finance" and, for the nine months ended 30 September 2015 and the year ended 31 December 2015, the net book value of the building occupied by the Bekasovo distribution centre and its equipment (which was completed in 2015, but was not operational for the most of 2015).

The following table sets forth our Net Debt and Adjusted Net Debt as at the dates indicated:

	As at 30 September	As at 31 December		As at 1 January
	2016	2015	2014	2014
		(unaudited)		
Net Debt (in millions of Roubles)[(8)]	12,547	16,425	8,046	5,062
Adjusted Net Debt (in millions of Roubles)[(9)]	11,498	10,618	2,806	5,062

(8) Net Debt is calculated as total borrowings (long term loans and borrowings and short-term loans and borrowings and current portion of long-term loans and borrowings) less cash and cash equivalents; and

(9) Adjusted Net Debt is calculated as Net Debt adjusted for amounts receivable under the loan issued to CJSC "DM-Finance" (Sistema's subsidiary) in 2013.

The following table sets forth a reconciliation of our EBITDA and Adjusted EBITDA to our profit for the periods indicated:

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
		(unaudited) (*in millions of Roubles*)		
Profit for the period	1,685	657	976	2,043
Add / (deduct):				
Finance income	(148)	(535)	(723)	(56)
Finance expense	1,418	1,251	2,053	918
Gain on acquisition of controlling interest in associate	(16)			
Impairment of goodwill			363	
Foreign exchange loss	10	595	922	582
Income tax expense	498	334	578	684
Depreciation and amortisation	1,176	638	954	740
EBITDA	**4,623**	**2,940**	**5,123**	**4,911**
Reverse effect of:				
Additional bonus accruals under the LTI program	88	28	1,062	716
Effect of disposal of Yakimanka building	—	—	—	(1,164)
Adjusted EBITDA	**4,711**	**2,968**	**6,185**	**4,463**

The following table sets forth a reconciliation of our Adjusted Net Profit to our profit for the periods indicated:

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
		(unaudited) (*in millions of Roubles*)		
Profit for the period	1,685	657	976	2,043
Additional bonus accruals under the LTI program (with related tax effects)	70	22	850	573
Effect of disposal of Yakimanka building (with related tax effects)	—	—	—	(931)
Impairment of goodwill	—	—	363	—
Adjusted Net Profit	**1,755**	**679**	**2,189**	**1,685**

The following table sets forth a calculation of our CROCI for the periods indicated:

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
	(unaudited) *(in millions of Roubles)*			
Adjusted EBITDA	4,711	2,968	6,185	4,463
Divided by:				
Average gross capital invested	16,203	11,884	10,657	7,609
CROCI (%)	**29.1**	**25.0**	**58.0**	**58.7**

The following table sets forth a calculation of average gross capital invested as at the dates indicated:

	As at 30 September		As at 31 December		As at 1 January
	2016	2015	2015	2014	2014
	(unaudited) *(in millions of Roubles)*				
Total assets	36,468	37,177	39,194	26,843	15,424
Amounts receivable under a loan granted to CJSC "DM-Finance"	(1,049)	(5,674)	(5,807)	(5,239)	—
Gross book value of the building occupied by the Bekasovo distribution centre and its equipment	—	(2,789)	(3,183)	—	—
Cash and cash equivalents	(455)	(1,813)	(1,934)	(1,670)	(860)
Current liabilities	(31,670)	(28,653)	(33,271)	(20,674)	(13,084)
Short-term loans and borrowings and current portion of long-term loans and borrowings	8,737	12,382	12,894	6,228	1,572
Accumulated depreciation and impairment in relation to property, plant and equipment	4,097	3,562	3,803	3,042	2,744
Accumulated amortisation in relation to other intangible assets	803	553	595	493	398
Gross capital invested	**16,931**	**14,745**	**12,291**	**9,023**	**6,195**
Add:					
Gross capital invested at the beginning of the period (or, with respect to the capital invested as at 1 January 2014, as at the beginning of the previous period)	12,291	9,023	9,023	6,195	5,752
Gross book value of the building occupied by the Bekasovo distribution centre and its equipment	3,183	—	—	—	—
	32,405	**23,768**	**21,314**	**15,218**	**11,947**
Divided by 2:					
Average gross capital invested	**16,203**	**11,884**	**10,657**	**7,609**	**5,974**

The following table sets forth a calculation of our Adjusted ROIC for the periods indicated:

	Nine months ended 30 September		Year ended 31 December	
	2016	2015	2015	2014
	(unaudited) *(in millions of Roubles)*			
Operating profit	3,447	2,302	4,168	4,170
Additional bonus accruals under the LTI program	88	28	1,062	716
Effect of disposal of Yakimanka building	—	—	—	(1,164)
Divided by:				
Average capital invested	11,506	8,001	6,682	4,208
Adjusted ROIC(%)	**30.7**	**29.1**	**78.3**	**88.4**

The following table sets forth a calculation of adjusted capital invested and average capital invested as at the dates indicated:

	As at 30 September		As at 31 December		As at 1 January
	2016	2015	2015	2014	2014
			(unaudited) (*in millions of Roubles*)		
Net debt	12,547	16,514	16,425	8,046	5,062
Total equity / (deficit)	501	2,481	395	2,646	(2,098)
Amounts receivable under a loan granted to CJSC "DM-Finance"	(1,049)	(5,674)	(5,807)	(5,240)	—
Net book value of the building occupied by the Bekasovo distribution centre and its equipment	—	(2,771)	(3,102)	—	—
Adjusted capital invested	**11,999**	**10,550**	**7,910**	**5,452**	**2,964**
Add:					
Capital invested at the beginning of the period (or, with respect to the capital invested as at 1 January 2014, as at the beginning of the previous period)	7,910	5,452	5,452	2,964	4,709
Net book value of the building occupied by the Bekasovo distribution centre and its equipment	3,102	—	—	—	—
	23,012	**16,002**	**13,363**	**8,416**	**7,673**
Divided by 2:					
Average capital invested	**11,506**	**8,001**	**6,682**	**4,208**	**3,837**

The following table sets forth a calculation of our Net Debt and Adjusted Net Debt for the periods indicated:

	As at 30 September	As at 31 December		1 January
	2016	2015	2014	2014
		(unaudited) (*in millions of Roubles*)		
Long-term loans and borrowings	4,265	5,465	3,488	4,350
Short-term loans and borrowings and current portion of long-term loans and borrowings	8,737	12,894	6,228	1,572
Cash and cash equivalents	(455)	(1,934)	(1,670)	(860)
Net Debt	**12,547**	**16,425**	**8,046**	**5,062**
Amounts receivable under a loan granted to CJSC "DM-Finance"	(1,049)	(5,807)	(5,240)	—
Adjusted Net Debt	**11,498**	**10,618**	**2,806**	**5,062**

Non-US GAAP Measures

	Year ended 31 December	
	2014	2013
	(unaudited)	
EBITDA (in millions of Roubles)(1)	4,911	2,771
Adjusted EBITDA (in millions of Roubles)(2)	4,463	2,771
Adjusted EBITDA Margin(3)	9.8%	7.7%
Adjusted Net Profit(4)	1,685	1,153
CROCI(5)	58.7%	46.4%
ROIC(6)	83.5%	55.7%
Adjusted ROIC(7)	88.4%	55.7%

(1) EBITDA is calculated as net profit before income tax expense, foreign exchange loss, gain on acquisition of controlling interest in associate, interest expense , interest income, depreciation and amortisation;

(2) Adjusted EBITDA is calculated as EBITDA, adjusted for the one-off effect relating to disposal of the building occupied by the Yakimanka Gallery in 2014, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and "*Management and Corporate Governance—Share-based Compensation of the General Director*") and additional cash bonuses under the LTI program;

(3) Adjusted EBITDA Margin is calculated as Adjusted EBITDA for a given period divided by revenue for such period expressed as a percentage;

(4) Adjusted Net Profit is calculated as net profit adjusted for the one-off effect relating to disposal of the building occupied by the Yakimanka Gallery in 2014 (together with related tax effects), as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan*" and *"Management and Corporate Governance—Share-based Compensation of the General Director"*) and additional cash bonuses under the LTI program;

(5) Cash Return on Capital Invested (CROCI) is calculated as Adjusted EBITDA divided by average gross capital invested (simple average of gross capital invested as at the respective dates). Gross capital invested is calculated as total assets (less amounts receivable under a loan granted to CJSC "DM-Finance", cash and cash equivalents and, for the nine months ended 30 September 2015 and the year ended 31 December 2015, the gross book value of the building occupied by the Bekasovo distribution centre and its equipment (which was completed in 2015, but was not operational for the most of 2015)) minus current liabilities (excluding short-term loans and borrowings and current portion of long-term loans and borrowings) plus accumulated depreciation and impairment in relation to property, plant and equipment and accumulated amortization in relation to other intangible assets;

(6) Return on Invested Capital (ROIC) is calculated as operating profit, adjusted for the effect of the disposal of Yakimanka building, divided by average capital invested (simple average of capital invested as at the respective dates). Capital invested is calculated as Net Debt plus total equity/(deficit) minus amounts receivable under a loan granted to CJSC "DM-Finance", short term loan issued to the related party and, for the nine months ended 30 September 2015 and the year ended 31 December 2015, the net book value of the building occupied by the Bekasovo distribution centre (which was completed in 2015, but was not operational for the most of 2015); and

(7) Adjusted ROIC is calculated as operating profit, adjusted for the effect of the disposal of Yakimanka building, as well as additional share-based compensation expense (see "*Management and Corporate Governance—Share-based Compensation of the Management Team—Long-Term Incentive Plan"* and *"Management and Corporate Governance—Share-based Compensation of the General Director*") and additional cash bonuses under the LTI program divided by average capital invested (simple average of capital invested as at the respective dates). Capital invested is calculated as Net Debt plus total equity/(deficit) minus amounts receivable under a loan granted to CJSC "DM-Finance" and, for the nine months ended 30 September 2015 and the year ended 31 December 2015, the net book value of the building occupied by the Bekasovo distribution centre and its equipment (which was completed in 2015, but was not operational for the most of 2015).

The following table sets forth a reconciliation of our EBITDA and Adjusted EBITDA to our net profit for the periods indicated:

	Year ended 31 December	
	2014	**2013**
	(unaudited) *(in millions of Roubles)*	
Net profit	2,043	1,153
Add / (deduct):		
Interest income	(56)	(11)
Interest expense	918	518
Foreign exchange loss	582	58
Income tax expense	684	419
Depreciation and amortisation	740	634
EBITDA	**4,911**	**2,771**
Reverse effect of:		
Additional bonus accruals under the LTI program	716	—
Effect of disposal of Yakimanka building	(1,164)	—
Adjusted EBITDA	**4,463**	**2,771**

The following table sets forth a reconciliation of our Adjusted Net Profit to our Net Profit for the periods indicated:

	Year ended 31 December	
	2014	**2013**
	(unaudited) *(in millions of Roubles)*	
Net profit	2,043	1,153
Additional bonus accruals under the LTI program (with related tax effects)	573	—
Effect of disposal of Yakimanka building (with related tax effects)	(931)	—
Adjusted Net Profit	**1,685**	**1,153**

The following table sets forth a calculation of our CROCI for the periods indicated:

	Year ended 31 December	
	2014	**2013**
	(unaudited) (*in millions of Roubles*)	
Adjusted EBITDA	4,463	2,771
Divided by:		
Average gross capital invested	7,609	5,974
CROCI (%)	**58.7**	**46.4**

The following table sets forth a calculation of our Adjusted ROIC for the periods indicated:

	Year ended 31 December	
	2014	**2013**
	(unaudited) (*in millions of Roubles*)	
Operating profit	4,170	2,137
Additional bonus accruals under the LTI program	716	—
Effect of disposal of Yakimanka building	(1,164)	—
Divided by:		
Average capital invested	4,208	3,837
Adjusted ROIC(%)	**88.4**	**55.7**

Selected Operating Data

	Nine months ended 30 September		Year ended 31 December		
	2016	2015	2015	2014	2013
Number of stores (end of period)	464	370	425	322	252
Detsky Mir stores	420	326	381	278	224
ELC stores	44	44	44	43	27
Yakimanka Gallery	—	—	—	1	1
Selling space (in thousands of square metres, end of period)(1)	533	435	491	390	320
Detsky Mir stores	528	430	486	381	312
ELC stores	5	5	5	4	3
Yakimanka Gallery	—	—	—	1	1
Selling space (in thousands of square metres, end of period) (1) (2)					
Moscow and Moscow region	359	300	342	268	223
Other Russian regions	159	123	137	106	83
Gross profit per sq.m (in thousands of Roubles) (3)	35	34	50	48	46
Revenue per sq.m (in thousands of Roubles)(4)					
Moscow and Moscow region	118	110	159	149	147
Other Russian regions	98	90	127	119	107
Number of tickets (Detsky Mir stores in Russia only) (in thousands) (5)	47,442	37,206	53,137	42,787	35,517
Moscow and Moscow region	14,463	11,086	16,063	12,819	11,126
Other Russian regions	32,979	26,120	37,074	29,968	24,391
Average ticket (Detsky Mir stores in Russia only) (in Roubles) (6)	1,218	1,142	1,206	1,119	1,071
Moscow and Moscow region	1,348	1,264	1,327	1,217	1,170
Other Russian regions	1,164	1,090	1,153	1,077	1,026
Like-for-like average ticket growth (Detsky Mir stores in Russia only) (7)	8.1%	8.6%	8.2%	5.0%	4.8%
Moscow and Moscow region	9.2%	10.0%	9.9%	4.4%	4.7%
Other Russian regions	7.7%	8.0%	7.5%	5.4%	5.0%
Like-for-like number of tickets growth (Detsky Mir stores in Russia only) (7)	4.4%	4.7%	3.7%	8.3%	8.2%
Moscow and Moscow region	3.3%	4.0%	3.5%	5.6%	7.0%
Other Russian regions	4.9%	4.9%	3.9%	9.3%	8.8%
Like-for-like revenue growth (Detsky Mir stores in Russia only) (7)	13.0%	13.6%	12.3%	13.7%	13.4%
Moscow and Moscow region	12.8%	14.4%	13.8%	10.2%	12.0%
Other Russian regions	13.0%	13.3%	11.6%	15.2%	14.2%

(1) Selling space (in square metres) is an area inside Russian stores used to sell products, and excludes storage areas.

(2) Includes only Detsky Mir stores in Russia.

(3) Gross profit per sq.m. is calculated by dividing gross profit for the period by average selling space for the period (calculated in thousands of square metres as simple average of selling space as of the beginning and as of the end of the period).

(4) Data for the nine months ended 30 September 2016 and 2015 not annualised and cannot be directly compared with the data for the years ended 31 December 2015, 2014 and 2013.

(5) Ticket is a receipt issued to a customer for its purchase (i.e. the amount in Roubles (including VAT) spent by a customer on a shopping trip) at a store in Russia only.

(6) Average ticket (expressed in Roubles) is calculated by dividing the total sales at Detsky Mir stores in Russia only during the relevant period by the number of tickets at such stores in that year.

(7) Like-for-like average growth, like-for-like number of tickets growth and like-for-like revenue growth as measures calculated on the basis of the operations of our Detsky Mir stores in Russia only. The Detsky Mir stores that are included in like-for-like comparisons are those stores that have been in operations for one full prior calendar year. For example, the like-for-like comparison of retail sales between 2014 and 2015 would include revenue of all Detsky Mir stores that were opened prior to 31 December 2013 and that were in operation during the entirety of 2014 and 2015. The like-for-like comparison of retail sales between the first nine months of 2016 and the first nine months of 2015 would include revenue of all Detsky Mir stores opened before 31 December 2014 (inclusive) that were in operation during the entirety of 2015 and nine months of 2016. Number of Detsky Mir stores included in the like-for-like revenue growth was as follows: 138 stores in 2013, 176 stores in 2014, 210 stores in 2015 and 272 stores in 2016. Like-for-like revenue is calculated on the basis of Russian store revenue (including VAT).

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

The following discussion and analysis should be read in conjunction with our Financial Statements included elsewhere in this Offering Memorandum. In addition to historical information, the following discussion contains forward-looking statements based on current expectations that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of numerous factors, including the risks discussed in the "Risk Factors" section and elsewhere in this Offering Memorandum.

Selected consolidated financial information in this section has been derived from the Financial Statements, (i) as at and for the years ended 31 December 2013 and 2014 under US GAAP and (ii) as at and for the years ended 2014 and 2015 and as at and for the three months and the nine months ended 30 September 2015 and 2016 under IFRS, in each case without material adjustments, unless otherwise stated, as well as management financial reports. The interim results are not necessarily indicative of the results that may be expected for a full year. For information regarding the basis of presentation of the Group's consolidated financial information, see "Presentation of Financial and Other Information."

Overview

We are the largest specialised children's goods retailer in Russia with a diversified product portfolio comprising toys, products for newborns, fashion (apparel and footwear), large items and other products. We are the market leader in terms of the size of our store network and in terms of revenue in a highly fragmented market for children's goods in Russia. According to Ipsos Comcon, in 2015, we had an estimated share of 32% (24% in 2014) of the specialised children's goods retail market in Russia and 13% (10% in 2014) of the total market of children's goods in Russia (including hyper- and supermarkets). Our largest competitor had a share of 9% of the specialised children's goods retail market and 4% of the total market of children's goods, also according to Ipsos Comcon.

We strongly benefit from the "Detsky mir" brand which dates back to the opening of the first "Detsky mir" branded store in central Moscow in 1947. Thereafter, during the Soviet period, all large children's stores or departments selling children's goods were named "Detsky mir". Accordingly, "Detsky mir" was closely associated with the entire children's goods retail industry in the Soviet Union and subsequently in Russia. This superior brand recognition persists and is confirmed by the findings of a recent consumer survey by Ipsos Comcon, where 97% of respondents mentioned our brand when prompted and 84% of respondents mentioned our brand without prompting.

As at 31 December 2016, we operated a network of 525 stores, comprising 468 stores in Russia and 12 stores in Kazakhstan operating under the "Detsky mir" brand ("**Detsky Mir stores**"), and 45 ELC stores in Russia. Our total selling space as at 31 December 2016 was approximately 596 thousand square metres. Headquartered and originated in Moscow, we have gradually expanded our footprint outside Moscow since 2003, and at present our network outside Moscow accounts for approximately 70% of our revenue. We primarily seek to operate in cities with populations in excess of 50,000 people. In Russia, we have a nationwide presence with stores located in 171 of over 300 cities with more than 50,000 inhabitants, based on Rosstat population data as at 31 December 2016. We have stores in all of Russia's 20 largest cities and in seven cities in Kazakhstan.

In addition to our retail stores, we offer our product portfolio through our websites www.detmir.ru and www.elc-russia.ru. In 2011, we launched our online store, which has experienced significant growth since then in terms of sales, the number of SKUs and functionality (including the introduction of an "in-store pickup" service). We believe that our superior brand recognition and customer loyalty are particularly important in capturing market share in the fast developing online segment of the market. In 2015, we completed the roll-out of our "in-store pickup" service for goods ordered online throughout our retail network in Russia. We are continuously improving our online proposition by expanding our online product range and further integrating our online and offline platforms. In the nine months ended 30 September 2016, we recorded over 63 million visits in our online store, and the number of orders placed via our online store was over 1 million. We believe we are the market leader in terms of market share by revenue in online sales of children's goods in Russia with an estimated market share of 6% in the first half of 2016, according to Ipsos Comcon.

We have an established supply chain and IT platform which supports our nationwide retail chain and our growth strategy. We operate two distribution centres located in the Moscow region: our owned distribution centre in Bekasovo with approximately 70,000 square metres of usable area, and our leased distribution centre in

Krekshino with approximately 20,000 square metres of usable area. To manage our inventory in the most efficient manner, we have customised warehouse management and automated stock replenishment systems based on the SAP platform. In line with our expansion strategy, in particular in the Urals and Siberian regions of Russia, we have made a preliminary decision to open a new distribution centre in the Urals in 2018.

In the nine months ended 30 September 2016, we had revenue of RUB54,226 million, representing a 35.7% increase from RUB39,967 million in the nine months ended 30 September 2015. In the nine months ended 30 September 2016, our like-for-like sales increased by 13.0% as compared to the nine months ended 30 September 2015. Our Adjusted EBITDA margin increased to 8.7% for the nine months ended 30 September 2016 from 7.4% for the nine months ended 30 September 2015. Our Adjusted Net Debt was RUB11,498 million as at 30 September 2016, representing an increase of 8.3% from RUB10,618 million as at 31 December 2015.

Key Factors Affecting our Results of Operations

We believe that the following main factors have affected the Group's results of operations during the periods under review and may have a significant impact on our results of operations in the future.

Russian Macroeconomic Conditions and Trends

General

Since most of our stores are located in Russia, changes in Russian macroeconomic conditions directly affect our financial performance.

At present, the Russian economy is facing significant challenges, primarily due to the decline in prices for oil and other commodities which are Russia's principal exports and important drivers of Russia's economy, as well as the effects of international economic sanctions imposed against certain Russian individuals and entities by the United States and European Union in connection with the Ukrainian crisis (factors which have also contributed to the weakening of the Rouble, a lack of access to financing for Russian borrowers and increased capital flight). According to Rosstat, Russia's real GDP growth slowed from 1.3% in 2013 to 0.7% in 2014. In 2015, GDP declined by 3.7%. According to the Ministry of Economic Development of the Russian Federation, Russia's GDP is expected to have decreased by 0.6% in 2016 and to increase by 1.1% in 2017, assuming the current level of global oil prices remains constant. Growth of annual disposable income slowed down from 8.0% in 2014 to 1.0% in 2015, and growth in annual consumer spending also slowed down from 6.7% in 2014 to 1.0% in 2015. CPI inflation increased to 12.9% in 2015 from 6.5% in 2013. See "*Risk Factors—Risk Factors Relating to Demand and Competition—General economic conditions in Russia affect consumer confidence and spending*" and "*Risk Factors—Risk Factors Relating to Political, Economic and Social Situation in Russia—If Russia were to return to high and sustained inflation, our results of operations could be adversely affected*".

The table below sets out the key Russian macroeconomic indicators affecting our business:

	Year ended 31 December		
Key macroeconomic factors	**2015**	**2014**	**2013**
Population, million (year-end)	147	146	144
Population of children (newborn to 12 years), million (year-end)	22.2	21.7	20.8
Annual GDP per capita (RUB)	563,265	543,439	495,348
Real GDP growth year-on-year (%)	(3.7)	0.7	1.3
Nominal GDP growth year-on-year in rouble terms (%)	3.7	9.8	6.1
Inflation (CPI) year-on-year (%)	12.9	11.4	6.5
Average unemployment rate (%)	5.6	5.2	5.5
Average monthly salary per number of a household (RUB)	34,030	32,495	29,792
Average monthly gross disposable income per number of a household (RUB)	21,495	20,296	18,690
Average monthly consumer spending per capita (RUB)	14,764	14,630	13,707
Average exchange rate (RUB per U.S. dollar)	60.96	38.42	31.85

Source: Rosstat, CBR

Following the downturn in the Russian economy, consumers in Russia have become more cautious on non-discretionary purchases, although purchases of fast moving consumer goods and children's goods have not yet been similarly affected. During the economic downturn, consumers tend to reduce spending by reducing the volume of their purchases or by shifting their purchasing pattern towards cheaper products, with these trends being particularly pronounced with respect to discretionary products. While we were able to adapt our product mix and pricing policies during 2014 and 2015 to avoid a significant negative impact of these trends on our financial performance, there can be no assurance that we will be able to do so in future similar downturns.

The state of the Russian economy (whether trending upwards or downwards) will continue to have a significant impact on our results of operations, as well as on our ability to implement our expansion strategy.

Exchange Rate Volatility

We earn our revenues in Roubles whereas some of our costs are denominated in foreign currencies, primarily the U.S. Dollar and Euro. Over 80% of the merchandise we sell is manufactured abroad, primarily in China, India, Bangladesh and Vietnam. Approximately 20% of this imported merchandise is sourced directly from manufacturers abroad with prices denominated in foreign currencies, and cost relating to such merchandise is denominated in foreign currencies. This relates predominantly to goods in respect of our own brand products that we source directly from foreign countries such as China. In addition, most of our leases are denominated in U.S. dollars or other foreign currencies and establish Rouble equivalent foreign-currency lease rates at fixed RUB/U.S.$ and/or RUB/EUR exchange rates, which are renegotiated annually or less regularly in accordance with the terms of the lease agreements. See "*Risk Factors- Risks Relating to Business and Strategy – We lease the premises for almost all of our stores and for our Krekshino distribution centre, and failure to renew such leases on commercially acceptable terms could affect our business*"

The RUB/U.S.$ exchange rate fluctuated significantly in 2013-2015 ranging from RUB29.93 per U.S.$1.00 in 2013 to RUB72.88 per U.S.$1.00 in 2015. During 2016 the RUB/U.S.$ exchange rate strengthened and saw less volatility. As a result of various factors, including the sharp decline in global oil prices, the Rouble depreciated materially against the U.S. Dollar and other foreign currencies during 2014. While the average RUB/U.S.$ exchange rate increased by 58% in 2015, our average retail prices increased by only 23% as we were able to negotiate better commercial terms with our suppliers and shifted our product mix towards lower-priced, traffic-generating categories (such as products for newborns) to drive growth of gross profit per square metre. During the periods under review, we were generally able to increase our gross profit per square metre from RUB46 million in 2013 to RUB50 million in 2015, primarily by negotiating better commercial terms with our suppliers and shifting our product mix towards traffic-generating categories (such as products for newborns).

If the Rouble further depreciates against the U.S. Dollar or other related foreign currencies that we use to source our merchandise or pay our expenses, our costs will increase and if we are not able to pass these costs to customers by increasing the Rouble price of our store merchandise, our profit margins will decrease. However, given there is a sufficiently long time (up to nine months) between placing our manufacturing orders at purchase prices and the products being placed on shelves, we have the ability to change selling prices to a certain extent in time to mitigate the impact of foreign currency fluctuations.

The value of the Rouble against foreign currencies is expected to continue to be volatile and may decline. See "*Risk Factors — Risks Relating to Our Financial Condition — Fluctuations of Rouble against the U.S. dollar could adversely affect our business*".

Children's Goods Market and Competitive Environment

We operate in a highly competitive environment characterised by low barriers to entry. We compete against a diverse group of competitors covering different product categories, including local and international players. Some of our competitors are general food retailers that compete with us in certain product categories, while others are specialised retailers focusing on particular segments of children's product offering. Among specialist retailers, we compete with Russian specialised children's goods retailers such as Korablik, Mothercare and Dochki-Synochki. In certain segments, we face competition from general food retailers (such as hyper- and supermarkets) and specialised retailers (such as monocategory retailers). In addition, we compete with domestic and international Internet retailers. According to Ipsos Comcon, in 2015, we had an estimated market share of 13.0% (by revenue) of the Russian specialised children's goods retail market. Ipsos Comcon estimates that the Russian children's goods market grew by 11.3% in 2013, 2.8% in 2014 and 3.0% in 2015, and is expected to grow by 0.7% in 2016 and 1.6% in 2017. We believe that we are well established to further increase our market share by capturing current opportunities available, among other factors, due to the downturn in Russian economy. For example, according to Ipsos Comcon, in 2016, total selling space in the children's goods industry in Russia decreased primarily as a result of the closure of the majority of stores of a number of Russian specialised children's goods retailers (such as Deti, Zdorovy Malysh and Mama), and the discontinuance of certain retail operations of some of our competitors (such as Akademia and Nati), reportedly due to financial difficulties. See "*Risk Factors – Risks Relating to Demand and Competition – Competition may affect our financial performance*".

Expansion of Our Retail Network and Growth of E-commerce

During the periods under review, we significantly expanded through new store openings our network of Detsky Mir stores, which increased the overall number of tickets and our revenue. The table below sets out the number of our stores and associated selling space for the periods indicated.

	Nine months ended 30 September		Year ended 31 December		
	2016	2015	2015	2014	2013
Number of stores at beginning of the period	425	322	322	252	216
Number of stores opened during the period	40	48	103	72	40
Number of stores closed during the period	1(1)	—	1	2	4
Total number of stores at period end	464	370	425	322	252
Total selling space at period end (thousands of square metres)	533	435	491	390	320
Total gross space at period end (thousands of square metres)	668	545	618	482	395

(1) During the nine months ended 30 September 2016, 1 store was relocated to better premises within the same geographic area.

In 2011, we opened our first store in Kazakhstan and at present we have 12 stores in Kazakhstan. Revenue from our Kazakhstan stores was RUB494 million, or 0.9% of our total revenue, in the nine months ended 30 September 2016 and RUB669 million, or 1.2% of our total revenue, in 2015. As part of our strategy with respect to Detsky Mir stores in Kazakhstan, we intend to increase the operational efficiency of our retail network in Kazakhstan, which we expect to improve its profitability.

In 2015 and 2014, selling space of our stores increased by 25.9% and 21.9%, respectively, and revenue increased by 33.2%, and 26.2%, respectively. We plan to continue to expand our retail network over the next few years and believe there is sufficient market capacity to target the roll out of approximately 250 new Detsky Mir stores during the period of 2017-2020, including approximately 70 new Detsky Mir stores in 2017, growing our footprint in Russia significantly while possibly doubling our store count in Kazakhstan. Any slowdown in our expansion strategy could result in a slowdown in revenue growth.

While contributing significantly to our revenue growth in the periods under review, our store expansion strategy has also required capital expenditures and resulted in increased selling, general and administrative expenses, in particular capital expenditures associated with the construction of our new distribution centre in Bekasovo (Moscow region), as well as with the opening of new stores. See also "*—Liquidity and Capital Resources—Capital Expenditures*".

In 2011, we launched the Detsky Mir online store, and in 2015 we launched an "in-store pickup" function in all our stores. According to Ipsos Comcon, in the first six months of 2016, our Detsky Mir online store had an estimated market share of 6% (as compared to 3% in 2015) of the online market of children's goods in Russia. During the periods under review our online sales have grown significantly. In the nine months ended 30 September 2016 and 2015, our online sales (excluding sales made via "in-store pickup" service) were RUB1,158 million and RUB496 million, respectively, which represented 2.1% and 1.2% of revenue, respectively. In 2015, 2014 and 2013, our online sales (excluding sales made via "in-store pickup" service) were RUB969 million, RUB443 million and RUB227 million, respectively, which represented 1.6%, 1.0% and 0.6% or revenue, respectively. The table below sets out the number of visits to our online stores, the number of orders, the conversion ratio and the average ticket (based on online sales analytics):

	Nine months ended 30 September		Year ended 31 December		
	2016	2015	2015	2014	2013
Visits (in millions)	63	44	63	43	29
Orders (in thousands)	1,027	230	536	159	72
Conversion ratio	1.45%	0.66%	0.85%	0.37%	0.25%
Average ticket, in-store pickup (in Roubles)	1,729	1,952	1,956	—	—
Average ticket, courier delivery (in Roubles)	3,483	3,415	3,358	3,563	3,491

In response to the rapid development of the e-commerce market, we are focusing on the implementation of an omni-channel sales strategy addressing the development of the online market. We believe we have been successful in integrating our online and offline platforms using our strengths as an offline retailer. In 2016, we implemented the "omni-pricing" initiative by lowering prices in our offline stores to match prices in our online store and offer customers a uniform pricing proposition. We expect that our online sales will continue to grow faster than our retail network sales and may comprise a larger share of our total revenue in the future as compared to 2013-2016. The success of our e-commerce sales channels depends on our ability to provide reliable and quality service to our Internet customers and the level of consumer trust in online purchasing. See "*Risk Factors — Risks Relating to Demand and Competition — We face increasing competition from online competitors*".

Like-for-like Revenue Growth

Like-for-like revenue growth is a key contributor to our results of operations and depends on both the number of tickets and average ticket. The table below sets out the like-for-like performance of our Detsky Mir stores for the periods under review:

	Nine months ended 30 September		Years ended 31 December		
	2016	**2015**	**2015**	**2014**	**2013**
Like-for-like average ticket growth (Detsky Mir stores in Russia only)	**8.1%**	**8.6%**	**8.2%**	**5.0%**	**4.8%**
Moscow and Moscow region	9.2%	10.0%	9.9%	4.4%	4.7%
Other Russian regions	7.7%	8.0%	7.5%	5.4%	5.0%
Like-for-like number of tickets growth (Detsky Mir stores in Russia only)	**4.4%**	**4.7%**	**3.7%**	**8.3%**	**8.2%**
Moscow and Moscow region	3.3%	4.0%	3.5%	5.6%	7.0%
Other Russian regions	4.9%	4.9%	3.9%	9.3%	8.8%
Like-for-like revenue growth (Detsky Mir stores in Russia only)	**13.0%**	**13.6%**	**12.3%**	**13.7%**	**13.4%**
Moscow and Moscow region	12.8%	14.4%	13.8%	10.2%	12.0%
Other Russian regions	13.0%	13.3%	11.6%	15.2%	14.2%

Like-for-like number of tickets and average ticket are impacted by a number of factors, including the location of our stores, our assortment, our pricing strategy, our marketing efforts, the state of and the level of service we offer customers. Growth in our like-for-like number of tickets and average ticket and our strong like-for-like revenue growth – are a direct consequence of our competitive pricing policy, as well as effective marketing and merchandising policies.

Our stores have a relatively long period over which they continue to grow like-for-like sales. The table below sets out like-for-like sales growth of our stores opened before 2012, as compared to our total like-for-like revenue growth:

	Nine months ended 30 September		Years ended 31 December		
	2016	**2015**	**2015**	**2014**	**2013**
Like-for-like revenue growth (Detsky Mir stores in Russia only)	13.0%	13.6%	12.3%	13.7%	13.4%
Like-for-like revenue growth (Detsky Mir stores in Russia opened before 2012)	9.2%	10.4%	9.5%	10.8%	13.9%

The following table sets out the like-for-like revenue growth of our Detsky Mir stores for each quarter of 2013, 2014 and 2015 years and the first three quarters of 2016:

2013				2014				2015				2016		
Q1	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**	**Q1**	**Q2**	**Q3**
11.2	17.6	15.8	10.2	25.4	12.4	8.2	12.3	13.5	17.8	10.3	9.4	13.2	13.3	12.5

Increases in cost of sales

In the nine months ended 30 September 2016 and 2015, costs of sales represented 66.7% and 65.4%, respectively, of our revenue. In 2015, 2014 and 2013, cost of sales represented 63.8%, 62.0% and 61.4%, respectively, of our revenue. The increase during the periods under review was primarily due to a shift in our product mix towards traffic-generating categories (such as products for newborns) and our investment in lowering prices to drive growth in the number of tickets. Cost of sales includes the cost of merchandise purchased from vendors, freight costs to transport merchandise to our distribution centres and customs duties if the product is imported, costs of transporting merchandise from the distribution centres to stores, write-off of excess and obsolete inventory, provision for inventory shrinkage, and bonuses and allowances received from merchandise vendors.

The strength of our relationship with our suppliers helps us to control purchasing costs, as it allows us to negotiate volume related discounts and receive bonuses and allowances which are typical for engaging in cooperative advertising and promotions with the supplier, as well as meeting certain volume targets. A strong supplier relationship can also give us access to more favourable payment terms, which provides increased flexibility in our working capital requirements. The increased scale of our retail operations in recent years has strengthened our bargaining power due to our increased purchase volumes. This has played a large part in achieving costs savings in our sourcing and maintaining our gross margins, principally by receiving higher bonuses and allowances from our suppliers. We account for supplier bonuses and allowances as a reduction of cost of goods sold unless they represent a reimbursement of specific, incremental, identifiable costs incurred by us in selling the supplier's products. Supplier bonuses and allowances (recognised within cost of goods sold) amounted to RUB7,834 million and RUB4,609 million in the nine months ended 30 September 2016 and 2015, respectively, and RUB7,835 million, RUB4,351 million and RUB2,863 million in 2015, 2014 and 2013, respectively.

From time to time, we also translate such costs savings into lower prices for our customers, which helps to further increase customer traffic. Conversely, some of the increases in costs of merchandise, caused by, among other things, inflation or changes in foreign currency exchange rates, can be passed on to customers.

Operating efficiency

Our operating expenses are largely driven by the size of our retail network. The largest components of our selling, general and administrative expenses are rent and utility costs and payroll, which amounted to RUB5,971 million and RUB4,957 million, respectively, representing 40.8% and 33.9%, respectively, of our total selling, general and administrative expenses in the nine months ended 30 September 2016. For 2015, our rent and utility costs and payroll amounted to RUB7,073 million and RUB6,809 million, respectively, representing 39.9% and 38.4%, respectively, of our total selling, general and administrative expenses.

As at 31 December 2016, almost all of our store premises were leased. All Detsky Mir store lease agreements and 43 out of 45 ELC store lease agreements establish Rouble-denominated lease rates or Rouble equivalent of foreign-currency lease rate at fixed RUB/U.S.$ or RUB/EUR exchange rates. While we believe that we have the ability to negotiate favourable lease terms due to the high level of traffic generated by our Detsky Mir stores, brand recognition, the superior quality of our store format compared to other Russian children's goods retailers and the size of our business, our rental and utility costs are primarily dependent on market rental rates, rates of inflation, foreign currency exchange rates and tariff increases for utilities which are initiated by service providers. Inflation risks are partially mitigated during the term of the lease through capped indexation clauses in most of our leases, and foreign currency exchange risks are mitigated in all our leases through a provision which caps increases in rental rates caused by changes in exchange rates. See "*Risk Factors – Risks Relating to Demand and Competition – We lease the premises for almost all of our stores and for our Krekshino distribution centre, and our failure to renew such leases on commercially acceptable terms, or at all, could affect our business*"

We expect rent and utility costs to continue to increase in absolute terms as a result of the further expansion of our retail network, the impact of inflation, rental rate increases made by lessors for non-fixed escalation agreements and upon lease renewals, and tariff increases for utilities. Changes in foreign currency exchange rates may also have a significant impact on our rental costs.

The table below sets out our payroll costs and related metrics for the periods under review.

	Nine months ended 30 September		Years ended 31 December		
	2016	2015	2015	2014	2013
Total payroll costs (in millions of Roubles)(1)	4,957	3,904	6,809	5,217	4,492
Payroll costs as a percentage of total revenue(1)	9.1%	9.8%	11.2%	11.5%	12.5%
Total employees (end of period)	10,641	8,795	9,979	7,782	7,042
Store	8,826	7,590	8,636	6,776	6,027
Head office	779	720	713	719	735
Warehouse	1,036	485	630	287	280
Personnel per store (end of period)	21	22	22	24	26
Total selling space (in thousands of square metres, end of period)	533	435	491	390	320

(1) Payroll costs for nine months ended 30 September 2016 and 2015 and for the years ended 31 December 2015 and 2014 are presented in accordance with IFRS. Payroll costs for the year ended 31 December 2013 are presented in accordance with US GAAP. They have been presented in the same table on the basis that there were no US GAAP differences impacting these amounts.

In recent years we have initiated a process to reduce our payroll costs as a percentage of sales. In particular, we have optimised the headcount of back-office store personnel and head office personnel and are focusing on automation of accounting functions, standardization and improvements of business processes. In addition, we are constantly optimising our cashier operations in order to decrease the number of employees at each store. See "*Business - Employees*". We expect that payroll costs will continue to increase in absolute terms as wage inflation is likely to continue in Russia and new store openings will require the hiring of additional employees.

Largely due to the measures described above, selling, general and administrative expenses (including depreciation and amortisation) as a proportion of our revenue have decreased to 29.3% in 2015 from 32.7% in 2013.

Seasonality

Our business is highly seasonal, with peak levels of sales during the third and fourth quarters due to the back to school, winter and New Year seasons. In 2015, our revenue in the third and fourth quarters accounted for 25.1% and 34.0%, respectively, of our total revenue for the year. In particular, our sales for the year are heavily dependent on the strength of the December holiday sales season. Retail sales of toys and expensive items of winter wear and footwear tend to peak at the end of the year due to the holidays season, as well as the colder weather. Stationery sales peak in the third quarter at the time of the start of the school year. Traffic generating products (such as products for newborns) tend to help us to partially smoothen the seasonal nature of our business.

Seasonality also requires that we invest additional working capital in order to secure sufficient stock of products based on seasonality trends, as well as manage our inventory levels to minimise obsolescence. We purchase inventory for the December holiday season in October and November and make payments for these purchases throughout December and in January, February and March.

We also aim to open new stores in the second half of the year, primarily in the fourth quarter, in order to take advantage of the year-end holiday shopping season. For example, in the fourth quarter of 2016, we opened 60 Detsky Mir stores, with the aggregate selling space of approximately 58 thousand square metres, and in the fourth quarter of 2015, we opened 55 new Detsky Mir stores with the aggregate selling space of approximately 56 thousand square metres. The seasonal fluctuations impacting our business generally demonstrate similar trends every year and therefore do not materially affect the year-on-year comparability of our financial results.

Recent Developments

This section contains forward-looking statements. These statements are not guarantees of future financial performance and our actual results could differ materially from those expressed or implied by these forward-looking statements as a result of many factors, including, but not limited to, those described under "Forward-Looking Statements". Investors are urged not to place undue reliance on the forward-looking statements set out below.

Stores and Space

In the fourth quarter of 2016, we opened 60 Detsky Mir stores, taking the total number of Detsky Mir stores opened in 2016 to 100 stores and the total number of Detsky Mir stores as at 31 December 2016 to 480 (468 stores in Russia and 12 stores in Kazakhstan). In the fourth quarter of 2016, we opened one new ELC store, taking the total number of ELC stores as at 31 December 2016 to 45. We generally aim to open new stores in the second half of the year, primarily in the fourth quarter, in order to take advantage of the year-end holiday shopping season.

We entered 10 new cities in Russia and one new city in Kazakhstan in the fourth quarter of 2016 and as at 31 December 2016 were present in 171 cities in Russia and seven cities in Kazakhstan. We added 64 thousand square metres of new selling space in the fourth quarter, with total selling space increasing to 596 thousand square metres as at 31 December 2016 (a 21.4% increase as compared to 31 December 2015).

Revenue and Profitability

According to our preliminary estimates, we expect our revenue for the year ended 31 December 2016 to be within a range of approximately RUB79.2 billion to RUB79.8 billion, representing an increase of approximately 30% as compared to RUB60.5 billion for the year ended 31 December 2015. Based on these estimates, we expect our gross profit margin to have declined to approximately 34% in 2016 from 36.2% in 2015.

According to our preliminary estimates, in the year ended 31 December 2016, our like-for-like revenue growth was approximately 10.8%, supported by like-for-like average ticket growth of approximately 6.2% and like-for-like number of tickets growth of approximately 4.4%. In the fourth quarter ended 31 December 2016, our like-for-like revenue growth was approximately 6.2%, primarily driven by like-for-like number of tickets growth of approximately 4.2% with like-for-like average ticket growth amounting to approximately 1.9%.

In line with our strategy to offer competitive pricing to our customers across both offline and online sales channels, in 2016 we implemented the “omni-pricing” initiative by lowering prices in our offline stores to match prices in our online stores and offer customer a uniform pricing proposition. The price matching primarily affected toys (our largest product category), and given that the share of sales of toys in our total revenue in the fourth quarter is traditionally very significantly higher than for the rest of the year, it had a particularly pronounced impact in the fourth quarter of 2016. The share of toys with “omni-pricing” across online and offline stores amounted to 38% in January 2016, 68% – in September 2016 and 92% in December 2016. In addition to the “omni-pricing” initiative impact, our revenue performance in the fourth quarter ended 31 December 2016 was further affected by the seasonal shift in the “autumn-winter” collection in our fashion category, which to a larger extent commenced selling in the third quarter (rather than in the fourth quarter as was in 2015) due to the colder autumn season in 2016, thereby supporting our revenue in the third quarter ended 30 September 2016, but affecting revenue in the fourth quarter ended 31 December 2016.

We expect our near term like-for-like revenue growth to be in line with 2016, primarily driven by our competitive pricing policy, and increase in the number of Detsky Mir stores included in the like-for-like revenue growth, with 103 Detsky Mir stores opened in 2015 entering the like-for-like panel in 2017.

We saw an increase in our revenue growth dynamics in first 24 days of January 2017 as compared to the beginning of the first quarter of 2016, with like-for-like revenue growth amounting to approximately 11.9%, including approximately 10.8% like-for-like number of tickets growth and approximately 1.0% like-for-like average tickets growth. We expect our gross profit margin to further decline in the near term, but at a slower rate than the gross margin decline in 2016 relative to 2015, as we have substantially completed our “omni-pricing” initiative and do not expect to lower prices further in the near term. We expect our Adjusted EBITDA margin for the year ended 31 December 2016 to be broadly in line with the year ended 31 December 2015.

Rent and Utility Costs and Payroll Costs

We expect our rent and utility costs, as a percentage of revenue, to decline to approximately 10% for the year ended 31 December 2016 from 11.7% for the year ended 31 December 2015, with further decline in the near term, primarily due to stable lease rates, benefitting from a continued soft market for retail commercial property leases in the geographies where we operate or plan to operate. We expect our payroll costs, as a percentage of revenue, to decline to approximately 9% for the year ended 31 December 2016 from 11.2% for the year ended 31 December 2015, with further decline in the near term, primarily due to the operating leverage benefit from spreading our fast-growing revenues over a relatively stable headquarters personnel cost base, as well as our ongoing efforts to improve operational efficiency.

Financings

In the fourth quarter of 2016, we opened additional and extended existing credit lines in the aggregate amount of RUB3.2 billion. In December 2016, we terminated a RUB1.2 billion revolving credit facility agreement from a related party, MTS Bank. No drawdowns under the facility were utilised.

We expect our Net Debt as at 31 December 2016 to be approximately RUB12.3 billion, as compared to RUB16.4 billion as at 31 December 2015. Taking into account amounts receivable of approximately RUB1.1 billion under a loan granted to CJSC "DM-Finance" (Sistema's subsidiary), we expect our Adjusted Net Debt as at 31 December 2016 to be approximately RUB11.2 billion.

Dividends

In December 2016, our General Shareholders' Meeting approved the payment of interim dividends for the nine months ended 30 September 2016 in the aggregate amount of RUB3,119 million, which were paid in full in December 2016.

The projections and trends described above may not materialise for a variety of reasons, as discussed in more detail in "*Risk Factors*". Furthermore, for a discussion of the most significant factors that have affected, and will continue to affect, our operations, see *"—Key Factors Affecting Our Results of Operations"*.

Results of Operations

Nine Months Ended 30 September 2016 as Compared to Nine Months Ended 30 September 2015 (prepared under IFRS)

The table below shows the components of our income statement for the nine months ended 30 September 2016 and 2015:

	Nine months ended 30 September		Rouble Change	% Change	% of revenue, nine months ended 30 September	
	2016	2015			2016	2015
	(unaudited) *(in millions of Roubles)*				*(%)*	
Revenue	54,226	39,967	14,259	35.7	100.0	100.0
Cost of sales	(36,151)	(26,125)	(10,026)	38.4	(66.7)	(65.4)
Gross profit	**18,075**	**13,842**	**4,233**	**30.6**	**33.3**	**34.6**
Selling, general and administrative expenses	(14,618)	(11,534)	(3,084)	26.7	(27.0)	(28.9)
Share of profit of associate, net of income tax	9	5	4	80.0	0.0	0.0
Other operating expenses, net	(19)	(11)	(8)	72.7	0.0	0.0
Operating profit	**3,447**	**2,302**	**1,145**	**49.7**	**6.4**	**5.8**
Finance income	148	535	(387)	(72.3)	0.3	1.3
Finance expense	(1,418)	(1,251)	(167)	13.3	(2.6)	(3.1)
Gain on acquisition of controlling interest in associate	16	—	16	100.0	0.0	0.0
Foreign exchange loss, net	(10)	(595)	585	(98.3)	0.0	(1.5)
Profit before tax	**2,183**	**991**	**1,192**	**120.3**	**4.0**	**2.5**
Income tax expense	(498)	(334)	(164)	49.1	(0.9)	(0.8)
Profit for the period	**1,685**	**657**	**1,028**	**156.5**	**3.1**	**1.6**

Revenue

The table below shows a breakdown of our revenue by source for the nine months ended 30 September 2016 and 2015:

	Nine months ended 30 September		Rouble Change	% Change	% of revenue, nine months ended 30 September	
	2016	2015			2016	2015
	(unaudited) *(in millions of Roubles)*				(%)	
Retail, excluding luxury and the online store [(1)]	53,017	39,300	13,717	34.9	97.8	98.3
Online store	1,158	496	662	133.5	2.1	1.2
Luxury retail [(2)]	—	108	(108)	(100.0)	0.0	0.3
Other	51	63	(12)	(19.0)	0.1	0.2
Total revenue	**54,226**	**39,967**	**14,259**	**35.7**	**100.0**	**100.0**

(1) Revenue for online sales made via in-store pickup is included in retail revenue.

(2) Revenue generated by the Yakimanka Gallery, which was closed in the first half of 2015.

Our revenue increased by RUB14,259 million, or 35.7%, to RUB54,226 million in the nine months ended 30 September 2016 from RUB39,967 million in the nine months ended 30 September 2015 primarily as a result of the following:

- *New Detsky Mir stores:* We opened 143 Detsky Mir stores within the period between 1 January 2015 and 30 September 2016.
- *Like-for-like revenue growth*: Like-for-like revenue growth at 272 Detsky Mir stores was 13.0%. This growth was mainly the result of a competitive pricing policy, marketing activities and improvements in merchandising. In the nine months ended 30 September 2016, we saw an increase in like-for-like average ticket of 8.1%, primarily due to improvements in product mix, in particular, an increase in the share of traffic generating categories such as products for newborns. Our stores saw like-for-like number of tickets growth of 4.4% in the nine months ended 30 September 2016.
- *Online store:* Online sales (which do not include in-store pickups of purchases ordered online) increased by RUB662 million, or 133.5%, to RUB1,158 million in the nine months ended 30 September 2016 as compared to RUB496 million in the same period in 2015. The significant increase was primarily driven by a significant increase in the number of online orders.

Cost of sales

Cost of sales increased by RUB10,026 million, or 38.4%, to RUB36,151 million for the nine months ended 30 September 2016 from RUB26,125 million for the nine months ended 30 September 2015. The increase was due to sales growth and was generally in line with the 35.7% increase in revenue in the same period.

Gross profit

For the reasons described above, gross profit increased by RUB4,233 million, or 30.6%, to RUB18,075 million in the nine months ended 30 September 2016 from RUB13,842 million in the nine months ended 30 September 2015.

Gross profit margin declined slightly to 33.3% in the nine months ended 30 September 2016 from 34.6% in the nine months ended 30 September 2015. This was largely due to our strategy of offering competitive pricing on certain SKUs to drive number of tickets growth which resulted in lower margins.

Selling, general and administrative expenses

The table below sets out our selling, general and administrative expenses by type for the nine months ended 30 September 2016 and 2015:

	Nine months ended 30 September		Rouble Change	% Change	% of Revenues Nine months ended 30 September	
	2016	**2015**			**2016**	**2015**
	(unaudited) (*in millions of Roubles*)				(*%*)	
Rent and utility	5,971	5,104	867	17.0	11.0	12.8
Payroll	4,957	3,904	1,053	27.0	9.1	9.8
Depreciation and amortisation	1,176	638	538	84.3	2.2	1.6
Other	2,514	1,888	626	33.2	4.6	4.7
Total selling, general and administrative expenses	**14,618**	**11,534**	**3,084**	**26.7**	**27.0**	**28.9**

Selling, general and administrative expenses increased by RUB3,084 million, or 26.7%, in the nine months ended 30 September 2016 as compared to the nine months ended 30 September 2015, as a result of increases in payroll, rent and utility and advertising expenses in connection with the continued expansion of our retail chain and online sales. However, selling, general and administrative expenses declined as a percentage of sales to 27.0% in the nine months ended 30 September 2016 from 28.9% in the nine months ended 30 September 2015, as a result of our continued efforts to further improve operational efficiency.

Rent and utility costs increased by RUB867 million, or 17.0%, in the nine months ended 30 September 2016 as compared to the nine months ended 30 September 2015, mostly due to new store openings during 2016, capped indexation rate in lease agreements (typically capped at 5-6% per year in rouble terms subject to negotiations with lessors) and increases in state-regulated utility tariffs. However, as a percentage of revenue, rent and utility costs declined to 11.0% in the nine months ended 30 September 2016 from 12.8% in the nine months ended 30 September 2015, as our retail network continued to mature and generate higher sales per square metre and rent indexation was slower than revenue growth due to decreasing lease rates in line with the market trend. Also, we signed a number of new long-term lease contracts with favourable extension options and indexation rates.

Payroll costs increased by RUB1,053 million, or 27.0%, in the nine months ended 30 September 2016 as compared to the nine months ended 30 September 2015, largely due to hiring employees for new stores. As a percentage of revenue, payroll costs declined to 9.1% in the nine months ended 30 September 2016, as compared to 9.8% in the nine months ended 30 September 2015, due to the reduction of headcount per store as a result of further automation of cashier operations and stock-taking activities. As of 30 September 2016, the total number of employees increased to 10,641 employees from 9,979 employees as at 31 December 2015. Headcount per store was 21 employees and 22 employees as at 30 September 2016 and as at 31 December 2015, respectively.

Advertising and marketing expenses increased by RUB75 million, or 12.6%, in the nine months ended 30 September 2016 as compared to the nine months ended 30 September 2015, largely due to a slight increase related to advertising campaigns. As a percentage of revenue, advertising and marketing expenses marginally declined to 1.2% in the nine months ended 30 September 2016 from 1.5% in the nine months ended 30 September 2015.

Depreciation and amortisation costs increased by RUB538 million, or 84.3%, in the nine months ended 30 September 2016 as compared to the nine months ended 30 September 2015. As a percentage of revenue, depreciation and amortisation costs increased to 2.2% in the nine months ended 30 September 2016 from 1.6% in the nine months ended 30 September 2015. The increase in 2016 was mostly due to an increase in capitalised costs associated with new store openings, as well as with the commissioning of our distribution centre in Bekasovo and implementation of SAP.

Other expenses, including bank fees, repairs and maintenance, materials used for sales, security and other auxiliary expenses, increased by RUB551 million, or 42.6%, in the nine months ended 30 September 2016 as compared to the nine months ended 30 September 2015, largely due to increased bank fees and software maintenance expenses.

Finance income and expenses

Finance income for the nine months ended 30 September 2016 decreased by RUB387 million, or 72.3%, to RUB148 million from RUB535 million for the nine months ended 30 September 2015. The decrease was primarily due to the partial repayment of loans receivable from CJSC "DM-Finance" during the period.

Finance expenses for the nine months ended 30 September 2016 increased by RUB167 million, or 13.3%, to RUB1,418 million from RUB1,251 million for nine months ended 30 September 2015. The increase was primarily due to a RUB206 million increase in interest expense on bank loans as a result of increased debt levels during 2016 as compared to 2015, which outweighed the decrease of the weighted average interest rate on our indebtedness to 12.5% as at 30 September 2016 from 14.3% as at 30 September 2015.

Foreign exchange loss

During the nine months ended 30 September 2016 we incurred a net foreign exchange loss of RUB10 million as compared to RUB595 million for the nine months ended 30 September 2015. The decrease was primarily due to a decrease in losses recognised on the revaluation of liabilities denominated in foreign currency, predominantly accounts payable, as a result of lower volatility of the Rouble in the nine months ended 30 September 2016.

Income tax expense

We pay corporate tax in Russia and Kazakhstan at the statutory rate of 20%; however, in the nine months ended 30 September 2016 and 2015 our effective tax rate (income tax expense as a percentage of profit before tax) was 22.8% and 33.7%, respectively, due to certain non-deductible tax expenses, such as shrinkage of inventory. The decrease in the effective tax rate was primarily due to prior period tax adjustments of RUB227 million in the nine months ended 30 September 2016.

Total income tax expense increased by RUB164 million, or 49.1%, in the nine months ended 30 September 2016 as compared to the nine months ended 30 September 2015 due to our profit before tax increasing from RUB991 million for the nine months ended 30 September 2015 to RUB2,183 million for the nine months ended 30 September 2016, partially offset by prior period tax adjustments of RUB227 million in the nine months ended 30 September 2016.

Year Ended 31 December 2015 Compared to Year Ended 31 December 2014 (prepared under IFRS)

The table below sets forth certain financial information regarding our consolidated results of operations for the years ended 31 December 2015 and 2014:

	Year ended 31 December		**Rouble Change**	**% Change**	**% of Revenues Year ended 31 December**	
	2015	**2014**			**2015**	**2014**
	(in millions of Roubles)				*(%)*	
Revenue	60,544	45,446	15,098	33.2	100.0	100.0
Cost of sales	(38,640)	(28,183)	(10,457)	37.1	(63.8)	(62.0)
Gross profit	**21,904**	**17,263**	**4,641**	**26.9**	**36.2**	**38.0**
Selling, general and administrative expenses	(17,725)	(14,262)	(3,463)	24.3	(29.3)	(31.4)
Gain on sale of a building, net	—	1,164	(1,164)	(100)	—	2.6
Share of profit of associate, net of income tax	9	13	(4)	(30.8)	0.0	0.0
Other operating expenses, net	(20)	(8)	(12)	(150.0)	0.0	0.0
Operating profit	**4,168**	**4,170**	**(2)**	**(0.1)**	**6.9**	**9.2**
Finance income	723	56	667	(1,191.1)	1.2	0.1
Finance expense	(2,053)	(918)	(1,135)	123.6	(3.4)	(2.0)
Impairment of goodwill	(363)	—	(363)	(100)	(0.6)	—
Foreign exchange loss	(922)	(582)	(340)	58.5	(1.5)	(1.3)
Profit before tax	**1,554**	**2,727**	**(1,173)**	**(43.0)**	**2.6**	**6.0**
Income tax expense	(578)	(684)	106	(15.5)	(1.0)	(1.5)
Profit for the year	**976**	**2,043**	**(1,067)**	**(52.2)**	**1.6**	**4.5**

Revenue

The table below shows a breakdown of our revenues by source for the years ended 31 December 2015 and 2014:

	Year ended 31 December		Rouble	%	% of Revenues Year ended 31 December	
	2015	2014	Change	Change	2015	2014
	(in millions of Roubles)				*(%)*	
Retail, excluding luxury and the online store[(1)]	59,447	44,405	15,042	33.9	98.2	97.7
Online store	969	443	526	118.7	1.6	1.0
Luxury retail[(2)]	108	588	(480)	(81.6)	0.2	1.3
Other	21	10	10	100.0	0.0	0.0
Total revenue	**60,544**	**45,446**	**15,098**	**33.2**	**100.0**	**100.0**

(1) Revenue for online sales made via in-store pickup is included in retail revenue.

(2) Revenue generated by the Yakimanka Gallery, which was closed in the first half of 2015.

Our revenue increased by RUB15,098 million, or 33.2%, to RUB60,544 million in the year ended 31 December 2015 from RUB45,446 million in the year ended 31 December 2014, as a result of the following:

- *New Detsky Mir stores:* We opened 159 Detsky Mir stores during 2014 and 2015.
- *Like-for-like revenue growth:* Like-for-like revenue growth at 210 Detsky Mir stores was 12.3%. In 2015, we witnessed an increase in Detsky Mir like-for-like average ticket of 8.2%, primarily due to improvements in our product mix. Our stores saw like-for-like number of tickets growth of 3.7% in 2015.
- *Online store:* Online sales (which do not include in-store pickups of purchases ordered online) increased by RUB526 million, or 118.7%, to RUB969 million in the year ended 31 December 2015 as compared to RUB443 million in the year ended 31 December 2014. The increase was driven by a significant increase in the number of online orders.

Cost of sales

Cost of sales increased by RUB10,457 million, or 37.1%, to RUB38,640 million for the year ended 31 December 2015 from RUB28,183 million for the year ended 31 December 2014. The increase was due to sales growth and was generally in line with the 33.2% increase in revenue in the same period.

Gross profit

For the reasons described above, gross profit increased by RUB4,641 million, or 26.9%, to RUB21,904 million for the year ended 31 December 2015 from RUB17,263 million for the year ended 31 December 2014.

Gross profit margin declined slightly to 36.2% in 2015 from 38.0% in 2014. This was largely due to our strategy of offering competitive pricing on certain SKUs to drive number of tickets growth which resulted in lower margins and due to the shift of our product mix towards traffic-generating categories (products for newborns), but this adverse effect was to a large extent offset by higher bonuses and allowances received from suppliers due to the increased scale of our business, sales of a larger proportion of higher-margin own brand goods as well as decreased logistics costs from greater centralisation as a result of the construction of the Bekasovo distribution centre.

Selling, general and administrative expenses

The table below sets out our selling, general and administrative expenses by type for the years ended 31 December 2015 and 2014:

	Year ended 31 December		Rouble	%	% of Revenues Year ended 31 December	
	2015	2014	Change	Change	2015	2014
	(in millions of Roubles)				*(%)*	
Rent and utility	7,073	5,799	1,274	22.0	11.7	12.8
Payroll	6,809	5,217	1,592	30.5	11.2	11.5
Advertising and marketing expenses	1,091	782	309	39.5	1.8	1.7
Depreciation and amortisation	954	740	214	28.9	1.6	1.6
Other	1,798	1,724	74	4.3	3.0	3.8
Total selling, general and administrative expenses	**17,725**	**14,262**	**3,463**	**24.3**	**29.3**	**31.4**

Selling, general and administrative expenses increased by RUB3,463 million, or 24.3%, in 2015 as compared to 2014, as a result of increases in payroll, rent and utility and advertising expenses in connection with the continued expansion of our retail chain. However, selling, general and administrative expenses declined as a percentage of sales to 29.3% in 2015 from 31.4% in 2014, as a result of our continued efforts to further improve operational efficiency.

Rent and utility costs increased by RUB1,274 million, or 22.0%, in 2015 as compared to 2014, mostly due to new store openings during 2015, capped indexation rate in lease agreements (typically capped at 5-6% per year in rouble terms subject to negotiation with lessors) and increases in state-regulated utility tariffs. However, as a percentage of revenue, rent and utility costs declined to 11.7% in 2015 from 12.8% in 2014, as our retail network continued to mature and generate better sales per square metre and rent indexation was slower than revenue growth. Also, we signed a number of new long-term lease contracts with favourable lease terms.

Payroll costs increased by RUB1,592 million, or 30.5%, in 2015 as compared to 2014, largely due to hiring employees for new stores. As a percentage of revenue, payroll costs marginally declined to 11.2% in 2015, as compared to 11.5% in 2014, largely due to reduction of headcount per store as a result of further automation of cashier operations and stock-taking activities. As of 31 December 2015, the total number of employees increased to 9,979 from 7,782 as at 31 December 2014. Headcount per Detsky Mir store declined to 22 employees in 2015 from 24 in 2014, as a result of these operational improvements.

Advertising and marketing expenses increased by RUB309 million, or 39.5%, in 2015 as compared to 2014. As a percentage of revenue, advertising and marketing expenses marginally increased to 1.8% in 2015 from 1.7% in 2014.

Depreciation and amortisation costs increased by RUB214 million, or 28.9%, in 2015 as compared to 2014. As a percentage of revenue, depreciation and amortisation costs was 1.6% in 2015 and 2014. The increase in 2015 was mostly due to an increase in capitalised costs associated with the commissioning of our distribution centre in Bekasovo and new store openings.

Other expenses, including bank fees, repairs and maintenance, materials used for sales, security and other auxiliary expenses, increased by RUB74 million, or 4.3%, in 2015 as compared to 2014, largely due to increased bank fees as a result of an increase in the number of transactions made with banking cards.

Gain on sale of a building, net

In the year ended 31 December 2014, we recorded a RUB1,164 million gain in disposal of a building. In December 2014, we sold the building occupied by our luxury retail store (Yakimanka Gallery), which on the date of disposal had a carrying amount of RUB229 million, to a third party for cash consideration of RUB1,440 million. In addition, we incurred transaction costs for the disposal of the building totalling RUB48 million.

Finance income and expenses

	Year ended 31 December		Rouble	%	% of Revenues Year ended 31 December	
	2015	2014	Change	Change	2015	2014
	(*in millions of Roubles*)				(%)	
Finance Income						
Interest income on bank deposits	94	55	39	70.9	0.2	0.1
Interest income on loans issued to related parties	629	1	628	62,800	1.0	0.0
Total	**723**	**56**	**667**	**1,191.1**	**1.2**	**0.1**

Finance income for the year ended 31 December 2015 significantly increased to RUB723 million from RUB56 million for the year ended 31 December 2014. The increase was primarily due to interest income of RUB628 million as a result of increased interest payments secured from a loan issued to CJSC “DM-Finance” in 2013.

	Year ended 31 December 2015	Year ended 31 December 2014	Rouble Change	% Change	% of Revenues year ended 31 December 2015	% of Revenues year ended 31 December 2014
	(in millions of Roubles)				*(%)*	
Finance Expenses						
Interest expense on bonds	39	98	(59)	(60.2)	0.1	0.2
Interest expense on bank loans	2,014	820	1,194	145.6	3.3	1.8
Total	**2,053**	**918**	**1,135**	**123.6**	**3.4**	**2.0**

Finance expenses for the year ended 31 December 2015 significantly increased by RUB1,135 million, or 123.6%, to RUB2,053 million from RUB918 million for the year ended 31 December 2014. The increase was primarily due to a RUB1,194 million increase in interest expense on bank loans as a result of increased higher debt levels during 2015 as compared to 2014. The weighted average interest rate on our indebtedness was 13.9% as at 31 December 2015, as compared to 12.3% as at 31 December 2014.

Impairment of goodwill

In 2015 we performed an impairment testing of goodwill, which indicated that the carrying value of the goodwill related to "Cub-Market", LLC (the operator of ELC stores in Russia) exceeded its recoverable amount. As a result, we recognised an impairment loss of RUB363 million for the year ended 31 December 2015.

Foreign exchange loss

During the year ended 31 December 2015 we incurred a net foreign exchange loss of RUB922 million as compared to RUB582 million for the year ended 31 December 2014. The increase was primarily due to the increased losses recognised on the revaluation of liabilities denominated in foreign currency, predominantly accounts payable, as Rouble and Kazakh tenge further depreciated against the U.S. dollar during the period.

Income tax expense

In 2015 and 2014 our effective tax rate (income tax expense as a percentage of profit before tax) was 37.2% and 25.1%, respectively, due to certain non-deductible tax expenses, such as shrinkage of inventory. The increase in the effective tax rate was primarily due to the impairment loss in 2015, which was not deductible for tax purposes.

Total income tax expense decreased by RUB106 million in 2015 as compared to 2014 due to our profit before tax decreasing from RUB2,727 million for the year ended 31 December 2014 to RUB1,554 million for the year ended 31 December 2015.

Year Ended 31 December 2014 Compared to Year Ended 31 December 2013 (prepared under US GAAP)

The table below sets forth certain financial information regarding our consolidated results of operations for the years ended 31 December 2014 and 2013:

	Year ended 31 December 2014	Year ended 31 December 2013	Rouble Change	% Change	% of Revenues Year ended 31 December 2014	% of Revenues Year ended 31 December 2013
	(in millions of Roubles)				*(%)*	
Revenue	45,446	36,001	9,445	26.2	100.0	100.0
Cost of sales	(28,183)	(22,093)	(6,090)	27.6	(62.0)	(61.4)
Gross profit	**17,263**	**13,908**	**3,355**	**24.1**	**38.0**	**38.6**
Selling, general and administrative expenses	(13,523)	(11,155)	(2,368)	21.2	(29.7)	(31.0)
Gain on disposal of a building, net	1,164	—	1,164	100.0	2.6	—
Depreciation and amortization	(740)	(634)	(106)	16.7	1.6	1.8
Interest in earnings of associates, net of tax	13	19	(6)	(31.6)	0.0	0.0
Other operating income and (expenses), net	(7)	(1)	(6)	600.0	0.0	0.0
Operating profit	**4,170**	**2,137**	**2,033**	**95.1**	**9.2**	**5.9**
Finance income	56	11	45	409.1	0.1	0.0
Finance expense	(918)	(518)	(400)	77.2	(2.0)	(1.4)
Foreign exchange loss	(582)	(58)	(523)	901.7	(1.3)	(0.2)
Profit before tax	**2,727**	**1,572**	**1,155**	**73.5**	**6.0**	**4.4**
Income tax expense	(684)	(419)	(265)	63.2	(1.5)	(1.2)
Profit for the year	**2,043**	**1,153**	**890**	**77.2**	**4.5**	**3.2**

Revenue

The table below shows a breakdown of our revenues by source for the years ended 31 December 2014 and 2013:

	Year ended 31 December		Rouble Change	% Change	% of Revenues Year ended 31 December	
	2014	2013			2014	2013
	(in millions of Roubles)				*(%)*	
Retail, excluding luxury and the online store[1]	44,405	35,147	9,258	26.3	97.7	97.6
Luxury[2]	588	605	(17)	(2.8)	1.3	1.7
Online store	443	227	216	95.2	1.0	0.6
Other	10	21	(12)	(57.1)	0.0	0.1
Total revenue	**45,446**	**36,001**	**9,445**	**26.2**	**100.0**	**100.0**

(1) Revenue for online sales made via in-store pickup is included in retail revenue.
(2) Revenue generated by the Yakimanka Gallery, which was closed in the first half of 2015.

Our revenue increased by RUB9,445 million, or 26.2%, to RUB45,446 million in the year ended 31 December 2014 from RUB36,001 million in the year ended 31 December 2013, as a result of the following:

- *New Detsky Mir stores:* We opened 89 Detsky Mir stores in 2013 and 2014.
- *Like-for-like revenue growth:* Like-for-like revenue growth at 176 Detsky Mir stores was 13.7%. In 2014, we saw an increase in Detsky Mir like-for-like average ticket of 5.0%, primarily due to our attractive product mix. This growth in like-for-like average ticket was also marginally higher than the growth of 4.8% in 2013. Our stores saw like-for-like number of tickets growth of 8.3% in 2014.
- *Online store:* Online sales (which do not include in-store pickups of purchases ordered online) increased by RUB216 million, or 95.2%, to RUB443 million in the year ended 31 December 2014 as compared to RUB227 million in the year ended 31 December 2013. The significant increase was driven by a continued trend of increasing consumer adoption of online shopping in Russia.

Cost of sales

Cost of sales increased by RUB6,090 million, or 27.6%, to RUB28,183 million for the year ended 31 December 2014 from RUB22,093 million for the year ended 31 December 2013. The increase was due to sales growth and was generally in line with the 26.2% increase in revenue in the same period.

Gross profit

For the reasons described above, gross profit increased by RUB3,355 million, or 24.1%, to RUB17,263 million for the year ended 31 December 2014 from RUB13,908million for the year ended 31 December 2013.

Gross profit margin declined slightly to 38.0% in 2014 from 38.6% in 2013. This was largely due to Rouble depreciation and our strategy of offering competitive pricing on certain SKUs to drive number of tickets growth.

Selling, general and administrative expenses

The table below sets out our selling, general and administrative expenses by type for the years ended 31 December 2014 and 2013:

	Year ended 31 December		Rouble Change	% Change	% of Revenues Year ended 31 December	
	2014	2013			2014	2013
	(in millions of Roubles)				*(%)*	
Rent and utility	5,799	4,715	1,084	23.0	12.8	13.1
Payroll	5,217	4,492	725	16.1	11.5	12.5
Advertising and marketing expenses	782	567	215	37.9	1.7	1.6
Other	1,725	1,381	344	24.9	3.8	3.8
Total selling, general and administrative expenses	**13,523**	**11,155**	**2,368**	**21.2**	**29.7**	**31.0**

Selling, general and administrative expenses increased by RUB2,368 million, or 21.2%, in 2014 as compared to 2013, as a result of increases in payroll, rent and utility and advertising expenses in connection with the continued expansion of our retail chain. However, selling, general and administrative expenses declined as a percentage of sales to 29.7% in 2014 from 31.0% in 2013.

Rent and utility costs increased by RUB1,084 million, or 23.0%, in 2014 as compared to 2013, mostly due to new store openings during 2014, capped indexation rate in lease agreements (typically capped at 5-6% per year in rouble terms subject to negotiations with lessors) and increases in state-regulated utility tariffs. However, as a percentage of revenue, rent and utility costs declined to 12.8% in 2014 from 13.1% in 2013, as our retail network continued to mature and generate better sales per square metre and rent indexation was slower than revenue growth. Also, we signed a number of new long-term lease contracts with favourable extension options.

Payroll costs increased by RUB725 million, or 16.1%, in 2014 as compared to 2013, largely due to hiring employees for new stores. As a percentage of revenue, payroll costs declined to 11.5% in 2014, as compared to 12.5% in 2013, largely due to reduction of headcount at the head of office and headcount per store by introducing further automation of cashier operations and stock-taking activities. As of 31 December 2014, the total number of employees increased to 7,782 from 7,042 as at 31 December 2013. Headcount per Detsky Mir store declined to 24 employees in 2014 as compared to 26 employees in 2013, as a result of these operational improvements.

Advertising and marketing expenses increased by RUB215 million, or 37.9%, in 2014 as compared to 2013. As a percentage of revenue, advertising and marketing expenses marginally increased to 1.7% in 2014 from 1.6% in 2013.

Other expenses, including bank fees, repairs and maintenance, materials used for sales, security and other auxiliary expenses, increased by RUB344 million, or 24.9%, in 2014 as compared to 2013, largely due to fines for cancellation of orders from luxury good suppliers of RUB120 million and RUB48 million write-off of accounts receivable as a result of the Group's decision to discontinue luxury retail operations and dispose of the Yakimanka Gallery.

Depreciation and amortization

Depreciation and amortisation costs increased by RUB106 million, or 16.7%, in 2014 as compared to 2013. As a percentage of revenue, depreciation and amortisation costs was 1.6% in 2014 and 1.8% in 2013. The increase in 2014 was mostly due to an increase in capitalised costs associated with new store openings.

Interest income and expense

Interest income for the year ended 31 December 2014 increased to RUB56 million from RUB11 million for the year ended 31 December 2013. The increase was primarily due to an increase in the interest payments secured from a loan issued by the Group to CJSC "DM-Finance" in 2013.

Interest expense for the year ended 31 December 2014 increased by RUB400 million, or 77.2%, to RUB918 million from RUB518 million for the year ended 31 December 2013. The increase was primarily due to increased debt levels and increased interest rates in 2014. The weighted average interest rate on our indebtedness was 12.3% as at 31 December 2014, as compared to 9.6% as at 1 January 2014.

Foreign exchange loss

During the year ended 31 December 2014 we incurred a net foreign exchange loss of RUB582 million as compared to RUB58 million for the year ended 31 December 2013. The significant increase was primarily due to the increased losses recognised on the revaluation of liabilities denominated in foreign currency, predominantly accounts payable, as the rouble depreciated against the U.S. dollar during the period.

Income tax expense

We pay corporate tax in Russia and Kazakhstan at the statutory rate of 20%, however, in 2014 and 2013 our effective tax rate (income tax expense as a percentage of income before income tax expense) was higher at 25.1% and 26.7%, respectively, due to certain non-deductible tax expenses, such as shrinkage of inventory.

Total income tax expense increased by RUB265 million in 2014 as compared to 2013 due to our income before income tax expense increasing from RUB1,572 million for the year ended 31 December 2013 to RUB2,726 million for the year ended 31 December 2014.

Liquidity and Capital Resources

Our historical liquidity needs have arisen primarily from the necessity to finance capital expenditures for the maintenance and expansion of our retail network. In the past, we financed the expansion of our operations primarily via cash flow from operations, domestic bank borrowings, and domestic bond issuances. We plan to continue to finance our future capital requirements through a mixture of cash flows from operating and financing activities, including domestic and international bank borrowings and bond issuances. Our ability to generate cash from our operations will depend on our future operating performance, which in turn depends, to some extent, on general economic, financial, competitive, market, regulatory and other factors, many of which are beyond our control.

Cash Flow

Nine Months Ended 30 September 2016 and 2015 (prepared under IFRS)

The table below summarises our cash flow for the nine month periods ended 30 September 2016 and 2015:

	Nine months ended 30 September	
	2016	2015
	(*in millions of Roubles*)	
Consolidated Cash Flow Data		
Net cash received from / (used in) operating activities	1,538	(3,058)
Net cash received from / (used in) investing activities	3,955	(4,355)
Net cash (used in) / received from financing activities	(6,972)	7,556

Net cash received from/(used in) operating activities

Net cash received from operating activities during the nine month period ended 30 September 2016 was RUB1,538 million compared to net cash used in operating activities of RUB3,058 million during the nine month period ended 30 September 2015. This change was primarily due to a RUB2,928 million increase in cash received from operations mainly as a result of RUB1,028 million increase in the Group's net profit, a RUB2,153 decrease in trade receivables and a RUB1,004 million increase in advances paid and other receivables, which were partially offset by a RUB799 million increase in inventories.

Net cash received from/(used in) investing activities

Net cash received from investing activities during the nine month period ended 30 September 2016 was RUB3,955 million compared to net cash used in investing activities of RUB4,355 million during the nine month period ended 30 September 2015. In the nine months ended 30 September 2016, net cash was used mostly as follows: RUB749 million used for purchase of property, plant and equipment related to store openings and RUB196 million for payments for intangible assets such as IT licenses and the cost of their implementation. The net cash inflow in the nine months ended 30 September 2016 principally reflected the repayment by CJSC "DM-Finance" of the loan in the amount of RUB 4,875 million.

Net cash (used in)/received from financing activities

The amount of net cash used in financing activities for the nine month period ended 30 September 2016 was RUB6,972 million compared to cash received from financing activities of RUB7,556 million for the nine month period ended 30 September 2015. The net cash outflow in the nine months ended 30 September 2016 principally reflected the repayment of existing borrowings of RUB18,927 million, which was offset by the receipt of borrowings of RUB13,570 million.

Years Ended 31 December 2015 and 2014 (prepared under IFRS)

The table below summarises our cash flow for the years ended 31 December 2015 and 2014:

	Year ended 31 December	
	2015	2014
	(*in millions of Roubles*)	
Consolidated Cash Flow Data		
Net cash (used in)/generated by operating activities	(679)	1,492
Net cash used in investing activities	(5,218)	(2,646)
Net cash generated by financing activities	6,160	1,964

Net cash (used in)/generated by operating activities

Net cash used in operating activities during the year ended 31 December 2015 was RUB679 million compared to net cash generated by operating activities of RUB1,492 million during the year ended 31 December 2014. This change was primarily due to a RUB1,067 million decrease in the Group's net profit, RUB4,167 million increase in inventories, offset by RUB1,135 million increase in finance expenses and RUB3,494 million increase in trade payables.

Net cash used in investing activities

Net cash used in investing activities during the year ended 31 December 2015 increased by RUB2,572 million to RUB5,218 million compared to RUB2,646 million for the year ended 31 December 2014. The increase was primarily due to a RUB3,012 million increase in capital expenditures in connection with the commissioning of our distribution centre in Bekasovo and store openings.

Net cash generated by financing activities

The amount of net cash generated by financing activities for the year ended 31 December 2015 was RUB6,160 million compared to cash generated by financing activities of RUB1,964 million for the year ended 31 December 2014. The net cash inflow in 2015 principally reflected the receipt of borrowings of RUB36,746 million, which was partially offset by the repayment of existing borrowings of RUB27,783 million.

Years Ended 31 December 2014 and 2013 (prepared under US GAAP)

The table below summarises our cash flow for the years ended 31 December 2014 and 2013:

	Year ended 31 December	
	2014	2013
	(*in millions of Roubles*)	
Consolidated Cash Flow Data		
Net cash provided by operating activities	1,492	2,025
Net cash used in investing activities	(2,646)	(750)
Net cash generated by /(used in) financing activities	1,964	(2,047)

Net cash provided by operating activities

Net cash provided by operating activities during the year ended 31 December 2014 decreased by RUB533 million to RUB1,492 million compared to RUB2,025 million for the year ended 31 December 2013. This decrease was primarily due to a RUB846 million increase in inventories, offset by a RUB890 million increase in net profit.

Net cash used in investing activities

Net cash used in investing activities during the year ended 31 December 2014 increased by RUB1,896 million to RUB2,646 million compared to RUB750 million for the year ended 31 December 2013. This increase was primarily due to a RUB2,158 million loan granted to CJSC "DM-Finance", a subsidiary of Sistema, partially offset by RUB1,440 million proceeds from sale of the building occupied by the Yakimanka Gallery.

Net cash generated by / (used in) financing activities

The amount of net cash generated by financing activities for the year ended 31 December 2014 was RUB1,964 million compared to net cash used in financing activities of RUB2,047 million for the year ended 31 December 2013. The net cash inflow in 2014 principally reflected the receipt of borrowings of RUB19,211 million, which was offset by repayment of existing borrowings of RUB15,392 million.

The net cash outflow in 2013 principally reflected the repayment of existing borrowings of RUB10,875 million and repurchase of own shares from Sberbank for RUB4,542 million, which was offset by the receipt of borrowings of RUB13,791 million.

Capital Expenditures

We made capital expenditures of RUB945 million, RUB5,308 million, RUB1,945 million and RUB772 million in the nine months ended 30 September 2016 and the years ended 31 December 2015, 2014 and 2013, respectively. We funded these capital expenditures in part from cash from operations and in part through bank borrowings. During the nine months ended 30 September 2016 and the years ended 31 December 2015, 2014 and

2013, our capital expenditures were 1.7%, 8.8%, 4.3% and 2.1% of our total revenues, respectively. The IFRS and US GAAP numbers noted herein are comparable on the basis that there were no accounting policy differences impacting these line items.

During the periods under review, our capital expenditures comprised construction costs for our distribution centre in Bekasovo (which accounted for approximately 54% of capital expenditure (cash spending) in 2015), new store openings (which accounted for approximately 26% in 2015) and maintenance and IT costs (which accounted for approximately 20% in 2015).

Our future capital requirements mainly comprised the following:

- Opening of new Detsky Mir stores: We expect to open approximately 250 new Detsky Mir stores during the period of 2017-2020, including approximately 70 new Detsky Mir stores in 2017. In 2017, the expected capital expenditure for a standard Detsky Mir store opening is approximately RUB13 million (in 2016 prices), which is based on a store with an average selling space of approximately 1,050 square metres and average total space of approximately 1,280 square metres. The capital expenditure for a Detsky Mir store depends, among other factors, on the store's location and size category; for example, the capital expenditure to open a flagman Detsky Mir store in the centre of Moscow or other prime locations might be significantly higher than the capital expenditure for a standard store.
- Further investment in distribution centre in Bekasovo: In 2017, we plan to invest approximately RUB400 million (excluding VAT) in the installation of additional equipment in the distribution centre.
- Upgrade of IT system: In 2017, we plan to invest approximately RUB200 million in the implementation of SAP Hybris e-commerce platform.
- Capital expenditure in relation to potential construction of a new distribution centre in the Urals: we intend to evaluate options, in particular with respect to owning as opposed to renting of this new distribution centre, and plan make a final decision in the first half of 2017.

The amount and timing of our future capital requirements may differ materially from our current estimates for various reasons, many of which are beyond our control. As in the past, we plan to finance our capital expenditures primarily through operating cash flows and through banking debt, and, accordingly, our ability to make these capital expenditures in the future will primarily depend on our ability to maintain adequate operating cash flows and on our ability to obtain adequate external financing. Our ability to generate cash from our operations depends on our future operating performance, which is in turn dependent on general economic, financial, competitive, market, regulatory and other factors, including those discussed under "*Risk Factors*", while our ability to obtain external financing depends on numerous factors, including but not limited to our financial performance and creditworthiness, as well as our relationships with lenders. If our future cash flows from operations and other capital resources are insufficient to fund our planned capital expenditures, we may be forced to reduce or delay our capital expenditures.

Indebtedness

As at 30 September 2016, 31 December 2015 and 2014 and 1 January 2014, we had indebtedness in the amount of RUB13,002 million, RUB18,359 million, RUB9,716 million and RUB5,922 million, respectively. As at 30 September 2016, we had unused credit lines of RUB11,913 million. The weighted average interest rate on our indebtedness declined to 12.5% as at 30 September 2016 from 14.3% as at 30 September 2015.Our Net Debt was RUB12,547 million, RUB16,425 million, RUB8,046 million and RUB5,062 million as at 30 September 2016, 31 December 2015 and 2014 and 1 January 2014. As at 30 September 2016, all our indebtedness was denominated in Roubles and provided by five Russian banks. Our material financing facilities bear floating interest rates within a range from 10.5% p.a. to 12.9% p.a.

Certain of our credit facilities contain covenants requiring the Company to provide a creditor with prior or post written notification or obtain its written consent in respect of changes in the Group's corporate and shareholding structure. In particular, failure to notify or receive written consent if there is a decrease of Sistema Group's total direct and indirect shareholding below 50%+1 voting shares in the share capital of the Company or to provide post-notification in case of changes in the shareholding structure of more than 20% of the Company's charter capital, may lead to default under several of our credit facilities. In addition, a failure by the Company to comply with certain non-monetary obligations, such as regular reporting, may trigger cross-default provisions contained in the credit facilities. Certain of our credit facilities contain covenants requiring us to meet certain financial ratios, and failure by the Company to comply with financial ratios may, among others, restrict our ability to pay dividends without prior written consent of the creditors.

See Note 13 of the Interim Financial Statements.

Off-Balance Sheet Arrangements

We do not have off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our financial condition, sales, expenses, results of operations, liquidity, capital expenditures, or capital resources.

Commitments and Contingencies

Operating Leases

We lease retail space through operating lease contracts which expire in various years through 2023, all of which are classified as operating leases. Future minimum retail payments (without VAT) under non-cancellable operating leases in effect as at 30 September 2016, 31 December 2015 and 2014 and 1 January 2014 are as follows (all numbers IFRS):

	As at 30 September 2016	As at 31 December 2015	As at 31 December 2014	As at 1 January 2014
		(*in millions of Roubles*)		
Within one year	7,439	6,448	6,963	5,203
After one year but not more than five years	36,636	32,806	31,198	23,395
More than five years	11,056	9,490	8,746	6,508
Total	**55,131**	**48,744**	**46,907**	**35,106**

Taxation

Laws and regulations affecting businesses in the Russian Federation continue to change rapidly. These changes are characterised by different interpretations and arbitrary application by the authorities. Our management's interpretation of such legislation as applied to the activity of the Group may be challenged by the relevant regional and federal authorities. The tax authorities in the Russian Federation frequently take an assertive position in their interpretation of the legislation and assessments and as a result, it is possible that transactions and activities may be challenged. It is therefore possible that significant additional taxes, penalties and interest may be assessed. Under certain circumstances reviews may cover longer periods. Where uncertainty exists, the Group has accrued tax liabilities as management's best estimate of the probable outflow of resources which will be required to settle such liabilities. Our management believes that it has provided adequately for tax liabilities based on its interpretations of tax legislation. However, the relevant authorities may have differing interpretations, and the effects could be significant.

Quantitative and Qualitative Disclosure on Market and Other Risks

The main risks inherent to the Group's operations are those related to liquidity risk, credit risk, fluctuations in foreign exchange rates and market movements in interest rates, each of the risks is summarised below. A detailed description of the main risks is set out in Note 27 to the 2015 Annual IFRS Financial Statements.

Significant Accounting Policies

A detailed description of the main accounting policies used in preparing the Financial Statements is set out in Note 4 to the 2015 Annual IFRS Financial Statements and Note 2 to the Interim Financial Statements.

Critical Accounting Estimates and Judgements

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

A detailed description of certain of the critical accounting estimates and judgements used in prepared the Financial Statements is set out in Note 5 to the 2015 Annual IFRS Financial Statements.

Recent Accounting Pronouncements

Recent accounting pronouncements are described in Note 3 to the 2015 Annual IFRS Financial Statements and Note 2 to the Interim Financial Statements.

THE RUSSIAN CHILDREN'S GOODS RETAIL SECTOR

We principally operate in the Russian children's goods market through our network of specialised stores as well as our online channel and compete with other specialised retailers, hypermarkets and supermarkets, e-commerce players and the non-organised, traditional retailers. We are active in all five main product categories in the market, encompassing toys, products for newborns, fashion (apparel and footwear), large items and other (including stationery). In addition to our operations in Russia, we are also present in Kazakhstan.

Russian economy

According to the IMF, Russia is the 12th largest economy in the world and the 4th largest in Europe with a total GDP of approximately USD1.3 trillion in 2015. Due to favourable dynamics in oil and other commodities prices as well as an overall benign macroeconomic climate in 2010-2014, Russia's real GDP grew at a 2.4% CAGR and gross incomes of Russian households grew at a nominal CAGR of 10.9%, ahead of inflation, resulting in a period of relatively high consumer confidence.

In 2014, the slump in commodity prices amplified by economic sanctions imposed by the United States, Canada, the EU and other European countries triggered an economic crisis in Russia, which led to a reduction in disposable income and consumer spending in real terms (although both categories increased in rouble terms, due to the significant depreciation of the rouble as a result of the crisis), and also triggered an increase in the unemployment rate. The devaluation of the Russian currency over the same period contributed to a sharp increase in consumer inflation, which reached 12.9% in year-on-year terms in 2015. As a result, according to IMF estimates, in 2015 Russia's nominal (in rouble terms) GDP increased by 3.7% while real GDP contracted by 3.7%. Nevertheless, according to national accounts prepared by Rosstat, total consumption by Russian households reached RUB43.3 trillion in 2015 compared to RUB20.0 trillion in 2008, implying an above-inflation CAGR of 11.7% over the period. According to Rosstat's quarterly bulletin on "Household Income, Expenditure and Consumption", the average monthly consumer spending per member of a household has increased at 8.7% CAGR over 2008-2015. Furthermore, according to the IMF, the economy is expected to stabilise with real GDP growth resuming from 2017 onwards and inflation stabilising at approximately 4% from 2018 onwards.

Below is a summary of certain key macroeconomic factors that affect Russia's consumer consumption profile:

	Year ended 31 December								
Key macroeconomic factors	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR (2008-2015)**
Population, million	142.7	142.9	142.9	143.1	143.3	143.7	146.3	146.5	0.4%
Annual GDP per capita (RUB)	309,875	291,327	347,565	416,853	467,081	495,348	543,439	563,265	8.9%
Real GDP growth year-on-year (%)	5.2	(7.8)	4.5	4.0	3.5	1.3	0.7	(3.7)	—
Nominal GDP growth year-on-year in rouble terms (%)	24.2	(6.0)	19.3	20.0	12.1	6.1	9.8	3.7	—
Consumer price index year-on-year (%)	13.3	8.8	8.8	6.1	6.6	6.5	11.4	12.9	—
Average unemployment rate (%)	6.2	8.3	7.3	6.5	5.5	5.5	5.2	5.6	—
Average monthly salary per capita (RUB)	17,290	18,638	20,952	23,369	26,629	29,792	32,495	34,030	10.2%
Average monthly gross disposable income per member of a household (RUB)	10,661	11,640	13,425	15,053	16,734	18,690	20,296	21,459	10.5%
Average monthly consumer spending per member of a household (RUB)	8,217	8,687	10,122	11,286	12,624	13,707	14,630	14,764	8.7%
Year end Brent crude oil price (U.S. dollar per barrel)	45.6	77.9	94.8	107.4	111.1	110.8	57.3	37.3	—
Average exchange rate(1) (RUB per U.S. dollar)	24.9	31.7	30.4	29.4	31.1	31.8	38.4	61.0	—

Source: Rosstat, IMF WEO October 2016, CBR, Bloomberg

(1) The average rates are calculated as the average of the daily exchange rates on each business day (which rate is announced by the CBR for each such business day) and on each non-business day (which rate is equal to the exchange rate on the previous business day).

During the last decade the overall increase in personal income in Russia has led to a growing share of consumers' disposable income allocated to the purchase of non-food products. According to Rosstat, the share of non-food spending in total consumer spending has increased from 64.0% in 2004 to 71.5% in 2014.

Children demographics

In 2015 Russia's total population of children (0-12 years of age) reached approximately 22.2 million compared to approximately 17.5 million in Turkey, 10.8 million in France and 9.8 million in the United Kingdom, making it the largest children population in Europe. Russia's children population grew at a CAGR of 2.8% over the period of 2008-2015, surpassing a range of major developed and emerging countries and, as projected by Rosstat in its mid-case scenario, is expected to continue growing over the next five years with a 1.4% CAGR (i.e. the number of newborns is projected to exceed number of children reaching age of 13 in each year within the period). Despite a larger children population and faster growth rates compared to some of the other European countries, Russia's share of children in the total population remains significantly below other nations and reached just 15.2% of population compared to approximately 22.0% in Turkey, 19.9% in Brazil and 16.2% in France.

The table below sets forth the children population by country in 2015:

	2015			
Children (0-12 years old) population by country	**Children population, in millions**	**Share as % of total population**	**Children population CAGR (%) (2008-2015)**	**Children population CAGR (%) (2015-2020F)**
India	304.6	24.3	(0.1)	(0.2)
China	203.1	14.9	(0.4)	0.7
United States	52.7	16.4	0.1	0.2
Brazil	40.6	19.9	(1.1)	(1.2)
Russia	**22.2**	**15.2**	**2.8**	**1.4**
Turkey	17.5	22.0	(0.1)	(1.1)
France	10.8	16.2	0.4	0.0
United Kingdom	9.8	15.3	0.7	0.6
Germany	8.9	11.0	(1.1)	0.1
Poland	4.9	12.8	0.1	0.0
Kazakhstan	**4.1**	**22.8**	**2.8**	**1.2**

Source: Rosstat, U.S. Census Bureau

The high growth rates of the children population in Russia are explained by the low birth rates following the demographic trough in the 1990s, which saw birth rates decrease more than 40% by 2000 compared to the 1980s. The birth rates improved in the early 2000s as the political, economic and social environment stabilised, however the ageing of the population coupled with low life expectancy continued to weigh down on the replacement rate.

The table below sets forth Russia's demographic dynamics for the years indicated:

	Year ended 31 December											
Russia's demographic dynamics	**1980**	**1990**	**2000**	**2005**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**
Birth rate (births per 1,000 of population)	15.9	13.4	8.7	10.2	12.0	12.3	12.5	12.6	13.3	13.2	13.3	13.3
Death rate (deaths per 1,000 of population)	11.0	11.2	15.3	16.1	14.5	14.1	14.2	13.5	13.3	13.0	13.1	13.0
Rate of natural increase	4.9	2.2	(6.6)	(5.9)	(2.5)	(1.8)	(1.7)	(0.9)	0.0	0.2	0.2	0.3
Fertility rate (children per woman)	1.90	1.89	1.20	1.29	1.50	1.54	1.57	1.58	1.69	1.71	1.75	1.78

Source: Rosstat

In 2007 the Russian government launched a comprehensive demographic programme aimed at stabilising population within the range of 142-143 million people by 2016 with a further growth target of 145 million by 2025. In order to increase birth rates the government launched several pro-natalist programmes, including:

Maternity capital. Launched in January 2007, this programme offers financial compensation for a second or subsequent born or adopted child. The funds, generally, can be spent on family housing, the child's education or be transferred to the mother's pension savings. The "maternity capital" payment had been increasing between 2007-2015 and amounted to RUB453 thousand for the year 2015 compared to RUB250 thousand in 2007 (2007-2015 CAGR of 7.7%). The "maternity capital" payment for 2016 and 2017 remains unchanged since 2015. Besides this federal programme, select regions (including Moscow and Moscow Region, St Petersburg and Leningrad Region, and others) provide additional local "maternity capital" compensation for each third or subsequent child in the amount of approximately RUB100 thousand, allowing a wider use of funds (e.g. payments can be used for a car purchase or the child's medical treatment). Payments under the maternity capital programme are currently envisaged until 2020.

Young family. This federal programme subsidises house purchases for new families (where both spouses are below 35 years old). The government provides 30% of the calculated (according to programme's regulations) house price for childless families and 35% for families with children. The funds may be used for house purchases as well as construction, mortgage down-payments or prepayments.

Benefits for large families. This programme comprises a range of discounts and benefits from government bodies (kindergartens, schools, clinics, museums, etc.) provided to families with three or more children, as well as free travel on public transport and discounts on utility payments. Benefits are provided on both federal and regional levels.

Federal and regional subsidies. Government subsidies include prenatal allowance, lump-sum remuneration for childbirth, monthly child-care allowance, and lump-sum remuneration for the adoption of a child. These subsidies are paid from the social security fund as well as from federal and regional budgets. In addition to subsidies granted under federal law, most regions and cities pay additional allowances and low-income families are eligible for further subsidies.

Fueled by economic recovery as well as the above incentives, Russia saw a gradual growth in fertility rates which reached 1.78 children per woman in 2015 compared to just 1.20 in 2000, according to Rosstat data. Since the start of the maternity capital programme, the children population has increased from approximately 18.2 million in 2008 to approximately 22.2 million in 2015 which represents a 2008-2015 CAGR of 2.8%. The share of children in the total population has increased from 12.8% in 2008 to 15.2% in 2015.

The table below sets forth the number of children in Russia broken down by age group for the years indicated:

Russia's children population, by age group	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR (%) (2008-2015)**
(% share in total)									
Children 0-4	5.4	5.6	5.6	5.9	6.1	6.2	6.3	6.5	
Children 5-9	4.7	4.8	5.0	5.1	5.2	5.3	5.5	5.6	
Children 10-12	2.7	2.7	2.8	2.8	2.8	2.9	3.0	3.1	
Children 0-12	**12.8**	**13.1**	**13.4**	**13.7**	**14.1**	**14.4**	**14.8**	**15.2**	
(in thousands)									
Children 0-12	**18,245**	**18,674**	**19,200**	**19,585**	**20,210**	**20,754**	**21,676**	**22,207**	**2.8**

Source: Rosstat

Supported by increasing birth rates, the category of children aged 0-4 years has seen the most prominent growth in recent years with its share of the total population increasing from 5.4% in 2008 to 6.5% in 2015. As at 31 December 2015, children aged 0-4 years accounted for approximately 43% of the overall children's population, children aged 5-9 years accounted for approximately 37% and children aged 10-12 years accounted for approximately 20%. According to Rosstat, as of 1 January 2016 the distribution of Russia's children population by age was as follows:

As at 1 January 2016

	Number of children		
Distribution of Children's Population by Age	**Total**	**Male**	**Female**
Age			
0	1,931,054	992,631	938,423
1	1,930,684	992,745	937,939
2	1,912,981	982,094	930,887
3	1,920,333	987,077	933,256
4	1,816,734	933,446	883,288
5	1,693,235	868,774	824,461
6	1,714,255	879,180	835,075
7	1,706,443	873,149	833,294
8	1,615,070	828,099	786,971
9	1,489,208	762,466	726,742
10	1,492,848	762,270	730,578
11	1,499,960	767,742	732,218
12	1,483,771	760,081	723,690
Total	**22,206,576**	**11,389,754**	**10,816,822**

Source: Rosstat

At current birth rates, the number of children leaving the 12 year-old age group is lower than the number of children born in the same year, driving a projected growth rate of the children population of 1.4% CAGR 2015-2020F (according to Rosstat), which is ahead of corresponding growth rates of some of the largest developed and emerging countries (as estimated by the U.S. Census Bureau).

Russian children's goods market overview

The children's goods market comprises toys, apparel, footwear, products for newborns (including large items, or durable juvenile products) and stationery for children aged 0-12 years. The market experiences seasonality with peaks in September with "back to school" products and during winter holidays in December with New Year gifts.

Ipsos Comcon estimates the size of the Russian market in terms of retail sales (including 10% VAT) of these goods in cities with a population of over 100,000 people (see detailed definitions by products in "*—Russian children's goods market structure: product segments*"). According to Ipsos Comcon estimates, the retail sales of children's goods reached RUB515.7 billion in 2015 compared to RUB303.8 billion in 2008, resulting in a CAGR of 7.9% for the period. The market continued growing in nominal terms throughout the 2008/2009 and 2014/2015 recessions.

The table below sets forth the dynamics of the Russian children's goods market for the years indicated:

Russian children's goods market	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR (2008-2015)**
Value sales (in RUB billions)	303.8	331.2	347.6	395.7	437.3	486.6	500.5	515.7	7.9%
Year-on-year growth		9.0%	5.0%	13.8%	10.5%	11.3%	2.8%	3.0%	—
Value sales per capita (in RUB)	4,322	4,708	4,893	5,544	6,074	6,718	6,869	6,972	7.1%
Year-on-year growth		8.9%	3.9%	13.3%	9.6%	10.6%	2.2%	1.5%	

Source: Ipsos Comcon

Children's goods sales have demonstrated strong resilience during the recessions of 2008/2009 and 2014/2015 with year-on-year Rouble growth reaching 9.0% and 3.0%, respectively. This compares favourably against the performance of other consumer categories: consumer electronics suffered the most in both periods with decreases of 17.8% and 14.1% respectively. Apart from children's goods, FMCG was another category that continued to grow in spite of adverse macroeconomic conditions.

The table below sets forth the consumption dynamics by category in Russia for the years indicated:

Consumption dynamics by category in Rouble terms (Russia)	2008-2009, % change	2014-2015, % change
Consumer electronics	(17.8)	(14.1)
DIY	(12.5)	(4.9)
Real GDP	(7.8)	(3.7)
Furniture	(6.4)	(10.0)
Fashion	+2.3	(5.6)
Children's goods	**+9.0**	**+3.0**
FMCG	+9.3	+8.3

Source: Ipsos Comcon

Ipsos Comcon estimates that the Russian children's goods market will continue to grow in the mid-term (in nominal terms) due to the following factors:

- Continued increase in the children's population (see "—*Children demographics*");
- Continued prioritisation of spending on children's goods:
  - higher level of parents' education and wider Internet access driving more conscious consumer choices;
  - mothers better prepared for childbirth and fathers more actively participating in children's upbringing;
- Ongoing development of the retail channel: growth in specialised retail, hypermarket and online channels;
- Growth limited by setback in real incomes, trends in consumer inflation and consumer spending.

According to Ipsos Comcon estimates, the Russian children's goods market is set to reach RUB554.4 billion by 2020F which represents a CAGR (2015-2020F) of 1.5%. The table below sets forth the Russian children's goods market forecast for the years indicated:

Russian children's goods market forecast	2015	2016F	2017F	2018F	2019F	2020F	CAGR (2015-2020F)
Value sales (in Rouble billions)	515.7	519.5	527.6	536.0	545.2	554.4	1.5%
Year-on-year growth	3.0%	0.7%	1.6%	1.6%	1.7%	1.7%	—

Source: Ipsos Comcon

Russian children's goods market structure: product segments

Ipsos Comcon differentiates five core product segments comprising the children's goods market:

- *Childrenswear:* articles of clothing/apparel for babies, toddlers and children up to 12 years old. Includes all types of garments: bodysuits, dresses, skirts, trousers & shorts, jackets and coats, jumpers, leggings, tops, sleepwear, underwear, swimwear and hosiery. Nappies (diapers) disposable or cloth, are excluded (collectively, "**apparel**");
- *Children's footwear:* Includes all footwear for children up to 12 years old. This covers baby footwear (pram footwear and booties) as well as boy and girl's footwear, trainers (sneakers), boots, school footwear and slippers (collectively, "**footwear**");
- *Products for newborns:* Baby food, nappies (diapers), diapers and pants, baby care, feeding accessories, prams, strollers and developing goods, car seats, playpens and highchairs (collectively, "**newborns**");
- *Toys and games:* Aggregation of baby (0-18 months), infant (19-36 months), pre-school (3-4 years), construction, arts & crafts, scientific/educational, dressing up and role play, dolls and accessories, action figures & accessories, plush, model vehicles, radio/remote control toys, games and puzzles, outdoor & sports toys, ride-on vehicles and other traditional toys and games, which do not involve a video game component. The category includes electronic role-playing toys (e.g. toy telephones and mobile phones, TVs, steering wheel/driving activity sets, and radios), electronic learning and development toys (e.g. flash cards, magnetic letters, and other toys teaching basic literacy and numeracy) and pre-school computerised toys (e.g. computers for children of pre-school age, featuring educational activities and games) (collectively, "**toys**");
- *Stationery:* Books and school goods (including stationery products) for children (collectively, "**stationery**").

The apparel and footwear segments have historically together represented the largest market category amounting to a combined share of 42% of the total market in value terms (32% for apparel and 10% for footwear) in 2015. They are followed by the newborns and toys segments representing approximately 24% and 21% of the total market, respectively, with stationery being the smallest segment amounting to 13% of the market in 2015. In value terms, apparel represents not only the largest, but also the fastest growing market segment historically: total segment value reached RUB165 billion in 2015 compared to RUB103 billion in 2010 implying a CAGR of 10.0%. However, the newborns segment, which accounted for RUB123 billion in 2015, is projected to lead market growth in the near future at a 2015-2017F CAGR of 7.0%. This compares favorably against all other segments as the projected CAGRs for the same period are (3.2%) for apparel, 0.6% for footwear, 1.1% for stationery and 1.0% for toys. According to Ipsos Comcon, the newborns segment is one of the most resilient product categories, while apparel and footwear are experiencing a shift towards lower-price market price in the aftermath of the 2014/2015 financial crisis.

The table below sets forth the Russian market breakdown by segments for the years indicated:

Russian market breakdown by segments, value terms	2010	2011	2012	2013	2014	2015	2016F	2017F	CAGR (2010-2015)	CAGR (2015-2017F)
Total value, RUB billions										
Apparel	102.6	114.9	135.7	157.3	163.4	165.4	154.8	155.1	10.0%	(3.2%)
Footwear	36.6	38.6	40.6	46.9	47.9	52.3	52.4	53.0	7.4%	0.6%
Toys	84.2	103.2	109.8	114.5	106.8	109.8	111.0	112.0	5.4%	1.0%
Newborns	81.5	89.5	96.4	108.9	119.4	123.4	135.6	141.1	8.6%	7.0%
Stationery	42.7	49.6	54.8	59.1	63.0	64.9	65.7	66.4	8.7%	1.1%
Total	**347.6**	**395.7**	**437.3**	**486.6**	**500.5**	**515.7**	**519.5**	**527.6**	**8.2%**	**1.1%**
% of total market										
Apparel	29.5	29.0	31.0	32.3	32.6	32.1	29.8	29.4	—	—
Footwear	10.5	9.7	9.3	9.6	9.6	10.1	10.1	10.0	—	—
Toys	24.2	26.1	25.1	23.5	21.3	21.3	21.4	21.2	—	—
Newborns	23.4	22.6	22.1	22.4	23.9	23.9	26.1	26.8	—	—
Stationery	12.3	12.5	12.5	12.2	12.6	12.6	12.7	12.6	—	—

Source: Ipsos Comcon

Note: percentages may not sum up to 100% due to rounding

Russian children's goods market structure: geography

Sales of children's goods in Russia differ by regions due to differences in the populations of the regions as well as income levels. According to Ipsos Comcon's estimate for 2016, Moscow displayed the largest per capita spending on children's goods (RUB11,443) which was more than 60% higher than the average for all of Russia (RUB6,949). In total, spending in Moscow amounted to approximately 27% of purchases of children's goods in the country. Other large regions in terms of children's goods sales are Volga, Siberia and St. Petersburg which accounted for 15%, 12% and 11%, respectively, of the entire market in 2016F, respectively. Per capita incomes also substantially differ across Russia: according to Rosstat, Moscow had the highest level of income per capita of RUB59,567 in 2015, while Volga, Siberia and St. Petersburg regions had RUB26,188, RUB23,336 and RUB39,845, respectively. The Urals region had the third highest spending on children's goods per capita of RUB7,868.

The table below sets forth the breakdown of children's goods market by federal regions for 2016:

	Year ended 31 December 2016F	
Children's goods market by federal regions	% of total children's goods market	Per capita spending on children's goods per year, RUB
Moscow	27	11,443
St. Petersburg	11	11,053
North-West (excl. St. Petersburg)	2	4,253
Central (excl. Moscow)	10	4,400
Volga	15	5,243
Southern	11	6,124
Urals	9	7,868
Siberian	12	6,318
Far East	3	4,807
All Russia, cities 100,000+	**100**	**6,949**

Source: Ipsos Comcon

Note: South region includes North Caucasian District

Russian children's goods market structure: sales channels

Ipsos Comcon differentiates four key sales channels which comprise sales of children's goods in Russia and globally:

- *Specialised stores* comprise non-food specialty retailers and include multi-category players (e.g. diversified retailers offering a wide range of children's goods such as Detsky Mir, Korablik, Mothercare and Dochki-Synochki) and mono-category retailers (e.g. apparel retailers such as Sela or Gloria Jeans). Specialised stores accounted for approximately 40.8% in 2015 of the entire market (38.6% in 2016F)*;*
- *Hypermarkets* channel comprises modern food retail outlets and mainly consists of large stores (i.e. hypermarkets and supermarkets) which sell a range of children's products among their broader assortment. The assortment of children's goods is modest compared to specialty retailers and mainly includes products for newborns. Hypermarkets accounted for approximately 40.0% in 2015 of the overall market (39.1% in 2016 F);
- *Internet* represents children's goods ordered online (including domestic and international general online retailers, specialised online stores and online stores of offline retail chains). Internet sales accounted for approximately 8.1% of the market in 2015 (8.9% in 2016F);
- *Other* channel primarily comprises non-organised and traditional retail (open markets, kiosks, traditional grocery stores and other similar outlets), as well as catalogues, vending, home shopping and direct selling. This channel accounted for approximately 11.1% of the overall market in 2015 (13.6% in 2016F).

Traditionally non-organised retail outlets have been widespread in Russia and have historically been the dominant sales channel for the majority of goods categories, including children's goods. As a result, in 2010 the "Other" channel was the second largest sales channel of children's products with a 32.2% market share. However, with the development of the Russian economy and changing customer habits, growing personal incomes, increasing demand for wider product assortments and the proliferation of modern retail space similarly to the grocery market in Russia, this segment has been steadily losing market share and contracted to 13.6% of the market in 2016F. Specialised stores and hypermarkets have been the beneficiaries of this market transformation as customers gradually switched to these segments away from the "Other" channel. The share of the specialised sales channel increased from 34.3% in 2010 to 40.8% in 2015 and is expected to stay at approximately the same level of 40.4% in 2017F. The hypermarkets channel has also gained market share over the last six years from approximately 30.7% in 2010 to 39.1% in 2016F. The Internet channel, despite being the smallest, displayed the highest relative growth in market share (from 2.9% in 2010 to 8.9% in 2016F). Ipsos Comcon expects the Internet channel to continue to be the growth leader with 2017F market share of 9.3% driven by increasing Internet penetration in Russia and the growing propensity to shop online.

In value terms, sales of children's goods by specialised stores increased from RUB119 billion in 2010 to RUB200 billion in 2016F. The Internet channel posted the highest growth in relative terms and reached RUB46 billion in 2016F.

The table below sets forth the breakdown of the Russian children's goods market by sales channel for the years indicated:

Market breakdown by sales channel, RUB billions	2010	2011	2012	2013	2014	2015	2016F	2017F	CAGR (2010-2015)	CAGR (2015-2017F)
Total value, RUB billions										
Specialised stores	119.1	178.7	199.2	223.9	206.8	210.4	200.3	213.3	12.1%	0.7%
Hypermarkets	106.6	106.5	121.5	141.1	181.7	206.2	202.9	211.7	14.1%	1.3%
Internet	9.9	14.2	18.6	24.3	37.8	41.8	46.0	49.0	33.3%	8.3%
Other	112.0	96.2	97.9	97.3	74.2	57.4	70.4	53.7	(12.5%)	(3.3%)
Total	**347.6**	**395.7**	**437.3**	**486.6**	**500.5**	**515.7**	**519.5**	**527.6**	**8.2%**	**1.1%**
% of total market										
Specialised stores	34.3	45.2	45.6	46.0	41.3	40.8	38.6	40.4	—	—
Hypermarkets	30.7	26.9	27.8	29.0	36.3	40.0	39.1	40.1	—	—
Internet	2.9	3.6	4.3	5.0	7.6	8.1	8.9	9.3	—	—
Other	32.2	24.3	22.4	20.0	14.8	11.1	13.6	10.2	—	—

Source: Ipsos Comcon; absolute values calculated based on percentages provided in the report

Note: percentages may not sum up to 100% due to rounding

Sales channels overview

Specialised stores

According to Ipsos Comcon, specialised multi-category stores are the most popular retail channel for children's goods. Approximately 88% of customers have made purchases in specialised multi-category stores over the last 12 months, followed by hypermarkets / supermarkets (64% of customers made purchases). Sales channels such as non-specialised stores with children's section or pharmacies are less popular with 49% and 47%, respectively, of surveyed customers shopping there within the same period. Furthermore, approximately 59% of customers confirmed that they make purchases in the specialised multi-category stores most frequently, compared to just 19% opting to shop in hypermarkets / supermarkets and just 8% in specialised mono-category stores (i.e. stores where primarily one product category is sold). The table below sets out preferable children's goods shopping channels in Russia:

Preferable shopping channels in Russia	In which of these stores you made a purchase in the last 12 months?	Where do you shop most often?
Specialised multi-category stores	88%	59%
Hypermarkets / supermarkets	64%	19%
Non-specialised stores with children's section	49%	3%
Pharmacies	47%	1%
Specialised mono-category stores	43%	8%
Internet stores	43%	5%
Small convenience stores	42%	4%
HPC stores	39%	0%

Source: Ipsos Comcon

The popularity of specialised stores over other sales channels, including hypermarkets, is driven by specific customer preferences. According to Ipsos Comcon, affordable price is the most important factor determining choice of the shopping venue for children's products by the Russian consumer (voted for by 72% of customers).

The other essential factor is wide product assortment mentioned by 62% and specialised stores have a significant advantage in this area. Proximity to home, which primarily benefits food retailers, is only the third most popular factor, according to Ipsos Comcon, with 55% of votes. The table below sets forth factors affecting selection of children's goods purchasing place:

Factors affecting selection of purchasing place	Important factor
Affordable prices	72%
Extensive product assortment	62%
Store location	55%
Impressions from shopping	45%
Opportunity to order online	35%
Place for kids leisure / kids' corner	31%

Source: Ipsos Comcon

Internet

According to Internet World Stats, Russia is the country with the largest number of internet users in Europe with approximately 103.1 million users as of June 2016. The growing Internet penetration since 1990s has led to rapid proliferation of the domestic e-commerce market, which also includes sales of children's goods.

According to Statista, the overall online sales channel in Russia is currently at an emerging state and is significantly underdeveloped compared to the majority of developed markets. As of 30 June 2015, just 2.4% of total retail sales in Russia were generated via Internet compared to 15.9% in China and 15.2% in the United Kingdom.

Share of online sales in total retail market, % (2015)	Share of online sales
China	15.9%
United Kingdom	15.2%
Germany	11.6%
France	8.0%
US	7.3%
Russia	**2.4%**

Source: Statista

The Internet sales channel for children's goods includes specialised online stores (esky.ru, akusherstvo.ru, mytoys.ru and others), general e-commerce players (ozon.ru, ulmart.ru, wildberries.ru and others) and online stores of specialised offline retailers (Detsky Mir, Korablik, Mothercare and others).

Over the last seven years, the Internet channel has been steadily growing and reached 8.1% of the overall children's goods market in 2015 compared to just 1.5% in 2008. In value terms, online sales of children's goods reached RUB42 billion in 2015, representing a 7-year CAGR of 36.7%. The growth of online channel was driven by increasing Internet penetration in Russia as well as online shopping attractions: wider assortment compared to offline stores, time and convenience, immediate price comparison, ability to get rare goods to remote locations.

Ipsos Comcon estimates that online sales of children's products in Russia will continue growing and will reach approximately RUB49 billion in 2017F (9.3% of the total market) implying a CAGR (2015-2017F) of 8.3%.

Online sales of children's goods in Russia, RUB billions	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**2016F**	**2017F**	**CAGR (2008-2015)**	**CAGR (2015-2017F)**
Online sales of children's goods in Russia	4.7	7.3	9.9	14.2	18.6	24.3	37.8	41.8	46.0	49.0	36.7%	8.3%
Year-on-year growth	—	56.5%	35.4%	43.8%	30.8%	30.6%	55.5%	10.4%	10.1%	6.5%	—	—
Share of online sales channel in total market	1.5%	2.2%	2.9%	3.6%	4.3%	5.0%	7.6%	8.1%	8.9%	9.3%	—	—

Source: Ipsos Comcon

According to Ipsos Comcon, the online market for children's goods in Russia is currently highly fragmented with a large number of small online-only stores. We became the leader among specialised e-commerce stores in the first half of 2016 with a 5.9% market share. In 2015 we were the fourth largest specialised e-commerce store in children's goods segment.

Our management believes that general e-commerce players have lower online sales volumes than us in children's goods categories.

	Leading specialised players in the children's goods e-commerce segment(1)	**Online sales volume, RUB million including VAT (January-June, 2016)**	**Market Share (%)**
1	**Detmir.ru**	**1,260**	**5.9**
2	Esky.ru	850	4.0
3	Dochkisinochki.ru	830	3.9
4	Korablik.ru	760	3.6
5	Akusherstvo.ru	710	3.3
6	Mytoys.ru	530	2.5
7	Mamsy.ru	400	1.9
8	Mothercare.ru	400	1.9
9	Toy.ru	380	1.8
10	Babadu.ru	380	1.8

Source: Ipsos Comcon

(1) Excludes general online retailers.

Competitive Environment

According to Ipsos Comcon, we are the largest specialised children's products retailer in Russia with a 31.9% market share in the respective channel, and 13.0% share of the overall market in 2015. Other large multi-category chains are Korablik (3.8% market share), Mothercare (3.2% market share) and Dochki-Synochki (3.0% market share). The market is also populated with several mono-category players (Gloria Jeans, Sportmaster, Sela, Acoola, Zara Kids, H&M); however, they are present in just one product segment and generally operate in a different area (i.e. apparel or footwear).

Market shares of key specialised stores	Specialised stores channel (2015)	Overall children's goods market (2015)
Leading multi-category specialised retailers		
Detsky Mir	31.9%	13.0%
Korablik	9.3%	3.8%
Mothercare	7.8%	3.2%
Dochki-Synochki	7.4%	3.0%
Begemot	4.2%	1.7%
Smyk	0.7%	0.3%
Other	38.7%	75.0%

Source: Ipsos Comcon

Note: Market share for Dochki-Synochki and Begemot is based on number of stores

According to Ipsos Comcon, we more than doubled our market share in specialised stores channel from approximately 13.9% in 2011 to approximately 31.9% in 2015. Our market share growth was primarily driven by strong expansion of our network with 239 opened stores in 2012-2015.

Market share of Detsky Mir	2011	2012	2013	2014	2015
In overall children's goods market	6.3%	7.1%	8.2%	9.8%	13.0%
In specialised stores	13.9%	15.6%	17.8%	23.7%	31.9%

Source: Ipsos Comcon

We have shown an ability to successfully gain market share in its key categories, specifically in baby food. For example, according to AC Nielsen, our share in this category in Moscow and Moscow Region increased from 9% in 2014 to 13% in 2015 and 17% in the third quarter of 2016, while the market share of hypermarkets and other specialised stores decreased by the same amount.

Baby Food Sales by Channel in Moscow and Moscow Region	2014	2015	Q3 2015	Q3 2016
Hyper / supermarkets	58%	57%	55%	50%
Standalone children's stores	22%	20%	21%	23%
Detsky Mir	**9%**	**13%**	**15%**	**17%**
Minimarkets	11%	10%	10%	10%

Source: AC Nielsen

Below is an overview of the leading multi-category specialised retailers provided by Ipsos Comcon:

Specialised retailers snapshot	Detsky Mir	Korablik	Mothercare	Dochki-Synochki	Begemot
Product assortment strength[1]					
Toys	✓✓✓	✓	✓	✓✓✓	✓✓✓
Newborns	✓✓✓	✓✓✓	✓✓✓	✓✓✓	✘
Stationery	✓✓✓	✓	✘	✓✓	✓✓
Apparel	✓✓✓	✓✓	✓✓	✓✓	✘
Footwear	✓✓✓	✓	✓✓	✓✓	✘
Geographic presence	All regions excluding Far East	Moscow region, Central region	Moscow region, Central region	All regions	All regions excluding Far East
Number of stores (1H 2016)	468	189	108	151	67
Total selling space, thousands sq.m. (2016)	578	135	57	181	70
% of stores outside Moscow region (2016)	69%	25%	47%	68%	96%
Share of total market in 2015	13.0%	3.8%	3.2%	3.0%[3]	1.7%[3]
Price segment	Medium / low	Medium	High	Medium	Low
Online sales	✓	✓	✓	✓	✓
Average selling space, sq.m. (2016)	1,400[4]	713	524	1,200	1,047
Purchases in last 12 months[5]	71%	21%	16%	32%	16%
Prompted brand awareness[5]	97%	40%	42%	75%	74%

Source: Ipsos Comcon

(1) Number of ticks indicates assortment depth.

(2) As of 31 December 2016, excluding ELC stores.

(3) Based on number of stores.

(4) New store roll-out: gross space.

(5) Poll conducted in December 2016.

Over recent years, the market also witnessed the entrance of foreign players, albeit their presence is currently fairly limited:

- In 2011, Imaginarium opened its first store in Russia and as of first half of 2016, it operated a total network of 52 stores (average area of 150 square metres);
- In 2012, Hamleys opened its first store in Moscow. As of first half of 2016, it operated a total of 7 stores in Russia; and
- One of the first foreign retailers to enter Russia was Mothercare with its first store opening in 1994. As of the first half of 2016, it operated a total of 105 stores in Russia.

Opportunity in Kazakhstan

Kazakhstan is one of the largest countries in the CIS by population with approximately 18.2 million inhabitants. During 2008-2015 it has experienced high levels of the GDP growth in both nominal and real terms (CAGR of 14.3% and 4.6%, respectively). With population growing at 1.2% CAGR over the same period, nominal GDP per capita has been growing at a lower rate of approximately 12.4% CAGR. Kazakhstan maintained positive real GDP growth throughout both 2008/2009 and 2014/2015 financial crises, driven by the use of the "National Fund" to alleviate the economic downturn through a large stimulus plan. The "National Fund" was created in 2000 amid favourable prices for Kazahkstan's leading exports, namely oil, in order to serve as a stabilisation fund.

Overall population growth in Kazakhstan has been slowing down, with the rate of natural increase coming down from approximately 13 per 1,000 inhabitants in 2008 to 11 in 2015. However, this rate remains relatively high compared to European countries, propelled by high fertility rates (2.3 children per woman as of 2015). According to the U.S. Census Bureau estimates, in 2015 Kazakhstan had approximately 4.1 million children (0-12 years of age), with this demographic group exhibiting high growth with 2.8% CAGR over 2008-2015. As a result, the share of children in overall population is also high relative to some European and developing countries, reaching the level of 22.8% in 2015.

Kazakhstan's macroeconomic & demographic dynamics	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**2014**	**2015**	**CAGR (2008-2015)**
Nominal GDP (in KZT billions)	16,053	17,008	21,816	29,380	32,194	37,085	40,755	40,878	14.3%
Real GDP Growth (%)	3.3	1.2	7.3	7.5	5.0	6.0	4.3	1.2	
Nominal GDP per capita (in KZT thousands)	1,017	1,050	1,327	1,762	1,904	2,161	2,339	2,312	12.4%
Average exchange rate (1 USD/KZT)	120.3	147.5	147.4	146.6	149.1	152.1	179.2	221.7	
Population (mid-year in millions)	16.7	16.9	17.1	17.3	17.5	17.7	17.9	18.2	1.2%
Children population (0-12 years of age)	3.4	3.5	3.6	3.7	3.8	3.9	4.0	4.1	2.8%
Share of children population (% of total population)	20.4	20.6	21.0	21.3	21.7	22.1	22.5	22.8	
Birth rate (births per 1,000 of population)	22	21	21	21	20	20	20	19	
Death rate (deaths per 1,000 of population)	9	9	9	9	9	8	8	8	
Rate of natural increase	13	12	12	12	11	12	12	11	
Fertility rate (children per woman)	2.5	2.5	2.5	2.4	2.4	2.4	2.3	2.3	

Source: U.S. Census Bureau, IMF WEO October 2016, National Bank of Kazakhstan

BUSINESS

Overview

We are the largest specialised children's goods retailer in Russia with a diversified product portfolio comprising toys, products for newborns, fashion (apparel and footwear), large items and other products. We are the market leader in terms of the size of our store network and in terms of revenue in a highly fragmented market for children's goods in Russia. According to Ipsos Comcon, in 2015, we had an estimated share of 32% (24% in 2014) of the specialised children's goods retail market in Russia and 13% (10% in 2014) of the total market of children's goods in Russia (including hyper- and supermarkets). Our largest competitor had a share of 9% of the specialised children's goods retail market and 4% of the total market of children's goods, also according to Ipsos Comcon.

We strongly benefit from the "Detsky mir" brand which dates back to the opening of the first "Detsky mir" branded store in central Moscow in 1947. Thereafter, during the Soviet period, all large children's stores or departments selling children's goods were named "Detsky mir". Accordingly, "Detsky mir" was closely associated with the entire children's goods retail industry in the Soviet Union and subsequently in Russia. This superior brand recognition persists and is confirmed by the findings of a recent consumer survey by Ipsos Comcon, where 97% of respondents mentioned our brand when prompted and 84% of respondents mentioned our brand without prompting.

As at 31 December 2016, we operated a network of 525 stores, comprising 468 stores in Russia and 12 stores in Kazakhstan operating under the "Detsky mir" brand ("**Detsky Mir stores**"), and 45 ELC stores in Russia. Our total selling space as at 31 December 2016 was approximately 596 thousand square metres. Headquartered and originated in Moscow, we have gradually expanded our footprint outside Moscow since 2003, and at present our network outside Moscow accounts for approximately 70% of our revenue. We primarily seek to operate in cities with populations in excess of 50,000 people. In Russia, we have a nationwide presence with stores located in 171 of over 300 cities with more than 50,000 inhabitants, based on Rosstat population data as at 31 December 2016. We have stores in all of Russia's 20 largest cities and in seven cities in Kazakhstan.

In addition to our retail stores, we offer our products through our websites www.detmir.ru and www.elc-russia.ru. In 2011, we launched our online store, which has experienced significant growth since then in terms of sales, the number of SKUs and functionality (including the introduction of an "in-store pickup" service). We believe that our superior brand recognition and customer loyalty are particularly important in capturing market share in the fast developing online segment of the market. In 2015, we completed the roll-out of our "in-store pickup" service for goods ordered online throughout our retail network in Russia. We are continuously improving our online proposition by expanding our online product range and further integrating our online and offline platforms. In the nine months ended 30 September 2016, we recorded over 63 million visits in our online store, and the number of orders placed via our online store was over 1 million. We believe we are the market leader in terms of market share by revenue in online sales of children's goods in Russia with an estimated market share of 6% in the first half of 2016, according to Ipsos Comcon.

We have an established supply chain and IT platform which supports our nationwide retail chain and our growth strategy. We operate two distribution centres located in the Moscow region: our owned distribution centre in Bekasovo with approximately 70,000 square metres of usable area, and our leased distribution centre in Krekshino with approximately 20,000 square metres of usable area. To manage our inventory in the most efficient manner, we have customised warehouse management and automated stock replenishment systems based on the SAP platform. In line with our expansion strategy, in particular in the Urals and Siberian regions of Russia, we have made a preliminary decision to open a new distribution centre in the Urals in 2018.

In the nine months ended 30 September 2016, we had revenue of RUB54,226 million, representing a 35.7% increase from RUB39,967 million in the nine months ended 30 September 2015. In the nine months ended 30 September 2016, our like-for-like sales increased by 13.0% as compared to the nine months ended 30 September 2015. Our Adjusted EBITDA margin increased to 8.7% for the nine months ended 30 September 2016 from 7.4% for the nine months ended 30 September 2015. Our Adjusted Net Debt was RUB11,498 million as at 30 September 2016, representing an increase of 8.3% from RUB10,618 million as at 31 December 2015.

Competitive Strengths

We believe that the following strengths have contributed to our success and will continue to support our competitive position and strategy:

Large and growing consumer market segment that is resilient to economic cycles

We operate in a large addressable market segment that is highly resilient to economic downturn and is expected to grow in 2017, according to various sources. During 2015, there were 22.2 million children between 0-12 years of age in Russia (representing 15.2% of the total population), our target market, and the estimated size of the market for children's goods according to Ipsos Comcon was approximately RUB516 billion. Between 2008 and 2015, the population of children under 12 of age grew by 21.7% according to Rosstat, and this growth is expected to continue in the near term. This growth is underpinned by a significant increase in birth rates in Russia over the past decade from 10.2 births per 1,000 inhabitants in 2005 to 13.3 births per 1,000 inhabitants in 2014-2015. Sales of children's goods are highly resilient to economic conditions as compared to most other non-food retail market segments such as consumer electronics, DIY, furniture and fashion retail sales. For example, children's goods sales demonstrated strong resilience during the crisis of 2008/2009 with a year-on-year growth in Rouble terms of 9.0%, while most of other non-food market sales contracted (consumer electronics by 17.8%, DIY by 12.5%, furniture by 6.4%) or grew at a slower pace (fashion by 2.3%), according to Ipsos Comcon. During the 2014/2015 downturn, the children's goods market increased by 3.0% on a year-on-year basis in Rouble terms as compared to decrease in sales of consumer electronics by 14.1%, furniture by 10.0%, fashion by 5.6% and DIY by 4.9%, according to Ipsos Comcon. Between 2008 and 2015, the market for children's goods grew by 69.7% despite economic downturns in 2008/2009 and 2014/2015 according to Ipsos Comcon's estimates. In addition, Russian Government support and social benefits for families with two or more children has contributed to the economic resiliency of the market.

The undisputed market leader in the specialised children's goods retail market

We are the market leader in terms of the size of our store network and in terms of revenue in the highly fragmented market for children's goods in Russia. In 2015, we had an estimated market share of 32% of the specialised children's goods retail market and 13% of the total market of children's goods in Russia (including hyper- and supermarkets), according to Ipsos Comcon.

We have maintained and increased our leading market position despite competition from non-specialised retailers (primarily hyper- and supermarkets) as a result of our key competitive advantages such as strong brand awareness, the breadth of our product assortment, competitive pricing, our specific knowledge of our target customer group, the location of our stores in high traffic shopping malls and a superior customer shopping experience (as compared to general food retailers). Furthermore, according to Ipsos Comcon, the vast majority of customers in Russia prefer specialised children's goods retailers when shopping for children's products even though they may be available in hyper- or supermarkets, or non-organised retail markets, which further supports our growth plans.

We believe that our leading market position best enables us to capture growth opportunities in our target specialised children's goods retail market which is characterised by a relatively low concentration level in terms of other competitors' market shares. For example, in 2015 the next three largest specialised children's goods retailers after Detsky Mir collectively accounted for approximately 25% of the specialised children's goods market in Russia, according to Ipsos Comcon. In 2015, in terms of revenue, the second largest competitor in the specialised children's goods retail market in Russia had an estimated market share of 9% as compared to our market share of 32%.

The strength of our market position is underpinned by a number of advantages which also support our business model, allowing us to achieve superior financial performance and position us for growth in the future. These advantages include, among others, strong negotiating power in purchasing, the ability to enter into exclusive arrangements with our suppliers, enhanced flexibility in offering the lowest or competitive retail prices, as well as the ability to negotiate attractive lease agreements and attract skilled personnel.

Category-defining brand, highly popular customer proposition and longstanding presence in the market

The "Detsky mir" brand dates back to the opening of the first "Detsky mir" specialised children's goods store in central Moscow in 1947. Thereafter, during the Soviet period, all large children's stores or departments selling children's goods were named "Detsky mir". Accordingly, "Detsky mir" was closely associated with the entire children's goods retail industry in the Soviet Union and subsequently in Russia. More recently, we believe the "Detsky mir" brand has been further strengthened as a result of the expansion of our retail network nationwide since 2003. The iconic nature and unique strength of our brand is evidenced by high brand awareness. Based on the consumer survey conducted by Ipsos Comcon in 2016, the "Detsky mir" brand had 97% prompted awareness (as compared to 75% for one of our largest competitors).

We believe that our strong brand drives and supports our customer proposition, ultimately leading to strong customer traffic and sales. Our customer proposition is to offer one-stop shopping for children's goods with a comprehensive product assortment (up to 30,000 SKUs) across various product categories at affordable prices focused on middle and lower-middle income families, at conveniently located stores in modern shopping malls in densely populated residential areas. Also, our brand and our loyalty programme allow us to develop customer loyalty. This is a particularly important competitive advantage in the children's goods market because it generates repeat customer traffic. We have an industry-leading loyalty programme with over 14 million loyalty cards issued and a penetration ratio of 77% (share of sales made with a loyalty card) in the nine months ended 30 September 2016. At our stores, we offer an interactive and emotive shopping experience for children and parents with a focus on visual merchandising which further contributes to repeat traffic. Our strong ability to generate customer traffic also makes us very well positioned to secure attractive locations in shopping malls and other areas.

Highly diversified product selection that attracts customer traffic and supports growth and resilience of sales and profitability

We sell a broad variety of children's goods through our multi-category omni-channel one-stop shopping model. Although our primary target group is middle and lower-middle income young families with at least one child under 12 years of age, we believe that our diversified product selection and varied sales channels create a proposition that is attractive and accessible to a wider customer base. We are the retailer of choice for a broad range of children's goods, which allows us to develop strong customer loyalty.

We believe our diversified assortment including both staples and discretionary products also allows us to maintain a business that is highly resilient and profitable throughout the economic cycle, as the consumption of our staples categories remains highly robust in an economic downturn, whereas our high-margin discretionary product categories provide us with an opportunity to leverage economic recoveries and increases in consumer disposable incomes.

Within our product categories, we maintain a diversified mix of branded products comprising our own brands and leading international brands. Our own brand products primarily feature in fashion (apparel and footwear) merchandise, which accounts for approximately 76% of revenue in this category for the nine months ended 30 September 2016 and has the highest margin in our product assortment. We offer a wide selection of popular international brands such as Lego, Hasbro and Mattel, including many products that are exclusively offered or launched at our stores. Over the past few years, we have worked with key suppliers to obtain rights to exclusively offer their products and to expand our own brands enabling us to earn higher margins and offer products that our customers would not find elsewhere. Our market position also gives us access to products and promotion campaigns from leading international brands.

Depending on the size of a store, we offer from approximately 20,000 to 30,000 SKUs. Our highly diversified product selection and multiple categories enable us to reduce exposure to any one particular product category and the associated volatility in sales and earnings. In particular, we benefit from the substantial differences in market structures, competitive landscape, product flows, and growth and profitability drivers across categories such as fashion and footwear, toys, products for newborns, large items and stationery.

Having a broad assortment of products in a single store allows us to operate flexible product category management and pricing policies including the ability to cross-sell products to different types of customers, which further supports our like-for-like sales growth and gross profit per square metre. For example, our broad assortment allows us to introduce aggressive pricing for products for newborns which serve as the main traffic-generating category, ultimately leading to an increase in customer traffic, as well as growth in sales and profitability through increased sales of more profitable product categories such as fashion (apparel and footwear) and toys.

Rapidly growing e-commerce and omni-channel proposition underpin our growth

In addition to our retail stores, we offer our product portfolio through our websites www.detmir.ru and www.elc-russia.ru. In 2011, we launched our online store, which has experienced significant growth since then in terms of sales, the number of SKUs and functionality (including the introduction of an "in-store pickup" service). We believe that our superior brand recognition and customer loyalty are particularly important in capturing market share in the fast developing online segment of the market. In 2015, we completed the roll-out of our "in-store pickup" service throughout our retail network. We believe we are the market leader in terms of market share by revenue in online sales of children's goods in Russia with an estimated share of 6% in the first half of 2016, according to Ipsos Comcon. In the past several years, we have invested a considerable amount of managerial and financial resources in order to create an omni-channel platform and establish a customer proposition that has allowed us to achieve significant progress in developing our capabilities in the online segment of the market. In the nine months ended 30 September 2016, our online sales revenue (including sales via "in-store pickup" service) increased to RUB1,661 million, representing a 180.1% increase from RUB593 million in the nine months ended 30 September 2015. In 2015, our online sales revenue (including sales via "in-store pickup" service) increased to RUB1,260 million, representing a 455.1% increase from RUB227 million in 2013.

We have been successful in integrating our online and offline platforms drawing on the strengths of our offline retail operations. Our strong brand recognition underpins our online traffic and allows us to save on online marketing and advertising costs. Moreover, our country-wide offline footprint and offline purchasing volumes enable us to negotiate more attractive prices with suppliers than pure online players and offer lower prices for both our offline and online customers. Furthermore, our supply chain and nation-wide offline presence allow us to offer customers prompt and cost-efficient delivery solutions via our "in-store pickup" service that accounts for a substantial portion of online sales.

As at 31 December 2016, our online store offered approximately 40,000 SKUs which mainly included toys, large items, products for newborns and fashion (apparel and footwear). We intend to further expand our online product range to up to 50,000 SKUs primarily by increasing the range of apparel, footwear and products for newborns with a view to having a wider range of products offered online than in our offline stores.

Further integration of our online and offline platforms, where online sales serve as an additional channel to increase revenue at lower incremental costs, as well as expansion of our online store assortment, are among our primary strategic priorities in the coming years. We believe we are well positioned to compete successfully with pure e-commerce players primarily because of the strengths and scale of our offline operations and our high brand recognition.

We continue to invest in our online platform and omni-channel proposition, primarily focusing on the introduction of the mobile version of our online store, implementation of SAP Hybris e-commerce platform, as well as in further enhancement of our delivery capabilities in the regions with no offline presence through partnerships with third party operators and the Russian Post.

Asset-light cash-generative business model providing strong returns on capital and enabling consistent dividend payments

Almost all of our stores are leased, with a majority of them located in modern shopping malls. We believe this model is best suited to achieving strong returns on capital due to its low capital requirements and provides us with flexibility to promptly reconfigure the locations of our stores as and when appropriate to respond to changes in demand and traffic in local markets. Our leased-store based model with relatively limited expansion capital expenditure per store has historically helped us run our business with generally positive operating cash flows, and, therefore, to finance our expansion plans primarily through internally generated funds.

We adhere to a disciplined set of investment criteria when opening new stores, focusing on a full set of investment return metrics, specifically an internal rate of return ("**IRR**") of at least 40% over a 7-year cash flow profile without terminal value, targeted EBITDA break-even in four months after store opening, and a store maturity period (a target period for achievement of planned performance targets such as customer traffic and revenue per square metre) of 18-24 months. Our site evaluation process also takes into account potential delays in the opening of a new store due to overall delays in the opening of a new shopping mall in which we expect to locate the store. Typically, we open new stores in the fourth quarter of a year to take advantage of the higher seasonal sales at year end. We continuously monitor the performance of each store in our retail chain. We will consider closing a store if it fails to meet key performance indicators over a period of time or if we can replace it with an adjacent or proximate location that can be secured on better lease terms or that offers higher customer traffic. However, we have historically closed or relocated only a very small number of stores.

Overall, we believe our focus on an asset-light business model and IRR targets leads to strong financial performance and returns on capital. In 2015, we achieved a pre-tax Adjusted ROIC of 78.3% and CROCI of 58.0%. We believe that our Adjusted ROIC strongly compares to the respective metrics of the majority of Russian and international public retailers.

Additionally, our strong cash generation profile has enabled us to pursue expansion while at the same time reducing leverage and offering consistent dividend payouts to our shareholders in recent years.

Scalable supply chain and infrastructure platform

We believe that, by virtue of our longstanding presence in the market and our extensive experience of operating a multi-store network across Russia and Kazakhstan, we have developed strong capabilities to address the logistical and other operational challenges associated with our business. We view our supply chain, IT and human resources as the principal infrastructural functions which support our nationwide retail chain and serve as the necessary platforms to facilitate its expansion. We believe all of these platforms are scalable to support the implementation of our expansion strategy.

We operate two distribution centres in the Moscow region: our owned distribution centre in Bekasovo with approximately 70,000 square metres of usable area, and our leased distribution centre in Krekshino with approximately 20,000 square metres of usable area dedicated to our online business. Our newly constructed distribution centre in Bekasovo, commissioned in 2015 has enabled us to improve our centralisation levels. Our centralisation level (purchase costs for goods that passed through our distribution centres, as a percentage of total purchase costs for goods) increased from 20% in 2013 to 65% in 2016, thus decreasing our logistics costs significantly. In 2015, we also implemented new warehouse management and automatic replenishment systems (SAP EWM), which have allowed us to increase the efficiency and reliability of our supply chain flows. We also have a fully-integrated enterprise resource planning (ERP) system based on the SAP platform, which is able to support up to 800 stores.

With respect to human resources, we have an established divisional structure to manage our store network and well-tested procedures to hire employees for new stores and to manage the store opening process. In addition, we have a dedicated team at the head office that continuously evaluates opportunities to open new stores in attractive locations.

Strong management team with track record of delivering business growth

We believe the members of our management team are among the leading industry professionals in their respective business areas. All key members of the management team have an extensive track record of operating in the Russian retail market.

Our management team has executed an aggressive expansion plan which has resulted in a significant improvement in our operating and financial performance since 2012. Our store network increased from 252 stores in 2013 to 525 stores in 2016 which contributed to revenue growth of 26.2% in 2014, 33.2% in 2015 and 35.7% in the nine months ended 30 September 2016. Like-for-like sales grew at 13.4% in 2013, 13.7% in 2014, 12.3% in 2015 and 13.0% in the nine months ended 30 September 2016. Our Adjusted EBITDA margin increased from 7.7% in 2013 to 9.8% in 2014 and 10.2% in 2015, as well as from 7.4% in the nine months ended 30 September 2015 to 8.7% in the nine months ended 30 September 2016, in each case as compared to the prior period. The management team has also shifted our focus and planning from margin maximisation to customer- and sales-driven performance. For example, new competitive pricing on "Key Value Items" and product mix strategies have been implemented to drive customer traffic and sales. We increased the share of higher margin own brands in the fashion segment. In relation to suppliers, we have been able to negotiate improved commercial terms such as pricing and payment terms. We obtained larger bonuses for generating higher volumes of sales of certain products of suppliers, as well as increases in reimbursements for the costs of our marketing and promotional activities. We also achieved cost reductions through optimisation of head office and in-store headcounts and tightened control over administrative costs.

We believe our strong market position, strong brand and ambitious growth strategy will enable us to continue to attract and develop high-calibre managers in the future. We also offer our senior management long- and short-term performance-linked incentives. See also "*Management and Corporate Governance—Long-Term Incentive Plan*".

Business Strategy

Using our competitive strengths, we intend to implement the following business strategies:

Sustainable expansion of the store network

We believe we are well positioned to increase our market share and grow our store network by taking advantage of opportunities in various regional markets and expanding our presence in cities where we are currently present by opening additional stores, also pre-empting competition.

Strategically, we target cities with a population of over 50,000 people. There are over 300 cities in Russia with populations of more than 50,000 and many of them still do not have specialised children's retailers or a sufficient number of such stores to meet local demand. We will continue to expand both in cities where we are already present, and new cities.

We principally focus on obtaining leases for selling space in existing shopping malls where we are not present. In 2015, we reviewed 330 locations of which 126 were approved as potential locations for our stores. Most shopping malls aim to have a children's retailer as an anchor tenant, therefore we primarily compete only with specialised children's retailers for such locations and are in most cases able to secure attractive locations and lease rates given our nationwide presence, exceptional brand awareness and leading market position. In the current environment, we have significant potential for expansion through existing shopping malls primarily by replacing competitors and entering underpenetrated local markets.

We estimate that there are over 600 existing shopping malls in Russia without a Detsky Mir store; within these 600 we have identified at least 90 which represent a very strong strategic fit meeting our store opening criteria without any cannibalisation impact on the existing chain. We continuously evaluate and monitor the availability and pipeline of shopping malls in Russia across regions and will be consistently pursuing openings in shopping malls meeting our criteria. See "*—Sales Channels—Retail Stores—Store Selection Process*".

In addition to monitoring the shopping mall landscape, we assess the market opportunity in terms of saturation of regional markets and specific cities by specialised children's stores and modern retail channels overall. For example, we have identified over 130 cities with a population of 50,000-100,000 without any specialised children's stores which represent attractive new geographies for Detsky Mir.

From 2011 to 2016 (inclusive), we increased the number of Detsky Mir stores from 150 stores to 480 stores. We opened 103 Detsky Mir stores in 2015 and 100 Detsky Mir stores in 2016. We believe there is a market opportunity to target the roll-out of approximately 250 new Detsky Mir stores in 2017-2020, including approximately 70 new Detsky Mir stores in 2017, growing our footprint in Russia significantly while possibly doubling our store count in Kazakhstan. We believe we are uniquely positioned to capture the available growth opportunities in the Russian and Kazakhstani children's goods retailing segment, leveraging our unique brand strength, market leading position, omni-channel capabilities and long-term experience in the market. We have established processes and a dedicated team focusing solely on screening and evaluating potential opportunities for the new store openings on the basis of the economic development, consumers' disposable income, social and political environment in the respective regions and cities.

Continuous focus on measures to support further growth of like-for-like sales and gross profit per square metre

In recent years we have identified and realised significant improvements through the implementation of a comprehensive set of new policies, including significant revision of pricing and product assortment policies, as well as the elimination of supply chain difficulties to enhance availability of goods. Delivering further improvements (such as the development of a CRM system in order to better target our promotional activities), and adapting to changing customer preferences and sales channels to drive strong like-for-like sales growth and gross profit per square metre are the cornerstone of the strategy underpinning our growth plans.

In order to support gross profit, we invest in lowering prices to drive growth in the number of tickets primarily by keeping our assortment mix largely the same as in the past several years, with a shift in our product mix towards traffic-generating categories (such as products for newborns) and by improving commercial terms with suppliers. While products for newborns have lower margins, they contribute significantly to generating traffic and therefore can increase gross profit per square metre. Our ability to lower prices for our customers is supported by our large purchasing volumes that enable us to negotiate attractive prices with suppliers. The decrease in revenue resulting from our investment in lowering prices has been offset by decreasing logistics costs due to higher level of centralisation as a result of a new distribution centre in Bekasovo (the Moscow region), the bonuses for advertising and the volume related discounts the we receive from suppliers, as well as our selling an increasing share of higher margin own brand merchandise. In line with this strategy, while our gross profit margin has been gradually decreasing from 38.6% in 2013 to 36.2% in 2015, and from 34.6% in the nine months ended 30 September 2015 to 33.3% in the nine months ended 30 September 2016, our gross profit per square metre has increased from RUB46 thousand in 2013 to RUB50 thousand in 2015, and from RUB34 thousand in the nine months ended 30 September 2015 to RUB35 thousand in the nine months ended 30 September 2016.

Our store design concept has a highly interactive format that optimises selling space by way of integration of gaming and interactive zones with trading areas and product aisles. We consider our current store design concept launched in 2013 as one of our competitive advantages that allows us to obtain better lease terms from shopping malls and get higher traffic through customer loyalty.

In addition, we will continue to implement a series of ongoing measures such as price leadership on key value items, targeted promotion campaigns and fast reaction to prices set by competitors to support growth of like-for-like sales and growth in gross profit per square metre.

We will continue to seek additional ways of driving our like-for-like sales growth by entering into the exclusivity arrangements with our suppliers with respect to select innovative, high-demand products coming to the market.

Furthermore, we aim to maximise the impact of our industry-leading loyalty card programme on our sales growth. High loyalty card penetration ratio (77% of sales in the nine months ended 30 September 2016 were made using a loyalty card) provides us with unique data on our customers' purchasing behaviour and preferences. We are continuously working on improvements of information systems in order to better use such data for the purpose of direct marketing and refinement of our product offering.

Implementation of an omni-channel sales strategy addressing the development of the online market

Online sales of children's goods have experienced accelerated growth rates in recent years. According to Ipsos Comcon, the share of online sales in the total Russian market for children's goods was 9% in 2016 and is expected to expand further. Since the launch of our online platform in 2011, we have been focusing on adapting the "Detsky mir" brand and customer proposition, as well as integrating our offline advantages and online opportunities to extract the maximum benefit from the rapid growth of the online market.

We plan to continue the significant expansion of our online store assortment from 40,000 SKUs in 2016 to 50,000 SKUs in the medium term, with a view to having a wider range of products offered online than offline in our retail stores, development of our delivery capabilities, as well as the full integration with our retail store customer proposition and supply chain platform. In particular, the expansion of the online store assortment and further reduction of the average time between order confirmation and availability for in-store pickup will support further growth of our "in-store pickup" service and cross-selling opportunities. Moreover, we intend to generate higher online traffic by integrating it more with social media and by using multiple advertising channels to promote our online store. Furthermore, we expect to drive our online sales by expanding delivery geographies, in particular to cities where we do not currently have stores, as well as by collaborating with third parties. We also intend to implement SAP Hybris e-commerce platform in 2017, as well as the mobile version of our online sales platform.

Investment in our supply chain, supporting growth and enhancing scalability of the business model

Supply chain and related infrastructure are paramount to the retail proposition, and are of particular importance to a high-growth retailing company like Detsky Mir. We are focused on ensuring that our supply chain and related functions are scalable so that they can support the anticipated future growth of our business.

We seek to continue to utilise a flexible distribution model combining (i) a centralised platform based on our two distribution centres in the Moscow region (Bekasovo and Krekshino), and (ii) direct distribution by suppliers to the stores. We have increased the share of centralised deliveries from 20% of purchase costs for goods passed through the warehouse in 2013 to 65% of purchase costs for goods passed through the warehouse in 2016, and intend to further increase the share of centralised deliveries to 75-80% of purchase costs for goods passed through the warehouse by 2019, as we believe it will best address our needs and the specifics of delivery patterns from our suppliers and will ensure smooth deliveries of goods and minimise distribution costs. By increasing the share of centralised deliveries we specifically aim to reduce dependence on third party distributors, in particular with respect to domestically sourced products in the toys category, and internalise the respective profitability margins, as well as to work directly with large producers such as P&G who deal with high-volume wholesalers only.

To support our roll-out in the Ural and Siberian regions of Russia, we have made a preliminary decision to open a new distribution centre in the Urals with approximately 60,000 square meters of warehousing space in 2018. We intend to evaluate options, in particular with respect to owning as opposed to renting this new distribution centre, and make a final decision in the first half of 2017.

Ongoing improvements of our store operations and administrative functions enhancing efficiency and improving profitability

We are also improving our day-to-day operations, optimising our business processes and extracting additional optimisation opportunities from our significant scale. This relates to the entire spectrum of functions from sales to purchasing and head office operations. For example, we aim to further optimise our personnel structure, enhance automation and build on the optimisation initiatives we implemented in the course of the past four years. We expect the implementation of our initiatives in human resources to result in a decline in our payroll costs as a percentage of revenue. Furthermore, in addition to improving purchase prices and volume related discounts, we are also working on improving other commercial terms with our lessors and suppliers. For example, we are continuously seeking opportunities for exclusivity arrangements with our suppliers with respect to unique and high-demand products. As regards our lease agreements and rental rates, in the long-term we expect costs to increase in line with inflation, but to decrease as a percentage of revenue.

Corporate History

Our corporate history started in 1997 when the Company was established. However, the history of the "Detsky mir" brand goes back to the Soviet times and has an important influence on our business. Below we present the "Detsky mir" brand's history and our corporate history in four development stages.

1947—1996: Establishment of "Detsky mir" brand

In 1947, the first "Detsky mir" (or "*Children's world*") store was opened in the centre of Moscow. The "Detsky mir" brand was the only well-known brand for children's goods after its introduction in 1947. Moreover, following the establishment of the Detsky mir store in Moscow, all large children's stores in the Soviet Union were named "Detsky mir" although they may not have used the "Detsky mir" logo. By the 1970s, a network of Detsky mir stores had evolved into one of the largest trade groups in the Soviet Union in the consumer sector.

In 1991, following the dissolution of the Soviet Union, the Moscow city government established a joint stock company named Detsky mir under applicable laws at the time to own and operate the Detsky mir department store at Lubyanka in Moscow (the "**Lubyanka Store Operator**").

In 1994, Sistema acquired control over a 43% share in the Lubyanka Store Operator. At that time, the Lubyanka Store Operator did not own other stores in Russia under the Detsky mir brand or other stores generally using the "Detsky mir" name. Subsequently, Sistema consolidated 100% of shares in the Lubyanka Store Operator. In 2008, the Lubyanka Store Operator was reorganised by way of spin-off of Open joint stock company "Detsky mir—Retail Assets". As a result of the reorganisation, intangible assets previously owned by the Lubyanka Store Operator (including rights to the "Detsky mir" trademark, logo and other intellectual property rights) were transferred to Open joint stock company "Detsky mir—Retail Assets". In 2010, Open joint stock company "Detsky mir-Retail Assets" transferred the exclusive rights to these intangible assets to the Company. As part of a debt restructuring by Sistema's subsidiary operating in the real estate development market, Sistema's shares in the Lubyanka Store Operator were transferred to VTB in 2009. Thus, we no longer have rights to the building occupied by department store at Lubyanka in Moscow and at present the store operates under a different name.

1997—2002: Establishment of the Company

In 1997, Sistema established JSC Detsky mir-Center, a predecessor of the Company, to operate its assets in the children's retail sector.

In 2001, we acquired a 50% stake in "Detsky mir—Oriol" JSC in the Central Region of Russia from the Orel city government. In August 2016, following our acquisition of the remaining 50% stake, "Detsky mir—Oriol" JSC became our fully-owned subsidiary. "Detsky mir—Oriol" JSC operated a department store specialising in children's goods in Orel in the partially owned premises. In February 2017, we intend to open a renovated Detsky Mir store under our current design concept.

In 2002, we acquired Dom Igrushki (or "*Toy's House*"), a department store at Bolshaya Yakimanka Street in Moscow, which we subsequently transformed into a luxury store for children under the Yakimanka Gallery name. Following our decision to discontinue operations in the premium segment we in December 2014 sold 100% of our interest in LLC Detskaya Galereya "Yakimanka", which owned and operated the Yakimanka Gallery, and recorded a RUB1,164 million gain in disposal of a building for 2014.

2003—2011: Establishment and national expansion of the modern Detsky Mir retail chain

In 2003, Sistema approved a five-year plan to develop the Detsky Mir retail chain. In 2005-2006, we acquired two stores in Rostov and Tambov. Pursuant to the plan, between 2003 and 2007, we opened 85 new stores in Russia, expanding our business to the Central, North-Western, Volga, Ural, Siberian, and Southern regions. During this period, we increased total selling space of the retail chain by approximately 145,000 square metres and became the largest Russian children's goods retailer.

In 2007, we registered the trademark "Детский мир" (or "Detsky mir") that we currently use in our operations.

In 2011, we established TOO "Detsky mir—Kazakhstan" and opened our first store in Astana, Kazakhstan.

In 2011, we launched our online sales platform.

2012—2016: New management appointment and business turnaround

In July 2012, we acquired 100% of Sparthema Limited which owned "Cub-Market", LLC that is the owner and operator of the ELC stores in Russia under a franchise agreement with Early Learning Centre Limited, a large U.K. retail chain and a member of the Mothercare Group. The purchase price was U.S.$15.3 million. The ELC retail chain has small format stores and is focused on the smart toys product category.

In the second half of 2012, new senior management was appointed under Mr. Vladimir Chirakhov, our General Director, with a view to implementing a new growth strategy. In particular, the new management team has transformed our commercial operations, which has been key to increasing our market share, as well as implemented a wide range of cost-cutting and efficiency measures allowing us to improve our profitability.

In December 2013, we opened a store under our new store design concept at the "Mega Belaya Dacha" shopping mall in the Moscow region. The new store design concept aimed to increase sales density at a store by providing better in-store activities for children, an in-store navigation system and a brighter selling space.

In August 2014, at the site of the former store Voentorg on Vozdvizhenka Street in Moscow, we opened a flagship store with a selling space of 7,000 square meters, the biggest store in our retail chain. The store has a number of interactive and entertainment zones for children of different ages. The store has become a place of choice to visit for parents with children and a tourist destination.

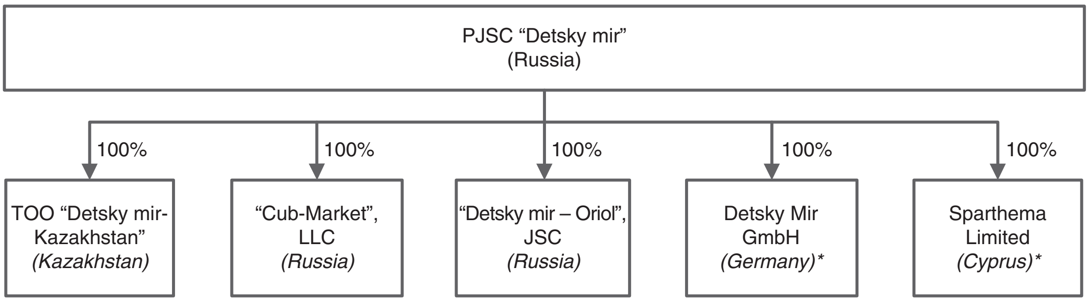
In August 2015, we opened our 70,000 square metre distribution centre in Bekasovo, the Moscow region.

In December 2015, FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED purchased from Sistema a 23.1% stake in the Company, for an aggregate consideration of RUB9.75 billion.

Corporate and Management Structure

Corporate structure

The chart below sets forth our corporate structure as at the date of this Offering Memorandum showing our significant subsidiaries.



* In the process of liquidation

The Company (PJSC "Detsky mir") is the parent company of the Group and owns and operates all Detsky Mir stores in Russia. TOO "Detsky mir—Kazakhstan" operates and develops Detsky Mir business in Kazakhstan. "Cub-Market", LLC owns and operates the ELC stores in Russia. "Detsky mir—Oriol" JSC owns and operates a Detsky Mir store in Orel.

Management structure

We are headquartered in Moscow. Our Management Board operates from our Moscow office and oversees the day-to-day operational management of the business. See "*Management and Corporate Governance*".

We have implemented a management structure that divides the responsibility for operational management between the central office in Moscow and the regional division offices. We believe that this structure combines the benefits of centralised management with effective local support. Our Moscow office has three internal departments covering the Moscow South Eastern, Moscow North Western and Central divisions. Our regional offices are registered as branches of the Company and cover the North Western, Volga, Urals, Siberian and Southern divisions. We also operate a division in Kazakhstan through TOO "Detsky mir—Kazakhstan", our wholly-owned subsidiary. Each subdivision is managed by a regional director who in turn reports to the Head of Trade Development Division in the Moscow office. Our regional subdivisions have local teams headed by a local manager who oversees 5-6 stores.

Retail Operations

Overview

We are the largest children's goods retailer in Russia and enjoy the highest brand recognition among Russian children's goods retailers, according to Ipsos Comcon. Based on the consumer survey by Ipsos Comcon conducted in 2016, 97% of respondents mentioned our brand when prompted. We also operate in Kazakhstan.

Our product portfolio comprises toys, products for newborns, fashion (apparel and footwear), large items and other products (including stationery). As at 31 December 2016, we operated 525 stores, including 480 Detsky Mir stores located in Russia and Kazakhstan, and 45 ELC stores located in Russia (primarily in Moscow). We primarily seek to operate in cities with populations in excess of 50,000. In Russia, we have a nationwide presence with stores located in 171 of over 300 cities with more than 50,000 inhabitants, based on Rosstat population data as at 31 December 2016. We have stores in all Russia's 20 largest cities. In addition to our core retail platform in Russia, we operated twelve stores in seven cities in Kazakhstan as at 31 December 2016. Our Detsky Mir stores in Russia are distributed as follows: 93 in Moscow, 54 in Moscow region, 33 in St. Petersburg and 288 in the regions.

Store Location

The map below shows the location of our stores across Russia and Kazakhstan as at 31 December 2016:

In Russia, we operate in 171 of over 300 cities with more than 50,000 inhabitants. In Kazakhstan, we operate in seven cities. Our stores are primarily concentrated in the Central, Volga, Ural and Siberian regions of Russia, which together accounted for 77% of our stores in terms of selling space and 78% of our revenue in 2015. The regional breakdown of our store base has remained largely unchanged in recent years reflecting our balanced growth across our footprint. The share of stores located outside Moscow in our total revenue and selling space has been stable in 2013-2016.

The table below presents the number of Detsky Mir stores and selling space of our retail network in Russia and Kazakhstan by region.

	Selling Space		Number of Stores		
	As at 31 December 2016		As at 31 December		
Regional Division	(in thousand sq. m.)	%	2016	2015	2014
Russia	578	98	468	374	272
Moscow and Moscow region	179	30	147	107	74
Central (excluding. Moscow and Moscow region)	88	15	71	62	42
Volga	74	12	61	52	44
Urals & Siberian	113	19	90	71	56
North Western	64	11	54	49	29
Southern	60	10	45	33	27
Kazakhstan	13	2	12	7	6
Total	**591**	**100%**	**480**	**381**	**278**

Product Offering

Our product assortment comprises five main categories: products for newborns, toys, large items, fashion (apparel and footwear) and other products (including stationery). Given the diverse nature of our product portfolio within the children's market, we are able to position ourselves as a multi-category children's goods retail chain offering a one-stop shopping destination. We have developed our product assortment to include both customer traffic generating products (such as products for newborns) as well as higher margin products (such as large items and fashion (apparel and footwear)). We continuously monitor consumer preferences and spending patterns and adjust our prices and product assortments in various categories to drive customer traffic and sales.

The table below sets out the composition of our Detsky Mir sales by product category as a percentage of total revenue for the periods indicated:

	Nine months ended 30 September		Year ended 31 December		
	2016	**2015**	**2015**	**2014**	**2013**
Products for newborns	33%	30%	29%	24%	20%
Toys	28%	31%	35%	37%	38%
Fashion (apparel and footwear)	28%	27%	25%	26%	27%
Large items	4%	5%	4%	5%	5%
Stationery and other	7%	7%	7%	8%	10%
Total revenue	**100%**	**100%**	**100%**	**100%**	**100%**

Following the current downturn in the Russian economy, consumers in Russia have become more cautious on non-discretionary purchases, although purchases of fast moving consumer goods and children's goods have not yet been similarly affected. During the economic downturn, consumers tend to reduce spending by reducing the volume of their purchases or by shifting their purchasing pattern towards cheaper products, these trends being particularly pronounced with respect to discretionary products. While we were able to adapt our product mix and pricing policies during 2014 and 2015 to avoid a significant negative impact of these trends on our financial performance, there can be no assurance that we will be able to do so in future similar downturns.

In order to support gross profit, we invest in lowering prices to drive growth in the number of tickets primarily by keeping our assortment mix largely the same as in the past several years, with a shift in our product mix towards traffic-generating categories (such as products for newborns) and by seeking to improve commercial terms with our suppliers. While products for newborns have lower margins, they contribute significantly to generating traffic and therefore can increase gross profit per square metre. Our ability to lower prices for our customers is supported by our large purchasing volumes that enable us to negotiate attractive prices with suppliers. The decrease in revenue resulting from our investment in lowering prices has been offset by decreasing logistics costs due to higher level of centralisation as a result of a new distribution centre in Bekasovo (the Moscow region), the bonuses for advertising and the volume related discounts the we receive from suppliers, as well as our selling an increasing share of higher margin own brand merchandise. In line with this strategy, while our gross profit margin has been gradually decreasing from 38.6% in 2013 to 36.2% in 2015, and from 34.6% in the nine months ended 30 September 2015 to 33.3% in the nine months ended 30 September 2016, our gross profit per square metre increased from RUB46 thousand in 2013 to RUB50 thousand in 2015, and from RUB34 thousand in the nine months ended 30 September 2015 to RUB35 thousand in the nine months ended 30 September 2016.

The table below sets forth the number of SKUs we offer in each category. On average fashion (apparel and footwear) products provide the highest margin, followed in descending order by toys, large items and products for newborns.

	As at 31 December 2016
Product category	**Number of SKUs (for a typical store)**
Fashion (apparel and footwear)	7,500
Toys	5,900
Products for newborns	3,500
Stationery and other	2,500
Large items	200
Total	**19,600**

Toys

Toys were our largest product category accounting for 35% of sales in 2015, and according to Ipsos Comcon, our share was 24% of the toys market, based on sales in 2015. We offer a broad assortment of toys, with approximately 5,900 SKUs in our typical store, including toys for boys and girls, toys for babies, sport and outdoor activities toys, construction sets and soft toys. Approximately 92% of toys sales in our assortment are branded products produced by leading international toy manufacturers such as Lego, Hasbro and Mattel, as well as other manufacturers. Own brand products accounted for approximately 7% of toys sales in this category in the nine months ended 30 September 2016. We believe we offer the best prices on toys as compared to our direct competitors. Our broad assortment and competitive pricing enables us to differentiate ourselves from our competitors.

Our market position enables us to enter into exclusivity arrangements with certain vendors, which gives us access to exclusive products and promotion campaigns. Our exclusivity arrangements enable us to sell certain products in Russia exclusively (for example, a controlled caterpillar under the Fisher Price brand, certain products by Hasbro, Lego, Mattel and Maclaren). These arrangements generate traffic, create customer loyalty, contribute to our like-for-like sales growth and make us more immune to price competition with other retailers.

Products for Newborns

Products for newborns is our second largest category, accounting for 29% of sales in 2015. According to Ipsos Comcon, our share was 18% of newborns market, based on sales in 2015. Products for newborns include baby food, baby diapers and baby care products. Baby food and baby care products belong to the fast moving consumer goods ("**FMCG**") category which tends to be manufactured by large multi-national companies, have high volumes, low margins, extensive distribution networks and high stock turnover. As FMCG products are repeat purchase items, products for the newborns category are a strategically important product category because they are key customer traffic generators. We believe we offer the best prices on products for newborns as compared to our direct competitors. While general food retailers may also offer competitive pricing on such FMCG products, they are not able to offer the full range of such goods or dedicate as much shelf space to these products as we can. Moreover, products for newborns allow us to dampen the seasonality effect on sales experienced by all non-food retailers because products for newborns generally do not experience severe seasonality. Own brand products accounted for 1% of sales in this product category in the nine months ended 30 September 2016.

Fashion (Apparel and Footwear)

Apparel and footwear comprised 25% of sales in 2015, respectively. According to Ipsos Comcon, our shares were 7% of the children's apparel market and 8% of the children's footwear market, based on sales in 2015. We target the "medium" to "medium-low" customer segments in this product category.

Our apparel offering includes outerwear, collection clothes, underwear, socks and accessories. Our footwear offering includes classic, casual, sports, hiking and beach and swimming pool footwear. We sell select leading international brands such as "Reima" (manufactured by Reima) and "Blue Seven" (manufactured by Obermeyer). The share of branded fashion products sales accounted for approximately 25% of the product category revenue in 2015. We also sell an extensive range of own brands fashion products which have been steadily increasing their share in total sales. In the nine months ended 30 September 2016, the share of own brand products in our apparel and footwear revenue reached 74% (71% in 2015) and 81% (69% in 2015), respectively. See also "*—Own Brands*" for more information on our own brands fashion products. Apparel and footwear are the most profitable product categories in our assortment and in line with our strategy we aim to further broaden our assortment in these categories by offering more own brands fashion products.

We are also focusing on offering more seasonal collections and on widening the range of each seasonal collection. For example, in 2016 we offered eight seasonal collections: spring, summer, hot summer, school season, pre-autumn, autumn, winter and New Year. With these changes, we intend to reposition ourselves from a traditional apparel retailer to a consumer-driven fast-fashion retailer. We expect that more seasonal collections will drive customer traffic, cross-selling opportunities and sales, but will also require that we carefully manage our costs, inventory and the supply chain.

Large Items

Large items, or durable juvenile products, accounted 4% of our sales in the nine months ended 30 September 2016. These items include child car seats, strollers, baby carriers and children's furniture. We primarily sell branded goods; however we also offer a significant assortment of own brand products in this category. Own brand products accounted for 32% of sales in this product category the nine months ended 30 September 2016.

Stationery and Other

Our stationery and other products category includes books, multimedia and products for sports, art, New Year and other creative activities. Own brand products accounted for 25% of this category in the nine months ended 30 September 2016. Sales of stationery are very seasonal with peak sales occurring in the "back to school" season in August-September.

Own Brands

Own brand products are strategically important to our business because they are a source of differentiation from competitors and carry higher margins. Our own brand products are typically priced in the "medium" to "medium low" price segments and are tailored to our customers. We offer a well-balanced price and quality proposition which is attractive to our customer base and also encourages customer loyalty. Own brand products also reduce our reliance on suppliers of brand name products. With their lower costs, our own brand products enhance our gross margins and contribute towards improving profitability per square metre.

In the fashion (apparel and footwear) category, own brand products accounted for 74% of our sales in apparel and 81% in footwear in the nine months ended 30 September 2016. The gross margin on our own brands in fashion (apparel and footwear) was higher than the margin on similar branded products in those categories in 2013-2016. In the toys, products for newborns and large item categories, the shares of own brand products were 7%, 1% and 32%, respectively, in the nine months ended 30 September 2016. At present, we do not intend to increase the share of own brand products in these product categories.

The table below summarises the share of own brand products in total sales of fashion (apparel and footwear) and large items, as well as total sales of all own brand products in terms of total sales:

	Nine months ended 30 September		Year ended 31 December		
	2016	**2015**	**2015**	**2014**	**2013**
Share of own brands apparel of total apparel sales (%)	74%	69%	71%	67%	62%
Share of own brands footwear of total footwear sales (%)	81%	74%	69%	65%	64%
Share of own brands large items of total large items sales (%)	32%	33%	30%	30%	29%
Share of own brand products of total sales (%)	26%	24%	23%	22%	20%

We have 25 fashion (apparel and footwear) own brands. Each brand has its own architecture, including the specific assortment of products, a target customer group and particular price positioning. Eight brands of our present brand portfolio were conceived and developed in-house, whereas others were outsourced to third parties on an exclusive basis. All own brand products are manufactured by third parties. In addition to promoting organic growth in our existing own brands, we intend to develop and introduce two new own brands for apparel and footwear in the medium term.

The table below summarises our main own fashion (apparel and footwear) brand portfolio as at 31 December 2016.

Brand	Product Category	Products	Design	Price Positioning
Orsolini	Apparel	Dress-up clothes for girls	In-house	Medium plus
Futurino	Apparel	Broad selection of casual clothes	In-house	Medium
Just Mom Ulla	Apparel	Clothes for pregnant women	Third party	Medium
Moya Goroshinka	Apparel	Apparel for babies	In-house	Lower medium
Jook	Footwear	Functional everyday footwear	In-house	Lower medium
Favaretti	Footwear	Broad selection of stylish footwear	In-house	Lower medium
True Safari	Footwear	Stylish everyday footwear	Third party	Lower medium
Run	Footwear	Functional, European style everyday footwear	Third party	Lower medium
Chessford	Apparel and footwear	European inspired school uniforms and accessories	In-house	Medium
TokkaTribe	Apparel and footwear	Winter outdoor and sportswear	Third party	Medium
Jomoto	Apparel and footwear	Sport apparel and footwear	In-house	Medium
Baby Go	Apparel and footwear	Eco-friendly clothes and footwear for infants and toddlers	In-house	Lower medium to medium

Our own brand products are primarily sourced in Southeast Asia, which has low labour costs and a wide choice of manufacturers. We principally order own brand products directly from local apparel and footwear manufacturing companies in China, India, Bangladesh and Vietnam, and it takes up to 75 days for the products to be shipped and stocked in our stores. In addition, we purchase own brand products from manufacturers in Russia and Uzbekistan, which take up to 30 days to be shipped and stocked in our stores.

Under the terms of our own brand product supply agreements, all products are subject to independent quality control under AQL2.5 standards which are checked by specialised third party service providers. In addition, the majority of own brand products are shipped to us already equipped with security tags and sometimes price tags, so they can be placed on store shelves quickly upon delivery at stores.

We offer a selection of large items under our own brand Babyton. Car seats and strollers are designed by third parties, while high chairs and playpens are designed in-house. We price these large items in the “low to medium” segment.

We intend to further increase the profitability differential between own brands and branded products through improvements in logistics and sourcing processes, more frequent rotation of suppliers. We believe that higher turnover and timely arrival of seasonal fashions and the introduction of new lines throughout the season will help to increase our sales.

Customer Base

We offer a comprehensive product range for children of ages between 0 and 12 years. We target two customer groups: (i) a core target group which primarily generates customer traffic in our stores, which includes young families with a child under 3 years of age where both parents are between 20 and 30 years old, are employed, and have an average monthly income of RUB15,000-30,000 per person; and (ii) a secondary target group which includes families with at least two children under 12 years of age where both parents are between 25 and 40 years old and have an average monthly income of RUB20,000-40,000 per person. The core target group is a key traffic generating customer group, visiting the stores 1-2 times per week. They predominantly buy products for newborns. In many cases, customers in the secondary target group have previously been part of our core target group, thus demonstrating loyalty to our stores. They generally visit our stores approximately five to six times per year, and are predominantly buyers of higher priced and higher margin goods. Families may move from one category to another as their circumstances changes, for example due to the birth of a new child. We aim to capture the core customer group at the beginning of their parental cycle.

In addition to the target customers described above who also use our online platform for shopping, the particular target audience for our online sales are expectant or new mothers, as well as young customers buying presents for the children of relatives or friends (toys in particular) for special occasions.

In 2016, our retail chain generated approximately 67.8 million tickets (consisting of 20.7 million in Moscow and the Moscow region and 47.1 million in other Russian regions and Kazakhstan) as compared to 53.1 million tickets in 2015 (consisting of 16.0 million in Moscow and the Moscow region and 37.1 million in other Russian regions and Kazakhstan). On average, in 2016 each of our stores had approximately 141 thousand customers as compared to 112 thousand in 2015. According to Masmi, 81% of respondents in 2013-2014 considered wide assortment and one-stop shop as the most important factors for selecting a children's goods retailer.

In general, we believe that customers look for five key factors in selecting a store to shop at for children's goods: broad product range, affordable prices, good price-quality ratio, proximity to home and guaranteed quality.

According to Ipsos Comcon, the most important factors in determining choice of shopping venue for children's products by Russian consumers were: affordable prices (voted for by 72% of customers), wide product assortment (62%), proximity to home (55%), impressions from shopping (45%), opportunity to order online (35%) and place for kids' leisure/ kids' corner (31%).

Pricing Policies

We aim to set competitive prices in each product category and with respect to certain product categories we set best prices among our direct competitors. In particular, we consider products for newborns as the key traffic generating product category, and we aim to offer the lowest price available on the market for these products. Based on the analysis of our customers' preferences we have created and maintain a watch list of approximately 1,000 SKUs with respect to which we aim to offer the lowest price. The availability of these products in a store and their prices are key drivers of customer traffic. To offer the best price for these products, we regularly monitor prices of general food retailers (such as hyper- and supermarkets) including Auchan, X5 Retail Group, Metro Cash and Carry and Magnit. We believe that our prices for products for newborns are, on the whole, at the same level or lower than the prices set by these competitors.

Fashion (apparel and footwear) products are our most profitable goods. We focus on sales of apparel in "medium" and "medium low" price categories priced from approximately RUB550 to RUB900 and footwear priced from approximately RUB1,100 to RUB2,300 per unit. We aim to offer fashion (apparel and footwear) products of own brands and third party brands at prices lower than our direct competitors in these categories. To adhere to these pricing policies we seek to improve inventory turnover, revise terms with suppliers to improve logistics and to focus on the share of our own brands fashion products in our overall product assortment. See also "*—Business Strategy*" and "*—Own Brands*".

Toys remain our key product category in terms of contribution to revenue. We aim to offer both the widest assortment and the best price among specialised retailers. We target competitive prices in comparison with our direct competitors. In this segment we also offer exclusive products, reducing our dependency on competitive dynamics.

The large items segment is fragmented and therefore there is no customer loyalty. However, we believe we generally have best or competitive prices on large items among online and offline retailers.

Furthermore, in line with our omni-channel sales strategy, in 2016 we implemented the "omni-pricing" initiative by lowering prices in our offline stores to match prices in our online store and offer customers a uniform pricing proposition.

Our pricing policy and ability to respond swiftly to changes in pricing environment have successfully strengthened our price leadership position and substantially increased our traffic which, in turn, has contributed to the steady growth of our like-for-like revenue and profitability of sales per square metre in 2013-2016.

Brand Awareness

The Detsky mir brand dates back to the Soviet times and has been and continues to be an iconic household name in Russia. Historically, "Detsky mir" was closely associated with the entire children's goods retail industry in the Soviet Union and subsequently in Russia. Based on the consumer survey by Ipsos Comcon conducted in 2016, the "Detsky mir" brand had 97% prompted awareness (as compared to 75% for one of the largest competitors).

Sales Channels

Our retail stores are our primary sales channel. As at 31 December 2016, we operated 525 stores, consisting of 480 stores under the "Detsky mir" brand name (nationwide in Russia and 12 stores in Kazakhstan) and 45 stores under the ELC brand name mostly in Moscow and the Moscow region. We also operate an online store launched in 2011, and since 2015 offer our customers an "in-store pickup" option.

The table below sets forth our revenue by sales channel:

Sales channel	For the Nine Months Ended 30 September				For the Year Ended 31 December					
	2016		2015		2015		2014		2013	
	(in millions of Roubles)	%	(in millions of Roubles)	%	(in millions of Roubles)	%	(in millions of Roubles)	%	(in millions of Roubles)	%
Detsky Mir stores in Russia	51,918	96%	38,297	96%	57,862	96%	43,099	95%	34,156	95%
Detsky Mir stores in Kazakhstan	494	1%	468	1%	669	1%	503	1%	407	1%
ELC stores	655	1%	597	1%	937	2%	813	2%	605	2%
Yakimanka Gallery	—	—	108	0	108	0	588	1%	606	2%
Online store(1)	1,158	2%	496	2%	969	2%	443	1%	227	1%
Total revenue	**54,226**	**100.0**	**39,967**	**100.0**	**60,544**	**100.0**	**45,446**	**100.0**	**36,001**	**100.0**

(1) Online store does not include sales through "in-store pickup" which are included in sales of offline stores.

Retail Stores

Detsky Mir Stores

The customer proposition of our Detsky Mir stores is to provide a one-stop shopping destination by supplying a broad, high-quality assortment in all our product categories at affordable prices. The stores are predominantly located in modern shopping malls, as well as in densely populated residential areas adjacent to major traffic routes or near underground or railway stations. As at 31 December 2016, we operated a network of 467 stores in shopping malls and 13 stores outside shopping malls. We consider shopping malls to be the most advantageous location for our stores because shopping malls regularly experience the highest customer traffic amongst retail locations and are generally located in central areas which are convenient and accessible to potential customers. The shopping malls where our retail stores are located can be divided in two categories: (i) shopping malls with total selling space above 150,000 square metres serving as evening and weekend consumer destination points, such as IKEA/MEGA shopping malls in Moscow and the Moscow region, with food court restaurants and family entertainment facilities, and (ii) smaller shopping malls with total selling space of 10,000 to 150,000 square metres located centrally next to busy transport links.

Store Formats and Clusters

All of our Detsky Mir stores operate in the same format in terms of product assortment, pricing policies, marketing and promotional activities, which allows us to ensure the consistency and scalability of our business, as well as to reduce logistic, marketing and administrative costs as compared to operating different store formats. Our product assortment for stores is determined centrally taking into account weather and climate conditions in particular regions of Russia.

In 2013, in cooperation with the international marketing agency CampbellRigg, we developed an innovative store design concept. This new store design concept has a highly interactive format based on international best practices and optimises selling space through the integration of gaming and interactive zones with trading areas and product aisles. It also has an improved in-store layout and an overall brighter design. Store layout is organised by product category, brand name and age group to the extent possible. In addition, our new design concept has areas where brand manufacturers' representatives can interact with customers as part of promotional campaigns. Our first store in new design format was opened in December 2013 in the "Mega Belaya Dacha" shopping mall in the Moscow region. Since then, we have been using the new store design concept for all new stores and transitioning existing stores to the new design concept. As at 31 December 2016, 271 stores operated under the new design concept.

Our unified store format consists of a standard product assortment of 20,000—30,000 SKUs (including fashion), separate zones for each of our five product categories and dedicated promotional area.

We operate stores in four size categories that differ in terms of selling space and number of SKUs as follows:

Size	Selling space per store (in sq. m.)	Average number of SKUs per store (excluding fashion)
Mini	less than 600	6,500
Super	600-1,500	11,000-14,000
Hyper	over 1,500	16,000
Flagman	over 2,000	18,500

The average size of our Detsky Mir stores is approximately 1,400 square metres of total space. Approximately 63% of our stores have selling space of 1,000-2,000 square metres.

ELC Stores

ELC stores offer various educational and learning games and other toys for newborns and children up to 14 years old. A typical ELC store offers approximately 4,600 SKUs and has selling space of 70-120 square metres including specialised in-store entertainment zones with games and English language classes. In 2015, the average ticket at ELC stores was RUB2,100 as compared to the average ticket at Detsky Mir stores of RUB1,206. Our ELC stores are typically located in modern shopping malls where other children's goods stores are present and there is high customer traffic. Before our acquisition of the ELC stores in 2012, they were mainly located in Moscow. Presently, we have ELC stores in other large cities such as Krasnodar, Tyumen, Ufa, Sochi, Samara, Ryazan, Togliatti and St. Petersburg.

The table below sets forth the number of ELC stores by region as at 31 December 2016:

	Number of stores	%	Selling space (in sq. m.)	%
Moscow and Moscow region	27	60.0%	3,055	64.9%
Volga	5	11.1%	409	8.7%
North Western	6	13.3%	569	12.1%
Siberian	2	4.4%	214	4.5%
Central	1	2.2%	70	1.5%
Southern	4	8.9%	390	8.3%
Total	**45**	**100%**	**4,707**	**100%**

In 2013, we extended the franchise agreement with Early Learning Centre Limited until 2023. Pursuant to the terms of the agreement, we are required to buy at least 60% of the products offered at our ELC stores from Early Learning Centre Limited with the balance to be bought from other manufacturers agreed with Early Learning Centre Limited. This split allows our ELC stores to purchase Detsky Mir store products and therefore we expect to realise supply synergies between the chains. We aim to locate ELC stores in the same shopping malls as Detsky Mir stores to benefit from high customer traffic. In addition, when placing an ELC store in the same shopping mall with a Detsky Mir store, we believe we can obtain better lease terms from such malls due to leasing a larger area. As part of our strategy with respect to ELC stores, prior to approving any expansion plans, we are currently focused on increasing the operational efficiency of this chain on a stand-alone basis, including by relocating a number of unprofitable stores.

For the nine months ended 30 September 2016 and 2015, revenue generated by ELC stores was RUB655 million and RUB597 million, respectively, representing 1.2% and 1.5% of our total revenue for the respective periods. During the last three years our subsidiary "Cub-Market", LLC (the operator of ELC stores in Russia) had modest financial results and recorded operating losses. Furthermore, as a result of an impairment testing of goodwill in 2015, we recognised an impairment loss with respect to "Cub-Market", LLC of RUB363 million in 2015. See also "*Risk Factors— Risks Relating to the Russian Legal and Regulatory Environment—Russian legal entities may be forced into liquidation on the basis of formal non-compliance with certain requirements of Russian law.*"

Store Selection Process

We seek to open our stores in convenient and easily accessible locations with high customer traffic and/or high population density. We use comprehensive investment criteria and procedures to evaluate proposals for, and to open, new stores. We have a dedicated development team of four employees which is responsible for searching for new suitable locations and which then engages representatives from other departments, including financial, legal and sales, in assessing the opportunity.

The core criteria for any particular location and size of a store are: (i) market size and socioeconomic conditions in the region (we primarily seek to operate in cities with populations in excess of 50,000); (ii) availability of premises in shopping malls; (iii) competition, including local market size, presence of key competitors and existing presence of our stores; (iv) access and catchment area; and (v) technical and legal considerations. For each identified location, we (i) perform site evaluation using statistical methods to forecast customer traffic and sales based on local demographics such as number of inhabitants, number of children and average salary; (ii) estimate net present value of cash flows from a particular store; and (iii) calculate an internal rate of return and a payback period (the time required for the store to generate sufficient cash flows to recover its opening costs). We forecast each new store's performance on the basis of the expected level of pedestrian and automobile traffic, expected birth rate, estimated level of the local population's disposable income and the level of competition. In addition, the proposed lease terms are taken into consideration. If we decide to open a new store in a location where we already operate an existing store, to avoid cannibalisation we apply an internal rate of return of 40% for the new store and expect that combined net present value of both stores should be higher than stand-alone net present value of the existing store.

All store locations and the related analyses are submitted to the Investment Committee (which includes the chief executive officer and the chief financial officer) for review and approval. In 2015, the Investment Committee reviewed 330 store locations proposed for opening and approved 126 of them, of which 103 stores were opened. In 2016, the Investment Committee reviewed 225 store locations proposed for opening and approved 100 of them, of which 95 stores were opened. As at 31 December 2016, we have identified and reviewed locations for store openings (we target to open 70 stores in 2017) and approved 32 locations (including 10 locations that have been leased).

As part of our decision making criteria, a new store should typically have a payback period of no more than three years, have a maturity period (i.e., to achieve the targeted customer traffic) of 18-24 months, and exceed a required internal rate of return of at least 40% over a period of seven years based on generated cash flows. Our site evaluation also takes into account potential delays in a new store opening due to overall delays in the opening of the new shopping mall where the store would be located. Typically, new stores are opened in the fourth quarter of a year in order to take advantage of higher seasonal sales at the end of the year.

We mainly locate our stores in existing shopping malls with at least 10,000 square metres of selling space. We believe that shopping mall locations are best for our stores because (i) they offer the highest traffic intensity, (ii) they offer suitable selling space for our format, (iii) they offer us the opportunity to locate near children's recreation areas, cinemas or food courts, and (iv) they allow us to launch a store rapidly. We believe that our Detsky Mir stores are a good proposition for shopping malls because (i) specialised children's stores are a must for most shopping malls in order to generate traffic and provide a good shopping experience to families visiting the mall, (ii) our exceptional brand awareness boosts mall traffic, (iii) we are a large and established counterparty with whom the mall owners can deal with confidence, and (iv) we have a fast and efficient store opening process due to our years of store opening experience. For these reasons, we believe that we are strongly positioned to compete for new shopping mall locations.

With respect to geographic expansion, we focus on:

(i) Moscow and St. Petersburg—these are the most mature markets with strong competition but many good locations are still available (with an estimated 217 existing shopping malls available for new stores);

(ii) Large cities with population of 1 million or more—these cities have established retail space (with an estimated 202 existing shopping malls available for new stores);

(iii) Mid-sized cities with population of 300,000—1 million—these cities tend to be underserved with no or limited presence by top retailers, but often have underdeveloped retail space (with an estimated 199 existing shopping malls available for new stores); and

(iv) Regional agglomerations of small cities with population of 50,000—300,000 (with an estimated 16 existing shopping malls available for new stores).

A typical new store opening can take up to six months from the identification of a suitable location, including the period of time necessary for the investment decision to be made. In advance of the opening, extensive publicity efforts are undertaken, employees are hired and trained and store equipment and merchandise are sourced. The typical period of time to fit-out a store is up to three months. We are often granted a payment deferral or a discounted rental rate for the fit-out period. The average cost of opening a new store (excluding the cost of inventory) for the stores opened in 2015 was RUB13 million (net of VAT) per new store.

We monitor the performance of each store in our retail chain on a weekly basis. We will consider closing a store if it fails to meet key performance indicators over a period of time or if we can replace it with an adjacent or proximate location if it can be secured on better lease terms or offers higher customer traffic. In 2013-2016, we closed eight stores (including Yakimanka Gallery), of which one store was relocated.

E-commerce

In addition to our retail stores, we operate online stores at our websites www.detmir.ru and www.elc-russia.ru. We have been successful in integrating our online and offline platforms by drawing on the strengths of our offline retail operations. Our strong brand recognition underpins our online traffic and allows us to save on online marketing and advertising costs. Moreover, we believe that our country-wide operations and offline volume of merchandise enables us to negotiate more attractive prices with suppliers than pure online players which are reflected in lower prices for both our offline and online customers. Furthermore, our supply chain and nation-wide offline presence allow us to offer customers prompt and cost-efficient delivery solutions via our "in-store pickup" service that generates a substantial portion of online sales.

Launched in 2011, our Detsky Mir online store and delivery service has experienced significant growth since then. In the nine months ended 30 September 2016, we recorded over 63 million visits in our online store. Based on the sales analytics, the number of placed orders via our online store was over 1 million with an average ticket (for courier delivery) of RUB3,483 in the nine months ended 30 September 2016 as compared to approximately 72,000 orders and average ticket of RUB3,491 in 2013. The conversion ratio increased from 0.25% in 2013 to 0.85% in 2015, and was 1.45% in the nine months ended 30 September 2016.

The table below sets forth the comparison of growth of number of visitors in our online store, orders made through our online store, conversion ratio and the average ticket size (for in-store pickup and courier delivery, based on the sales analytics) for the years ended 31 December 2016, 2015 and 2014.

	Nine months ended 30 September		Year ended 31 December		
	2016	2015	2015	2014	2013
Visits (in millions)	63	44	63	43	29
Placed orders (in thousands)	1,027	230	536	159	72
Conversion ratio	1.45%	0.66%	0.85%	0.37%	0.25%
Average ticket, in-store pickup (in Roubles)	1,729	1,952	1,956	—	—
Average ticket, courier delivery (in Roubles)	3,483	3,415	3,358	3,563	3,491

As at 31 December 2016, our online store offered approximately 40,000 SKUs, which mainly included products for newborns, large items, toys and fashion (apparel and footwear) products. Like in our retail stores, products for newborns are an important category and generate customer traffic while toys and fashion (apparel and footwear) products lead in profit generation. While we are one of the leading retailers among other specialised children's goods retailer in terms of online sales, we intend to expand our online product range up to 50,000 SKUs primarily by increasing the range of fashion (apparel and footwear) merchandise and products for newborns.

The target audience for our online sales are expectants or new mothers, as well as young customers buying presents for the children of relatives or friends (toys in particular) for special occasions. In the nine months ended 30 September 2016, our online sales were concentrated mainly in Moscow and the Moscow region which accounted for 52% and St. Petersburg which accounted for 14% of all online sales because all merchandise ordered online is delivered from a distribution centre located in Krekshino (Moscow region). Over the past three years we have significantly expanded our capabilities to deliver to other regions of Russia and considerably increased the share of other regions in total sales. In 2013, the combined share of Moscow, the Moscow region and St. Petersburg accounted for 85% of our online sales; accordingly other regions accounted for only 15% of total sales as compared to approximately 34% in the nine months ended 30 September 2016. In the future, we intend to deliver merchandise ordered online from our regional stores and a distribution centre in the regions in order to improve delivery times and attract more online customers.

Our customers can also order products from our online store by calling the call-centre, which is operated by a third party. We estimate that approximately 10% of online orders are made via the call-centre. Upon receipt of the order, the information is communicated to our distribution centre in Krekshino (Moscow region). Following the processing of the order, a third party logistic company delivers the product to the customer. Online customers may choose to pay cash or with a bank card to the delivery courier or with a bank card or via PayPal on the website when placing an order. In addition to direct courier delivery to customers, we offer delivery options to pickup points operated by third parties such as Boxberry and Ozon.

Our websites allow customers to determine if an item is in stock at a particular store, and we offer "in-store pickup" of online orders in our retail stores in Russia. In the nine months ended 30 September 2016, 48% of our online orders were made with our "in-store pickup" service. Upon receipt of the order online, the information is communicated to the retail store selected by the customer and within approximately 1.5 hours the order is available for pick up. We intend to support growth of our "in-store pickup" service which generates additional cross-selling opportunities. In our experience, customers visiting our store to collect "in-store pickup" orders tend to purchase additional products.

As we expect our online sales channel to grow at an accelerated pace in the medium term, we are also working on establishing an efficient integrated supply chain supporting our omni-channel distribution strategy. To this end, we intend to develop our online distribution network in close cooperation with our existing retail network. We believe this integration will provide us with a particular cost advantage in logistics and distribution over pure online retailers of children's goods. We intend to implement SAP Hybris e-commerce platform and expand the geography of our delivery area to regions in which we have no offline presence.

Our e-commerce promotion strategy leverages our high brand recognition and is integrated with our overall advertising activities. See "*—Marketing and Advertising*" for information on our marketing and advertising campaigns.

We review on a daily basis statistics on a number of visitors (based on Google Analytics, Yandex Metrica) to our online store, the conversion ratio of visits to orders, the average ticket and the number of declined orders. We also track changes in the product offerings of our main online competitors. The successful development of our online sales is reflected by an increase of our net promoter score for online from 27% in May-June 2015 to 46% in September-October 2016 as calculated by Ebeltoft Russia—IRG. A net promoter score reflects the customer satisfaction level calculated as percentage of promoters (customers willing to recommend Detsky Mir to others) minus percentage of detractors (customers who are dissatisfied with their experience with Detsky Mir).

Supply Chain

Our supply chain management system is one of the key elements of our business model and represents one of our key competitive advantages. The efficiency of our network, sourcing competencies and warehousing platform are critical to support geographic expansion, maintain competitive pricing and maximise availability of products in stores.

Our supply chain operations include warehousing and storage infrastructure (distribution centres), organisation of deliveries of products to stores and direct imports capabilities. Some of these operations are carried out in-house (such as certain customs clearance processes), while some are outsourced to third party service providers (primarily transportation).

We generally maintain a mix of direct deliveries to stores by our suppliers and a centralised distribution system, whereby products from suppliers are aggregated in the distribution centres and subsequently delivered to the stores.

Our SAP integrated platform, which includes SAP EWM and SAP Forecasting and Replenishment, allows us to forecast future sales, prevent supply chain bottlenecks and further improve the availability of goods in stores.

In line with our omni-channel strategy, the other principal direction of our supply chain infrastructure development is further integration of our existing supply chain platform servicing our store network and our online operations.

Suppliers

Relationship with Suppliers

Our suppliers include manufacturers, as well as major regional suppliers and distributors. In the nine months ended 30 September 2016, we had a diversified supplier base with our ten largest fashion (apparel and footwear) suppliers comprising 44% of our cost of goods sold for this category, and our ten largest suppliers of toys, products for newborns, large items and other (including stationery) comprising 42% of our costs of goods sold for this category.

We generally seek to enter into supply agreements directly with manufacturers or their local Russian representative offices to secure favourable pricing, minimise foreign currency exchange exposure and secure direct access to products. Where we are unable to do this, or to broaden our product range, or where it is not economically viable, we enter into arrangements with distributors and trading companies. In the nine months ended 30 September 2016, over 80% of our merchandise inventory was manufactured abroad, primarily in China, India, Vietnam and Bangladesh. Of this imported merchandise inventory, approximately 80% is purchased from local offices of international manufacturers or their distributors and approximately 20% is sourced directly by us (primarily own brand products) from manufacturers in Southeast Asia and we arrange for its transportation and customs clearance.

We purchase toys and products for newborns and stationery mainly from the local offices of the international manufacturers or their local distributors under contracts where the prices are set in roubles. Our own brand products in the fashion (apparel and footwear) category are purchased by us under direct import contracts with manufacturers in Southeast Asia and Europe where the prices are set in U.S. dollars or euro. See also "*—Direct imports" and "Risk Factors—Risks Relating to Our Financial Condition—Fluctuations in the value of the rouble against the U.S. dollar or the euro could adversely affect our financial condition*" for a description of risk of foreign currency exchange exposure.

As at 31 December 2016, we had seven direct suppliers in toys, 58 in products for newborns, 59 in large items and 25 in stationery and other products.

We generally enter into standard framework agreements with our suppliers for a fixed term with an automatic extension of term or extension under an additional agreement. Due to our market position and the scale of our operations, we are an important customer to many of our suppliers and, therefore, we are usually able to negotiate favourable supply terms including and the funding of promotional activities. Such framework supply agreements provide for general terms, such as rights and obligations of the parties, quality and packaging of the supplied goods and guarantee periods. With regard to each individual delivery, the buyer provides the supplier with an order specifying the assortment and amount of goods to be delivered based on the price-list agreed by the parties. See "*—Contract Terms*".

We also aim to enter into exclusivity arrangements with our suppliers which (i) enhance traffic generation, (ii) contribute to like-for-like sales growth, (iii) improve customer loyalty and (iv) protect us from price competition in the pre-sale period. For example, in 2016 we had exclusivity arrangements with Mattel, Hasbro, Lego, Maclaren and Artsana. We are generally in a unique position in the children's goods sector to benefit from high-impact exclusivity arrangements.

The prices for our merchandise manufactured abroad are generally linked to the U.S. Dollar or Euro, and our suppliers adjust the price of their products based on the value of these currencies. However, despite the significant devaluation of the Russian Rouble against the U.S. Dollar and Euro at the end of 2014 and subsequent high currency volatility, our strong bargaining power has allowed us to negotiate only moderate increases in the average purchase prices with our suppliers, most of which we were able to pass on to customers by increasing the prices of the products we sell. In 2015, average retail prices in Detsky Mir stores increased by 23%, while the Rouble depreciated against the U.S. Dollar during the same period by 60%. We decided to invest in lowering prices and absorbed part of the significant devaluation of the Rouble which allowed us to increase our market share and gross profit per square metre.

In coordination with the suppliers, as part of inventory management, we conduct sales campaigns where the level of discount depends on the success of sales, and such discount may gradually increase. The remaining portion of unsold stock, which is usually insignificant, is given to charity.

Contract Terms

Our bargaining power and strong long-term relationships with regional and international suppliers allow us to increase our payment deferral period and thus reduce working capital requirements. For the majority of our domestically sourced products, we generally pay 30-60 days after the date of sale in a store. For imported products, depending on the supplier, we use a letter of credit to guarantee payment, occasionally pre-pay and settle the invoice in full within 60-180 days of shipment (on FOB terms).

For products in the toys category payments are made 90-110 days after the date of shipment (with regard to three largest suppliers that account for approximately 60% of sales in this segment) and 30-60 days after the date of sale in a store (with regard to other suppliers); for products in the fashion (apparel and footwear) category payments are generally made 30-60 days after the date of sale in a store (with regard to approximately 20% of sales in this segment) and 90-110 days after the date of shipment (with regard to other suppliers); and for products in the newborns category the payment is generally made 25 days after the date of supply. The payment terms for products in the stationery product category are the generally same as for the toys product category.

Our supply contracts generally contain pre-agreed price lists and provide that prices will be fixed for not less than 180 days. The actual supply volumes and assortment of products are set out in the specifications that we submit to suppliers on the basis of the price list from time to time. For products the demand for which is subject to seasonal fluctuations, we may have a pre-agreed schedule of supplies in our supply contracts.

With respect to our own brand products which we source under direct import contracts with manufacturers we have agreed upon a letter of credit opened for up to 180 days which allows us to minimise risks of losing control over product quality and supply.

Our contracts with suppliers generally provide for bonuses paid by suppliers upon accrual of a certain volume of supplies. The bonus is usually set either as a percentage of the volume of supplies or as a fixed amount. The contracts may contain differentiated bonuses for various categories of products. In addition, some of our suppliers offer discounts for advertising and marketing campaigns that we hold in relation to their products.

See "*Regulation of the Russian Retail Sector—Regulation of Retail—Federal Trading Law*" for the discussion of the regulatory restrictions on payment terms and bonuses paid by suppliers.

Direct Imports

We directly import approximately 20% of our imported merchandise inventory (primarily own brand products in the fashion (apparel and footwear) category), while the remaining 80% of the imported inventory is purchased from local offices of international manufacturers and distributors. We directly import products from both Asian and European manufacturers and primarily purchase products on a FOB basis with prices set in U.S. Dollars or Euros. Accordingly, we are responsible for contracting with third party transportation providers and freight companies, such as specialised container operators, for the shipping of products by sea from the port of manufacturers to the Russian border, mainly to the St. Petersburg port and the Kotka and Ust-Luga ports near St. Petersburg. We have an in-house department which handles customs clearance and other import-related procedures. Following customs clearance, products are typically delivered to our distribution centres in Bekasovo and Krekshino.

Distribution Centres

We presently operate two distribution centres in Bekasovo and Krekshino in the Moscow region. In 2015, we opened our new distribution centre in Bekasovo (approximately 50 kilometres from Moscow) with 70,000 square metres of useable area, and a capacity to serve up to 500-600 stores. Our Krekshino distribution centre has a total warehousing area of 20,000 square metres designed for 20,000 pallets, and serves our online and ELC stores. The distribution centres are equipped with racking storage capacities, and also allow for both pick-by-line and cross-docking delivery models, whereby products are dispatched upon receipt from the supplier without being transferred to the storage areas of the distribution centre. The inventory of the distribution centre turns in approximately 35 days and logistic costs account for approximately 4.5-5.5% of the purchase costs for goods passing through the distribution centre. To support our roll-out in the Ural and Siberian regions of Russia, we have made a preliminary decision to open a new distribution centre in the Urals with approximately 60,000 square meters of warehousing space in 2018. We intend to evaluate options, in particular with respect to ownership as opposed to rent, and make a final decision in the first half of 2017.

The percentage of our goods that was centrally distributed increased from 20% of purchase costs for goods that passed through our distribution centre in 2013 to 65% of purchase costs for goods that passed through our distribution centres in 2016. We intend to increase centralised distribution to 75%-80% of purchase costs for goods that passed through our distribution centres by 2019. The increased percentage of centralised distribution allows us to achieve economies of scale, increase in-store availability of products, minimise transportation costs, as well as enable us to engage in a larger number of direct relationships with the manufacturers and reduce dependency on the distributors and traders. The remaining portion of 35% of purchase costs for goods in 2016 was distributed directly by our suppliers to our stores. Our suppliers directly deliver a portion of products for newborns to our stores due to cost efficiency reasons and in line with the market practice.

Furthermore, in 2015 we completed the implementation of the new enterprise resource planning system SAP. Our warehouse management system is now fully integrated into the SAP platform which allows us to have full visibility over the full cycle of the supply chain flows from ordering, processing in a warehouse or a store and delivery to a customer.

Transportation to Retail Stores

Our deliveries to stores are almost exclusively carried out by trucks. Currently, we do not own a transportation fleet and fully outsource the transportation functions to third party logistics providers in line with our asset-light strategy. We conduct procurement tenders among logistics companies for their services on an annual basis. We do not enter into long-term contracts with such service providers as we believe the market is highly competitive and we can best achieve commercially attractive terms through an annual tender.

Competition

We compete directly with other children's goods retail chains, general food retailers (hyper- and supermarkets), online retailers (general and specialised) and other retailers (non-organised and traditional retail (open markets, grocery stores)). We compete on the basis of price, product assortment, customer service and location, as well as benefits (such as loyalty cards). Among specialist retailers, we compete with Russian specialised children's goods retailers such as Korablik, Mothercare and Dochki-Synochki. In certain segments, we face competition from general food retailers (such as hyper- and supermarkets) and specialised retailers (such as monocategory retailers). Additionally, we face competition from unorganised retail markets and street shops and smaller retailers which may be dealing in grey market products. We expect in the future there will be increasing competition from pure online retailers, both domestic and international. See "*Industry Overview—Russian children's goods market structure: sales channels*" and "*Risk Factors—Risks Relating to Demand and Competition*".

Marketing and Advertising

The objective of our marketing activities is to attract customers, improve brand loyalty and awareness, promote our products and evaluate market information and trends. Our marketing programme includes advertising campaigns, as well as other promotional activities. In 2011, we launched a loyalty programme, as described below. At the date of this Offering Memorandum, our marketing team consists of 30 employees.

Advertising Campaigns and Promotional Activities

We typically engage in advertising campaigns and other promotional activities to drive customer traffic, to prompt impulse purchases, to drive the sales of seasonal products and to enhance "Detsky mir" brand awareness. We use multiple advertising channels for our campaigns, including television, internet (including social media), catalogues, in-store and mall displays. In the past, we have jointly procured television advertising with PJSC MTS, a Sistema subsidiary and a leading telecommunications provider in Russia and the CIS. This arrangement has allowed us to obtain more favourable terms on advertisement because of larger overall volume as compared to stand-alone procurement, and we intend to continue joint procurement of television advertising with PJSC MTS if more favourable terms can be obtained compared to those available via separate procurement. Our product advertising campaigns with respect to particular products are typically reimbursed and funded by the suppliers of such products who consider us to be their retailer of choice and our retail stores to be their best sales channel. These campaigns include integrated marketing communications, consisting of (i) national promotion campaigns using television and Internet, including our websites (www.detmir.com and www.elc-russia.com) and social media; (ii) printed advertising, principally catalogues and leaflets; and (iii) in store decorations and in-store audio announcements. Our marketing activities include promotional campaigns, the introduction of new collections and sales, promotion products for babies, coupons and special releases. We launch numerous promotional campaigns during the year: (i) two seasonal campaigns ("back to school" and "New Year" campaigns); (ii) two launches of new seasonal fashion collections (spring-summer and autumn-winter collections); (iii) two campaigns associated with the Men's Day on February 23 and Women's Day on March 8; (iv) three coupon promotions (Women's Day on March 8, back to school and New Year); and (v) special promotions associated with new toy or movie releases or generally in relation to launches of products for newborns. Each promotional campaign has its own creative concept and offers the best prices on the most popular products involved in the campaign.

We use a number of online marketing tools to attract new visitors to our online store. We utilise search engine optimisation. Approximately 80% of traffic to our online store is coming from search results and is unpaid while the remaining portion is attributable to online advertisement. In addition, we use referral marketing as a method of promoting us to new customers through referrals by our existing customers. Furthermore, we actively promote our brand and online store through social media. During high season, we increase our online marketing activities by placing contextual and targeted advertising.

We also publish and send our newspaper and leaflets to residences in the catchment area of our stores which supports ongoing traffic to the stores. We generally have 15 editions of newspaper per year and 10 editions of leaflets per year.

In recent years, bonuses and allowances received from suppliers for cooperative advertising, promotions and volume discounts have covered our advertising and marketing expenses. The table below sets forth bonuses and allowances received from suppliers (which are recorded as a reduction in cost of goods sold) and total advertising and marketing expenses, as well as the related coverage ratio, for the nine months ended 30 September 2016 and 2015 and for the years ended 31 December 2015 and 2014 (under IFRS).

	Nine months ended 30 September		Year ended 31 December	
	2016	**2015**	**2015**	**2014**
Bonuses and marketing income from suppliers recognised as a reduction in cost of goods sold (in RUB millions)	7,834	4,609	7,385	4,351
Advertising and marketing expenses (in RUB millions)	671	596	1,091	782
Coverage ratio	9%	13%	15%	18%

The table below sets forth bonuses and allowances received from suppliers (which are recorded as a reduction in cost of goods sold) and total advertising and marketing expenses, as well as the related coverage ratio, for the years ended 31 December 2014 and 2013 (under US GAAP).

	Year ended 31 December	
	2014	**2013**
Bonuses and marketing income from suppliers recognised as a reduction in cost of goods sold (in RUB millions)	4,351	2,863
Advertising and marketing expenses (in RUB millions)	782	567
Coverage ratio	18%	20%

In addition, as a part of the loyalty programme described in "*—Loyalty programme*", we communicate with our customers through e-mail and SMS.

Loyalty Programme

In 2011, we introduced the "Yo-Yo" bonus card which is given to customers free of charge. By completing a questionnaire customers receive 200 initial bonus points for free. One bonus point equals one Rouble. Customers earn bonus points in the amount of 5% of the purchase price for all their merchandise purchases at our Detsky Mir stores, as well as at our online store. Customers may use the accumulated bonus points to obtain up to a 20% discount on merchandise purchased from our Detsky Mir stores. Bonus points expire one year after they are earned. As at 31 December 2016, we had issued over 14.6 million "Yo-Yo" bonus cards in Russia. Through our bonus card programme, we have obtained the contact details of over 9 million customers for use in marketing activities.

We communicate with the holders of the bonus card through e-mail and SMS. We also have special promotional activities for holders of the bonus card, such as birthday bonuses, double bonuses for apparel and footwear purchases and pre-sale activities. We use a CRM system in order to better target our promotional activities based on the customer's use of the bonus card. As set out in the table below, approximately 77% of Detsky Mir sales in the nine months ended 30 September 2016 was generated by customers using their "Yo-Yo" bonus cards. The average ticket for customers using our "Yo-Yo" bonus card is more than 30% higher as compared to the average ticket for customers not using the card.

The below table shows some statistics on usage of our "Yo-Yo" bonus cards by customers:

	As at or for the nine months ended 30 September		As at or for the years ended 31 December		
	2016	2015	2015	2014	2013
Share of Detsky Mir tickets of customers using "Yo-Yo" bonus card	71%	63%	64%	60%	63%
Share of total Detsky Mir sales from customers using "Yo-Yo" bonus card	77%	69%	70%	68%	71%

Real Estate

As at 31 December 2016, we operated 525 stores, which included 523 leased stores and two owned stores (Detsky Mir stores in Rostov and Tambov). In addition to these owned stores, "Detsky mir—Oriol" JSC also owns a portion of premises that are currently under reconstruction where a department store specialising in children's goods was located. We lease the remaining portion of premises from a third party. Following acquisition of 100% of shares in "Detsky Mir—Oriol" JSC in August 2016, we intend to open a Detsky Mir store under our current design concept in February 2017.

The leased stores account for 99.2% of our total selling space. As at 31 December 2016, approximately 60% of our lease agreements have a lease term of more than five years, approximately 31% of our lease agreements have a lease term of one to five years and the remaining 9% of our lease agreements have a lease term of less than one year. Adhering to our asset-light business model, we intend to continue expanding our retail store network mainly through leases.

Typical long-term lease terms include (i) a lease term of 5+ years with a preferential right to renew the lease; (ii) indexation rate capped at 5-6% to an agreed rental rate (subject to negotiations with lessors); (iii) operating expenses to be borne by us; (iv) our unilateral right to terminate the lease with 3-5 months' notice; and (v) our obligation to insure the goods in the store.

Most of our lease agreements with respect to stores located in Russia establish Rouble-denominated lease rates or a Rouble equivalent of foreign-currency lease rates at fixed Rouble/U.S. Dollar, Rouble/Euro or Rouble/U.S. Dollar-Euro exchange rates. Out of 466 Detsky Mir store lease agreements as at 31 December 2016, 325 provided for Rouble-denominated lease rates, 114 provided for U.S. Dollar-denominated lease rates, 14 provided for EUR-denominated lease rates and 13 provided for dual U.S. Dollar/Euro lease rates. Out of 45 ELC store lease agreements as at 31 December 2016, 22 provided for Rouble-denominated lease rates, 19 provided for U.S. Dollar-denominated lease rates, two provided for EUR-denominated lease rates and two provided for dual U.S. Dollar/Euro lease rates. Due to the significant depreciation of the Rouble against the U.S. Dollar and the Euro in the end of 2014 and the subsequent volatility of the Rouble, we renegotiated lease agreements with lease rates established in U.S. Dollars and/or Euros, and introduced caps for Rouble/U.S. Dollar or Rouble/Euro exchange rates, as well as provisions to renegotiate these caps annually or establish caps for a certain period of time. As at 31 December 2016, the average exchange rates with respect to 56 agreements providing for an annual renegotiation of caps were RUB38 per U.S.$1, RUB53 per EUR1 and RUB46 for dual EUR/U.S.$ exchange rate, and the average exchange rates with respect to 85 Detsky Mir store lease agreements providing for longer-term fixed caps (in average, for not less than 4 years) were RUB38 per U.S.$1, RUB49 per EUR1 and RUB44 for dual EUR/U.S.$ exchange rate. As at 31 December 2016, 20 ELC store lease agreements provided for fixed Rouble/U.S. Dollar, Rouble/Euro or Rouble/U.S. Dollar-Euro exchange rates, with average exchange rates of RUB48 per U.S.$1, RUB61 per EUR1 and RUB44 for dual EUR/U.S.$ exchange rate, while three ELC store lease agreements provided for rental payments based on the CBR's RUB/U.S.$ exchange rate. Since 1 January 2016, a predominant portion of our lease agreements for new stores are denominated in Roubles. All our twelve lease agreements with respect to stores located in Kazakhstan establish Tenge-denominated lease rates. While our selling space increased from 390 thousand square metres as at 31 December 2014 to 491 thousand square metres as at 31 December 2015, our rent and utility costs decreased from 12.8% of revenue for 2014 to 11.7% of revenue for 2015.

Consistent with a typical market practice for leasing space in newly constructed shopping malls in Russia, we usually first enter into a preliminary lease agreements with lessors, which contain an obligation for the parties to enter into a short-term lease agreement from the date on which the real property was registered and until the date when a long-term lease agreement between the parties has been registered with the registration authorities. We usually negotiate the preliminary lease agreement, the short-term agreement and the long-term lease agreement as one package.

We own our distribution centre in Bekasovo (Moscow region) with approximately 70,000 square metres of useable area. In addition, we lease a distribution centre in Krekshino (Moscow region) under a lease agreement. The lease term for our Krekshino distribution centre is 10 years which expires in 2019. See "*Material Contracts—Other Agreements—Long-term lease agreement No. 3A DM/0409 DDA with LLC Fenix-K*" for a description of the material terms of the lease.

See "*Risk Factors—Risks Relating to our Business and Strategy—We lease the premises for almost all of our stores and for our Krekshino distribution centre, and our failure to renew such leases on commercially acceptable terms, or at all, could affect our business*".

Information Technology

Our IT infrastructure is critical to our operations, as well as key to the growth of our business. In 2015, we completed the upgrade of our IT systems on the basis of SAP. The SAP system is able to support up to 800 stores. By introducing SAP, we switched from a number of integrated IT systems into one unified SAP platform and an integrated purchasing, logistics and sales support system. The integrated SAP platform includes (i) SAP merchandising (product management); (ii) SAP Forecasting and Replenishment; (iii) SAP EWP (warehouse management); (iv) POS Data management; and (v) Business Objects (Business analytics). One of the advantages of this upgrade was the integration of the highly productive platform with the SAP HANA database for corporate data storage.

We have two data centres and perform data back-up procedures on a daily and weekly basis. As at the date of this Offering Memorandum, we have not experienced any material information technology system failures or disruptions.

Our Internet website for online sales is based on the Unix operating system and was developed by a third party. In line with our business strategy, following the implementation of the new enterprise resource planning system on the basis of SAP platform in 2015, we have started upgrading our e-commerce solutions on the basis of SAP Hybris (e-commerce suite) which is expected to replace the existing Unix operating system in 2017. SAP Hybris e-commerce platform will allow us to boost our digital presence by developing a user friendly interface for our customers and by introducing various creative e-commerce solutions, which should enable us to fully integrate our retail and online stores to execute our omni-channel strategy.

We believe that our scalable IT platform will support the growth of our retail chain and e-commerce and will not experience any material limitations in terms of IT technologies in the near future.

Intellectual Property

As at 31 December 2016, we held the exclusive right to use (i) 69 trademarks in Russia, including a well-known trademark related to the "Детский мир" ("Detsky mir" in Cyrillic) name, a trademark related to "Detsky mir" logo (image of four blocks of different colours and "Detsky mir" in Cyrillic), seven trademarks related to various forms of the "Detsky mir" name and 60 trademarks related to our own brand products; (ii) two trademarks in Kazakhstan related to the "Detsky mir" name and logo (image of four blocks of different colour and "Detsky mir" in Cyrillic and Kazakh language); and (iii) eight trademarks in Turkmenistan related to various forms of the "Detsky mir" name and logo (four blocks of different colour and "Detsky mir" in Cyrillic and Turkmen language). We have also applied for the registration of nine trademarks in Russia and two trademarks in Armenia related to the "Detsky mir" name in Cyrillic and Armenian characters and logo (four blocks of different colour). In addition, we have applied for the registration our trademark "Detsky mir" (four blocks of different colour and "Detsky mir" in Cyrillic) as a well-known trademark in Kazakhstan.

The trademark registrations are valid for 10 years from the date of registration, and we plan to renew them once they expire. We monitor potential trademark infringements in Russia and other countries to avoid our trademarks being infringed, as has occurred in the past. See "*Risk Factors—Risks relating to Business and Industry—A* *deterioration of the value of the "Detsky mir" brand name or infringement of the related trademarks could negatively impact our business*". We have also registered a number of Internet domain names. As at 31 December 2016, we owned 37 domain names in the "RU", "COM" and other domains, including detmir.ru and det-mir.ru. We do not have material patents or other material intellectual property.

Employees

As at 30 September 2016 and 31 December 2015, 2014 and 2013, we had 10,641, 9,979, 7,782 and 7,042 employees, respectively. The growth in the number of our employees is a result of our organic growth during 2013-2015, including as a result of the commissioning of the Bekasovo distribution centre. While payroll costs in 2013-2016 increased in absolute terms, they have gradually decreased as a percentage of revenue from 12.5% in 2013 to 9.1% in the nine months ended 30 September 2016, with our disciplined approach to personnel management resulting in greater personnel productivity.

As at 30 September 2016, we had 21 employees per store as compared to 22, 24 and 26 employees as at 31 December 2015, 2014 and 2013, respectively. The decline in the number of employees per store is mostly attributable to employee headcount optimisation with respect to both head office and in-store personnel. In 2013-2016, we outsourced cleaning and loading services to third party services providers, we reduced a significant number of senior cashiers as a result of implementation of modern cash registers and we reduced the number of sales staff as a result of improvements in in-store business processes. In the future, we intend to maintain the increased role of the outsourced personnel especially in cleaning and loading services. We also optimised business processes in our headquarters by eliminating overlaps in responsibilities between different departments. Moreover, as part of our efforts to further increase our operational efficiency, we centralised our accounting function in Kazan and we are now considering centralisation of our other administrative functions.

As at 30 September 2016, approximately 86% of our employees at our headquarters and approximately 90% of our retail employees were under 45 years old. As at 30 September 2016, approximately 79% of our employees at our headquarters and approximately 51% of our retail employees were employed by us for more than one year.

The table below sets forth the breakdown of our employees by functional area:

	As at 30 September	As at 31 December		
	2016	**2015**	**2014**	**2013**
Function				
Store personnel	8,826	8,636	6,776	6,027
Head office	779	713	719	735
Distribution centre personnel	1,036	630	287	280
Total	**10,641**	**9,979**	**7,782**	**7,042**

In 2015 and 2014, the employee turnover (i.e. ratio of voluntary and involuntary employee terminations to the average number of employees) was approximately 75% as compared to 79% in 2013. Our rate of employee turnover reflects primarily the departure of employees that are hired during the peak seasons under less than three month term contracts, who accounted for 22% of our retail employees as at 30 September 2016. This level of employee turnover is generally in line with employee turnover for the retail sector in Russia.

Our employees are not members of trade unions, and there are no collective bargaining agreements between us and our employees. We consider that our relations with our employees are satisfactory and we have not experienced any work stoppages.

Compensation

The salary of our in-store employees consists of a fixed part and a variable part which accounts for approximately 70% of total compensation. We use different compensation policies depending on the type of employee, which are designed to attract, motivate and retain the best employees. We offer our senior management performance-linked incentives. See also "*Management and Corporate Governance—Interest of Directors and Officers*".

We make mandatory contributions to the Russian state pension fund but we do not provide any additional retirement benefits to our employees upon their retirement or afterwards.

Personnel Training and Career Development

We have different development plans for different types of employees. In particular, with respect to certain promising employees at our headquarters we have individual career development plans. Moreover, we use external training programmes such as career enhancement trainings for our senior management and specialised training for legal and sales departments.

Insurance

The insurance industry is not yet fully developed in Russia, and many forms of insurance protection common in more economically developed countries are not yet available in Russia or are not available on comparable or commercially acceptable terms, including coverage for business interruption. We do not currently maintain insurance coverage for business interruption, product liability or loss of key management personnel, as these are not industry practice in our sector. For a number of our stores we do not currently maintain insurance coverage against damage caused by fire, water, natural disasters, theft and third-party wrongdoing. Similarly, we do not have third-party liability insurance coverage in place for a number of our stores. We believe that our current insurance arrangements comply with insurance requirements under Russian law. These insurance policies include inventory insurance, insurance of cash in cash registers and certain types of third-party liability insurance. Our insurance policies currently in force are provided by major Russian insurance companies such as RESO-GARANTIA. We intend to enter into D&O liability insurance arrangements with one of the major insurance companies to cover liability of our directors, officers and other individuals who are entitled to represent the Company and/or make statements on behalf of the Company. See "*Risk Factors—Risks Relating to Business and Industry—Our insurance policies may be insufficient to cover losses arising from business interruption, damage to our property or third-party liabilities*".

Legal Proceedings

From time to time, we are involved in litigation in the ordinary course of our business activities. There have been no governmental, legal or arbitration proceedings against us (including any such proceedings which are pending or threatened of which we are aware) during the 12 months preceding the date of this Offering Memorandum which may have, or have had in the recent past, significant effects on our financial position or profitability.

REGULATION OF THE RUSSIAN RETAIL SECTOR

In this Offering Memorandum, summaries of Russian laws and regulations are qualified by reference to the entire Russian language text of such laws and regulations, although such text is not incorporated by reference herein.

Regulation of Retail

The retail industry in Russia is regulated by general civil and administrative legislation and specialised legislation covering quality standards, health and safety, sanitary rules and consumer protection. A number of permits and consents, including those relating to health and safety, are required in order to open a new store. Regulatory authorities exercise considerable discretion in matters of enforcement and interpretation of applicable laws, regulations and rules, as well as in matters of issuance and renewal of permits and monitoring compliance with the terms thereof. Compliance with requirements imposed by regulatory authorities may be costly and time-consuming, and may, in certain cases, result in delays in the commencement or continuation of the Group's operations.

State and Local Bodies Involved

The key state and local bodies are:

- The Ministry of Industry and Trade, which, among other things, is the principal federal body authorised to develop the governmental policy for, and the regulatory regime of, trade.
- The Federal Service for Supervision in the Area of Protection of Consumer Rights and Human Welfare (the "**Federal Consumer Service**"), which is the principal federal body authorised to monitor compliance with sanitary and epidemiological laws and regulations and to exercise control over the protection of consumer rights.
- The Ministry of Health Protection, which, among other things, is the principal federal body authorised to develop the governmental policy for, and the regulatory regime of, health protection.
- Regional and local municipal authorities, which control compliance by the companies operating in their respective regions and municipalities with various regional and local rules.
- State courts, which resolve civil and administrative disputes and consider criminal cases, such as invalidating provisions of consumer contracts that violate consumer rights, as well as imposing criminal sanctions for offences in the retail industry, such as the manufacture and sale of goods not in compliance with the appropriate standards.
- The Ministry of Civil Defence Affairs, Emergencies and Remediation of Consequences of Natural Disasters, which, among other things, supervises compliance with fire safety regulations.
- The Federal Labour and Employment Service, which supervises labour relations and the social protection of employees under the Russian Labour Code dated 30 December 2001, as amended (the "**Labour Code**").
- The Federal Service for Intellectual Property ("**Rospatent**"), which registers intellectual property rights, including rights to trademarks, and certain agreements relating to intellectual property rights, including licence agreements for the use of a trademark, agreements for the transfer of the right to a trademark and franchising agreements.
- The FAS, which promotes the development of the commodity markets and competition by exercising state control over the observance of anti-monopoly legislation and prevents and terminates monopolistic activity, unfair competition and other actions restricting competition. The FAS, among others, oversees the acquisition of controlling stakes in companies and dominant market position by business enterprises.
- The Federal Customs Service, which develops governmental policy and the regulatory regime for custom operations and exercises control over the transfer of goods across the borders of the Russian Federation.

Applicable Legislation

The key pieces of Russian legislation regulating the retail market are:

- The Federal Trading Law, which became effective on 1 February 2010, (i) contains requirements related to trading activities in Russia, including antitrust provisions and restrictions for supply contracts with respect to food products, (ii) divides regulatory authority between federal, regional and municipal bodies with respect to trading activities, and (iii) introduces regional trade registers that will include information on suppliers, entities carrying out trading activities and the market conditions in the territories of relevant constituent entities of the Russian Federation.

- Federal Law No. 2300-1 "On Protection of Consumers' Rights" dated 7 February 1992, as amended (the "**Consumer Protection Law**"), establishes a general legal framework for regulating the relationship between retailers, manufacturers and service providers, on the one hand, and customers, on the other hand, in connection with the sale of goods, performance of works and rendering of services. The Consumer Protection Law sets out the right of customers to purchase goods of good quality and to receive information on goods and their manufacturers and retailers. The Consumer Protection Law provides for liability of retailers, manufacturers and service providers for violating consumers' rights. The Consumer Protection Law also invalidates any provisions in a consumer contract purporting to limit consumer rights provided by law.
- Federal Law No. 29-FZ "On Quality and Safety of Food Products" dated 2 January 2000, as amended (the "**Law on Quality and Safety**"), establishes a general framework for safeguarding the quality and safety of food products. The Law on Quality and Safety sets out general quality and safety requirements for the manufacture, packaging, storage, transportation and sale of food products as well as the disposal or destruction of poor-quality and unsafe food products.
- Federal Law No. 52-FZ "On Sanitary and Epidemiological Welfare of the Population" dated 30 March 1999, as amended (the "**Law on Sanitary and Epidemiological Welfare**"), requires food products to meet certain sanitary standards. According to this law, food products that do not conform to established sanitary standards and represent a danger to customers must be withdrawn immediately from production and sale. The Law on Sanitary and Epidemiological Welfare also establishes the framework for supervision of companies' compliance with sanitary and epidemiological regulations.
- Federal Law No. 184-FZ "On Technical Regulation" dated 27 December 2002, as amended, establishes the legal framework for the development and enactment of state standards, as well as voluntary technical requirements, relating to manufacture, use, storage, transportation, sale and utilisation of goods and for compliance with these standards and requirements, including mandatory certification procedures. Food products and non-food products sold by retailers are subject to either mandatory certification (e.g., children's clothes, domestic radio-electronic equipment) or quality declaration (e.g., most food products and clothing).
- Federal Law No. 38-FZ "On Advertising", dated 13 March 2006, as amended imposes certain requirements for advertising of goods and services and prohibits unfair, inaccurate or misleading advertising.
- Federal Law No. 69-FZ "On Fire Safety" dated 21 December 1994, as amended, establishes a general legal framework of fire safety measures and provides for the general powers of state authorities to perform audits and check compliance by organisations with fire safety regulations.
- Federal Law No. 89-FZ "On Production and Consumption Waste" dated 24 June 1998, as amended, sets general rules for handling waste.

Import operations are subject to the provisions of the Customs Code of the Customs Union adopted on 27 November 2009, as amended, which relate to, among other things, safety of children's toys, safety of products for children, safety of cosmetic and perfume products and safety of certain food products for children. We import mostly own brands children apparel and footwear and certain stationery products. The key act establishing requirements to the imported goods is the Technical Regulation of the Customs Union "On safety of products, purposed for children, approved by Decision of the Customs Union Commission No. 797 dated 23 September 2011 (the "**Safety Regulation**"). The Safety Regulation sets out the mandatory requirements to the chemical, biological, technical, thermal safety of the children's products. The relevant products must undergo the necessary conformity check by the customs authorities which is to be confirmed by the relevant mark.

Violation of any of the above laws could result in civil and administrative sanctions for non-complying companies and/or their managers and criminal sanctions for non-complying managers.

Federal Trading Law

The antitrust provisions of the Federal Trading Law primarily relate to retail trade and trade of food products, and mainly aim to limit the ability of major food retail chains from taking advantage of their market position and exercise pressure on suppliers and small retailers. The Federal Trading Law does not apply to foreign trade activities; trade on commodities exchanges; activities in connection with the sale of goods on retail markets; and sale and purchase of securities, real estate, products intended for production and technical use, such as energy resources.

The most significant antitrust provisions of the Federal Trading Law include: (i) prohibiting the imposition of certain conditions mainly on suppliers, such as the obligation of suppliers to make payments in exchange for the right to supply food products to food retail chains and/or the right to change the range of products supplied and/or the obligation to reimburse any expenses not related to the performance of the supply contract and the subsequent sale of a certain shipments of products; and (ii) the limitation on leases or any acquisitions of additional retail space within the territory of a constituent entity of the Russian Federation, a municipal area or a city district for food retail chains with a share exceeding 25% of the total amount of food products sold during the preceding financial year within the territory of the relevant constituent entity of the Russian Federation, municipal area or city district (such limitation with respect to municipal areas and city districts came into effect from 1 July 2010).

The Federal Trading Law introduced requirements and restrictions with respect to the terms and conditions of supply contracts for food products, including: (i) limitations on time between delivery of products and payment by retailers to suppliers which are linked to the shelf life of the relevant food products; (ii) limitations on fees that suppliers are often required to pay to retailers when retailers agree to purchase larger volumes of products, marketing and promotion fees, fees for logistics services, processing, packaging of these products and other such services (from 1 January 2017 such fees collectively may not exceed 5% of the price of the food products, cannot be imposed on certain basic types of food products, such as bread and milk, and cannot be included into the price of goods, thus prior to 1 January 2017 only the volume fees were capped at 10% of the price of the food products); (iii) a ban on imposing fees on suppliers for the performance of and/or amendments to contracts; (iv) a ban on imposing fees on suppliers for supply rights and assortment alterations, as well as ban on reimbursements for loss of or damage to the goods which occurred after the ownership transfer and not by supplier's fault and reimbursements of costs not connected to supply of goods; (v) a ban on requiring suppliers to subscribe to ancillary services such as advertising and marketing services as preconditions to entering into a supply contract; (vi) a ban on the use of commission contracts or similar contracts in wholesale trade; and (vii) the obligation to disclose the tender process for selecting suppliers and the main terms and conditions of the related supply contracts.

The Federal Trading Law also sets forth limitations on time periods for retailers to exercise payments to suppliers based on the types of supplied goods: (i) food products expiring within 10 days are to be paid for within 8 business days from the delivery date; (ii) food products expiring within 10 to 30 days are to be paid for within 25 days from the delivery date; and (iii) food products with an expiration period of more than 30 days and alcohol produced in Russia are to be paid for within 40 days from the delivery date. Failure to comply with the established payment deadlines may lead to administrative fines.

In addition, under the Federal Trading Law, the Russian Government is empowered to impose maximum retail prices for certain "socially important food products" for a period of up to 90 days when retail prices have increased by or over 30% within a 30-day period in a Russian region.

Technical requirements

Russian legislation establishes technical requirements to the children's goods. The key regulations are as follows:

- Sanitary and epidemiological rules and regulations No. 2.3.2.1940-05 "Children's food business organisation", approved by Chief sanitary officer on 17 January 2005, as amended, establishes requirements to the necessary supporting documents, raw materials and components to be used in children's food production, package requirements, chemical compound, etc.
- Sanitary and epidemiological rules and regulations No. 2.4.7/1.1.1286-03 "Hygienic requirements for clothing of children, teenagers and adults, children's goods and materials for the products contacting human skin", approved by Chief sanitary officer on 17 April 2003, as amended, establishes requirements to wear, clothing, linen, bags, toys, diapers, school supplies, baby carriages, bicycles and various other relevant goods.
- Rules on Sale of Certain Categories of Goods (Government Regulation No. 55 dated 19 January 1998, as amended) set out the requirements as to marking and labelling of children's goods.

- Government Regulation No. 239 "On Measures Related to State Regulation of Prices (Tariffs)" dated 7 March 1995, as amended, provides that regional governments may limit the amount of surcharges on baby food products.

Licensing

Generally, trade operations in the Russian retail industry are not subject to licensing.

Regulation of Intellectual Property

The Civil Code of the Russian Federation, as amended (the "**Civil Code**"), generally provides for the legal protection of trademarks registered with Rospatent. In addition, in accordance with the Agreement Concerning the International Registration of Marks (Madrid, 1891) and protocols thereto, Russia protects trademarks registered with the Worldwide Intellectual Property Organisation if international registration of such trademarks extends to Russia. Upon the registration of a trademark, Rospatent issues a certificate of registration of the trademark, which is valid for 10 years from the date on which the application for registration was filed. This term may be extended for another 10 years an unlimited number of times. In the absence of registration (i) the entity using the designation may be not able to protect its trademark against unauthorised use by a third party; (ii) if a third party has previously registered a trademark similar to the designation in question, then the entity may be held liable for unauthorised use of such trademark. Agreements for assignment of rights to a trademark, franchising agreements, licence agreements and pledge agreements are subject to registration with Rospatent. An unregistered licence agreement is invalid and unenforceable under Russian law and may trigger civil, administrative and criminal liability.

The Russian Civil Code recognizes a concept of a well-known trademark, i.e. a mark which, as a result of its widespread use, has become well known in association with certain goods among the relevant consumers in Russia.

Well-known trademarks enjoy more legal benefits than ordinary trademarks—these include:

- broader coverage—an owner of a well-known trademark may exercise its exclusive rights in association with goods beyond those for which the relevant trademark was originally registered, provided that the use of a n identical or confusingly similar trademark by a third party would cause consumers to associate the third party's trademark with the owner of the well-known trademark and would affect the legitimate interests of the owner of the well-known trademark; and
- an unlimited registration period—unlike the ordinary trademarks (which can be registered for 10 years and renewed for each subsequent 10 years period an unlimited number of times), the well-known trademarks registration generally remains effective for an unlimited period of time.

In order to register a mark as a well-known trademark, a person using the mark must submit the relevant application to Rospatent, together with certain documents including evidence that the relevant mark has become well known (such as the results of consumers surveys, documentary evidence of costs incurred for the advertising of the mark, etc.). Rospatent must take a decision on the application within 10 months from the application date but this period may be extended for additional 10 months subject to the regulator's requests for and consideration of additional documents and/or clarifications from the applicant.

The application may be denied in the following circumstances:

- the applicant has not provided the documents evidencing that the relevant mark has become well known; or
- the relevant mark has become well known after the priority date of another person's trademark which is identical or confusingly similar with the relevant mark and which has been registered for the use in respect of similar goods.

The mark is recognized a well-known trademark from the date of its registration (i.e. its entry into the register of well-known trademarks).

Regulation of Real Estate

Set out below is the legal framework relating to land and other real estate in Russia.

State Bodies

In addition to the state bodies and their subdivisions having authority over general matters, a number of state bodies specifically regulate turnover and construction of real estate in Russia, including:

- The Federal Service for State Registration, Cadastre and Cartography ("**Rosreestr**"), which maintains the Unified State Real Estate Register ("**Real Estate Register**") consisting of the state register of rights to real property and transactions therewith and a state register (cadastre) of real estate.
- The Ministry of Regional Development of the Russian Federation, which is authorised to review and comment on construction documentation.
- Local authorities, which are authorised to issue the construction, reconstruction, replanning and operation permits.

Applicable Legislation

Russian legislation regulating the ownership and leasehold rights to real estate and real estate construction includes the following:

- the Russian Civil Code;
- Russian Land Code No. 136-FZ dated 25 October 2001, as amended (the "**Land Code**");
- Russian Town Planning Code No. 190-FZ dated 29 December 2004, as amended (the "**Town Planning Code**");
- Federal Law No. 122-FZ "On State Registration of Rights to Immovable Property and Transactions Therewith" dated 21 July 1997, as amended (the "**Law on State Registration 1**");
- Federal Law No. 218-FZ "On State Registration of Real Estate" dated 13 July 2015, as amended (the "**Law on State Registration 2**", the Law on State Registration 1 and the Law on State Registration 2 together the "**Laws on State Registration**");
- Federal Law No. 221-FZ "On State Cadastre of Real Estate" dated 24 July 2007, as amended; and
- certain other federal and regional laws and regulations.

General Provisions

Most land in Russia is currently owned by the state (i.e., federal, regional or local authorities). The share of privately owned buildings and similar real estate is increasing due to a less restrictive regulatory regime with respect to these assets as compared to land.

Starting from 1 January 2017 the Real Estate Register includes a cadastre, in which the details of real estate, such as measurements, boundaries and other detailed characteristics, are recorded, and a register for the registration of title to real estate and transactions in relation to registered real estate. As a general rule, only land plots with a state cadastre number may be the subject of real estate transactions.

All land is categorised as having a categorised purpose, for example, agricultural land, land for use by industrial enterprises, power companies and communication companies, land for military purposes, forestry land and reserved land (i.e., land which is owned by the state or municipalities and may be used only upon being transferred to other categories). In addition, land plots have a type of permitted use established in accordance with the local city-planning regulations. If there are no local city-planning regulations, types of permitted use are established by a resolution of government authorities, a lease agreement and a development plan for a land plot. Land must be used in accordance with its categorised purpose and type of permitted use. Under the Land Code, land plots owned by the state or the municipalities generally may be sold or leased to Russian and foreign persons or legal entities. However, certain land plots owned by the state may not be sold or leased to the private sector and are referred to as "withdrawn from commerce" (for example, national parks and reserves and land used for military purposes are typically withdrawn from commerce). Foreign investors may not own land plots (i) in border areas specified by the presidential decree; and (ii) located within the borders of sea ports and other areas specified by federal law. Also, neither foreign investors nor Russian companies having a foreign shareholding exceeding 50% may own agricultural lands, although they are permitted to lease such lands.

Under Russian law, a land plot and any buildings constructed upon it may be owned by different persons, in which case the owner of the building(s) may request that the owner of the land underneath the building(s) creates a set of legal rights so that the owner of the building(s) may access the land.

In addition, Russian law provides that real estate may be expropriated for "state or municipal needs". From 1 April 2015 a new law providing for the amendments to the Russian Land Code which simplify the procedure of expropriation came into force. The law sets forth a detailed outline of the expropriation procedure and provides, in particular, that the real estate rights holders (which includes land owners, users and tenants) are entitled to receive a copy of a decision on expropriation within 10 days after its adoption by the respective authority and full compensation upon execution of the agreement on expropriation of real estate. Such compensation for the expropriated real estate shall comprise the market value of the real estate or rights in relation to real estate, and any damages caused by expropriation, including the loss of profit. Registration of transfer of the ownership title to real estate is permitted only after full payment of the said compensation.

State Registration of Rights and Transactions Involving Real Estate

All rights to real estate (including land plots and buildings) and certain transactions involving real estate must be registered in the Real Estate Register maintained by Rosreestr.

Information from the Real Estate Register is publicly available and contains material information about the registered property, including, inter alia, any registered encumbrances (limitations) on the property. Since 1 March 2013, a previous owner of property is entitled to register an objection to the registration of ownership rights in the Real Estate Register. If the person who registered the objection has not pursued his challenge in court within three months, the objection is annulled (and further objection by the same person is not permitted).

Under the Laws on State Registration, registration with the Real Estate Register is required for, inter alia: (i) rights to, and encumbrances on, buildings, facilities, land plots and other real estate; and (ii) transactions involving registered real estate such as a creation of a mortgage or an entry into a lease for a term of not less than one year. Real estate and transactions involving registered real estate are registered with the Real Estate Register in the registration district where the property is situated.

Rights to real estate only arise upon state registration. The failure to register a title to real estate generally results in invalidity or non-existence of the title. Where the parties fail to register a transaction that has to be registered, such transaction may either be not recognised by the court or declared null and void or, in case of lease agreements, unenforceable against third parties as discussed below.

Regulation of Real Estate Construction

The main stages of the building construction process typically include the following:

- obtaining land rights;
- preparation of design documentation and obtaining infrastructure/utilities documentation;
- obtaining a construction permit from state or local authorities;
- performing construction works;
- obtaining an operation permit upon completion of construction works in compliance with the relevant technical / construction requirements; and
- registration of title to the new building.

Regulation of Real Estate Sales and Leases

Under the Russian Civil Code, agreements with respect to the sale or leasing of real estate must expressly set out the details of the real estate sold/leased and the price of the sale or rent under the lease.

The transfer of ownership under a real estate sale agreement is subject to state registration, whereas the sale agreement itself is not subject to state registration.

Lease agreements are subject to state registration, except for short-term lease agreements (i.e. leases which are for a term of less than one year) and preliminary lease agreements. Russian statutory provisions are not entirely clear as to the status of unregistered long-term lease agreements and may be interpreted to the effect that such non-registered lease agreements are deemed to be invalid (i.e. not binding for the parties to the agreement and creating no legal effect in respect to third parties). Pursuant to Russian case law, however, such lease agreements are binding on the parties (provided that the lessor and the tenant agreed on all material terms of the lease and started performing the lease agreement), but cannot be enforced against any third parties. In particular, the tenant will not have a pre-emptive right to enter into a lease agreement for a new term. Moreover, in case the lessor transfers the title to the leased property, the tenant may not be able to enforce the lease agreement against the new owner of the property, i.e. the new owner may disregard the previous owner's agreement with the tenant and evict the tenant if the tenant fails to negotiate a lease agreement with the new owner. Accordingly, the tenant may have to find alternative premises or enter into a lease agreement on terms less favourable than the terms of the agreement with the previous owner of the leased property.

Obligations of Land Plot Owners and Leaseholders

Owners and leaseholders of land plots and buildings are required to comply with federal, regional and municipal laws and regulations. For example, they are required to use the land plot in accordance with its designated purpose and not to cause harm to the environment. Regional and municipal laws and regulations and agreements entered into with local and municipal authorities may provide for additional financial and other obligations, such as financing of local transportation and social infrastructure. The owner of a building will usually bear all liabilities that may arise in connection with the building, including ongoing maintenance and major repairs.

Land and Real Property Taxation

Property Tax

The property tax rate is established by the regional authorities of the Russian Federation but may not exceed 2.2% of the average annual net book value of the relevant property (excluding certain real estate property, as described below) calculated under RAS. Currently, the regional authorities of the most developed Russian regions have set the tax rate at the highest possible rate. Property tax is payable on a quarterly basis.

Starting from 2014, certain real estate assets are subject to property tax at their cadastral value, rather than net book value. The list of real estate assets subject to property tax at the cadastral value includes real estate assets that qualify as:

- business centres and shopping centres, as well as premises in them;
- non-residential premises, which are designed (in accordance with their respective cadastral certificates or technical records) and actually used as offices, trading facilities, catering facilities and facilities for rendering household services;
- immovable property objects, owned by foreign organisations that do not carry out business activities in Russia through a permanent establishment or not related to business activities of those organisations carried out through their permanent establishments in Russia.
- residential premises, which are not accounted as fixed assets on the balance sheet of their owner.

Starting from 2016, maximum tax rate applicable to real estate taxable at cadastral value does not exceed 2%.

Land is subject to a separate land tax described below.

Land Tax

The land tax rates are determined by the municipal authorities but may not exceed limits specified in the Tax Code: (i) 0.3% of the register (cadastre) value for the agricultural and housing land; and (ii) 1.5% of the register (cadastre) value for all other land, which includes land for use in the retail industry.

Russian Antimonopoly Regulation

Federal Law No. 135-FZ "On Protection of Competition" dated 26 July 2006, as amended (the "**Competition Law**"), provides for a mandatory pre-approval by the FAS of the following actions:

- other than in respect to financial organisations, such as banks, an acquisition by a person (or its group) of more than 25% of the voting shares of a Russian joint-stock company (or one-third of the interests in a Russian limited liability company), except upon incorporation, and the subsequent increase of these stakes to more than 50% of the total number of the voting shares and more than 75% of the voting shares (one-half and two-thirds of the interests in a Russian limited liability company), or acquisition by a person (or its group) of ownership or rights of use with respect to the core production assets and/or intangible assets of an entity which are located in Russia if the balance sheet value of such assets exceeds 20% of the total balance sheet value of the core production and intangible assets of such entity, or obtaining rights to determine the conditions of business activity of a Russian entity or to exercise the powers of its executive body by a person (or its group), or an acquisition by a person (or its group) of more than 50% of the voting shares (interests) of a foreign entity, which has supplied goods, works and/or services to Russia in an amount exceeding RUB 1 billion in the preceding year, or other rights to determine the conditions of business activity of such entity or to exercise the powers of its executive body, if, in any of the above cases, the aggregate asset value of an acquirer and its group together with a target and its group (excluding the asset value of the seller and its group, if as a result of the acquisition the seller and its group cease to determine the conditions of business activity of the target) exceeds RUB 7 billion and at the same time the total asset value of the target and its group exceeds RUB 250 million, or the total annual revenues of such acquirer and its group, and the target and its group for the preceding calendar year exceed RUB 10 billion and at the same time the total asset value of the target and its group exceeds RUB 250 million;

- mergers and consolidations of entities, other than financial organisations, if their aggregate asset value (the aggregate asset value of the groups of persons to which they belong) exceeds RUB 7 billion, or total annual revenues of such entities (or groups of persons to which they belong) for the preceding calendar year exceed RUB 10 billion; and

- founding of a business entity, if its charter capital is paid by the shares (or limited liability company interests) and/or the assets of another business entity (other than financial organisation) or the newly founded business entity acquires shares (or limited liability company interests) and/or the assets of another business entity based on a transfer act or a separation balance sheet and rights in respect of such shares (or limited liability company interests) and/or assets as specified above, at the same time provided that the aggregate asset value of the founders (or group of persons to which they belong) and the business entities (or groups of persons to which they belong) which shares (or limited liability company interests) and/or assets are contributed to the charter capital of the newly founded business entity exceeds RUB 7 billion, or total annual revenues of the founders (or group of persons to which they belong) and the business entities (or groups of persons to which they belong) which shares (or limited liability company interests) and/or assets are contributed to the charter capital of the newly founded business entity for the preceding calendar year exceed RUB 10 billion.

The above requirements for a mandatory pre-approval by the FAS will not apply if the transactions are performed by members of the same group, if the information about such a group of persons was disclosed to the antimonopoly authority and there were no changes within one month prior to the date of the transaction within that group of persons. In such cases, the FAS must be notified of the transactions subsequently in accordance with Russian anti-monopoly legislation. Furthermore, the requirement for a mandatory approval of transactions described in the first bullet point above will not apply if the transactions are performed by members of the same group where a company and individual or an entity, if such an individual or an entity holds (either due to its participation in this company or based on the authorities received from other persons) more than 50% of the total amount of votes in the equity (share) capital of this company.

A transaction entered into in violation of the above requirements may be invalidated by a court decision pursuant to a claim brought by the FAS if the FAS proves to the court that the transaction leads or could lead to the limitation of competition in the relevant Russian market. The FAS may also issue binding orders to companies that have violated the applicable antimonopoly requirements and bring court claims seeking liquidation, split-up or spin-off of business entities if a violation of antimonopoly laws was committed by such business entities. In addition, a company may be subject to the administrative fine of an amount from RUB 150,000 to RUB 250,000 for the failure to file a FAS post-transactional notification and from RUB 300,000 to 500,000 for the failure to file an application for FAS pre-approval of the transaction.

Under the Competition Law, a company with a dominant position in the relevant market is prohibited from misusing its dominant position. Specifically, such company is prohibited from:

- establishing and maintaining monopolistically high or monopolistically low prices of goods;

- withdrawing goods from circulation, if the result of such withdrawal is an increase in the price of goods;

- imposing contractual terms upon a counterparty which are unprofitable for the counterparty or not related to with the subject matter of agreement (i.e., terms that are economically or technologically unjustified);

- reducing or terminating, without economical or technological justification, production of goods if there is a demand for the goods or orders for their delivery have been placed and it is possible to produce them profitably;
- refusing or evading, without economical or technological justification, to enter into a contract with customers in cases when the production or delivery of the relevant goods is possible;
- establishing without economical, technological or other justification different prices for the same goods;
- establishing unjustifiably high or unjustifiably low price of a financial service by a financial organisation;
- creating discriminatory conditions;
- creating barriers to entry into the market for the relevant goods or forcing other companies to leave the market;
- violating pricing procedures established by law; and
- manipulating prices in the wholesale and/or retail electricity (capacity) markets.

In the event of breach of any terms of business conduct required by the FAS, the FAS may initiate proceedings to investigate a breach of antimonopoly laws. If a breach of the antimonopoly laws is identified, the FAS may initiate administrative proceedings which may result in the imposition of a fine calculated on the basis of the annual revenues received by the company in the market where such breach was committed. Such fines may include an administrative fine of an amount from RUB 300 thousand to RUB 1 million or, if such violation has led or may lead to the prevention, limitation or elimination of competition, an administrative fine of up to 15% of the proceeds of sales of all goods, works and services in the market where such violation was committed, but not more than 2% of gross proceeds of sale of all goods, works and services for the year preceding the year of the violation. Russian legislation also provides for criminal liability of company managers for violations of certain provisions of antimonopoly legislation. Furthermore, for systematic violations, a court may order, pursuant to a suit filed by the FAS, a compulsory split-up or spin-off of the violating company, and no affiliation can be preserved between the new entities established as result of such a mandatory reorganisation.

Limitations on Concerted Actions

The Competition Law's restrictions on concerted actions and discrimination have been especially important for the Russian retail industry. According to the Competition Law, concerted actions are actions taken in the absence of any agreement between market participants and meet the following criteria: (a) the result of such actions is in the interest of each concerting market participant; (b) such actions were known in advance to each of the market participants due to public announcement made by one of them regarding commitment of such actions; and (c) such actions are not caused by market circumstances equally affecting all economic entities in the respective market. Concerted actions are prohibited if they result or may result in, inter alia, (i) price fixing, discounts, extra charges or margins; (ii) coordination of auctions and tenders; (iii) allocation of a market by territory, volume of sales or purchases, types of goods, customers or suppliers; (iv) reduction or termination of goods production; or (v) refusal to enter into contracts with certain buyers (customers). In addition, concerted actions are prohibited if they result or may result in restriction of competition by way of, among others, (x) imposing unfavourable contractual terms, (y) fixing disparate prices for the same goods, for unjustified reasons other than economic or technological reasons or (z) creating barriers to entering or exiting a market.

In addition, the Competition Law prohibits retail companies from imposing on counterparties discriminating conditions for the entry into the market or making sales, such as establishing barriers to their entry into the market or disparate pricing.

Federal Antimonopoly Service

The FAS is the state body principally authorised to deal with and accordingly polices violations of the Competition Law, the Federal Trading Law and the Advertising Law, such as cartels and concerted actions and coordination of business activities, anti-competitive economic concentration (including unlawful expansion of retail space in a market where the retailer has a 25% market share), unfair competition and unfair, inaccurate or misleading advertising.

Russian legislation vests ample powers in the FAS permitting it to take necessary actions, including to (i) initiate proceedings regarding violation of anti-monopoly legislation; (ii) issue orders or impose fines; (iii) bring judicial actions to enforce the antimonopoly laws against companies and their officers, including, inter alia, through invalidating in full or in part any agreements that violate anti-monopoly law. Historically, FAS has fined a number of Russian retailers on the grounds of their wrongful discrimination against suppliers by way of (x) imposing unequal or unfair conditions on suppliers, (y) refusing to enter into supply agreements with willing and able suppliers thus creating barriers to the suppliers' access to the market or (z) tying their entry into marketing agreements with suppliers to the turnover of their goods.

The Law on Advertising, as well as the Competition Law, restricts unfair competition in terms of information flow such as: (i) dissemination of false, inaccurate, or distorted information that may inflict losses on an entity or cause damage to its business reputation; (ii) misrepresentation with respect to the nature, method, and place of manufacture, consumer characteristics, quality and quantity of a commodity or with respect to its producers; (iii) incorrect comparison of the products manufactured or sold by it with the products manufactured or sold by other entities; (iv) sale of commodities in violation of intellectual property rights, including trademarks and brands; or (v) illegal receipt, use, and disclosure of information constituting commercial, official or other secret protected by law.

Regulation of Employment and Labour

Employment and labour matters in Russia are regulated by the Labour Code, and certain other federal and regional laws and regulations as well as local acts.

Employment Contracts

As a general rule, employment contracts in Russia are for indefinite terms. Russian labour legislation restricts entrance into term employment contracts with certain exceptions, such as senior management positions.

An employer may terminate an employment contract only on the basis of specific grounds listed in the Labour Code, including:

- liquidation of an enterprise or downsizing of staff;
- failure of the employee to comply with the position's requirements due to lack of professional qualification as evidenced by the results of an evaluation;
- systematic failure of the employee to fulfil his or her duties;
- any single gross violation by the employee of his or her duties;
- provision by the employee of false documents prior to entry into the employment contract; and
- other grounds as stated in the Labour Code or other federal laws.

An employee dismissed due to downsizing or liquidation is entitled to receive compensation (including a severance payment) and, depending on the circumstances, salary payments for a certain period of time.

The Labour Code also provides protections for certain categories of employees. For example, except in cases of liquidation of an enterprise, an employer cannot dismiss pregnant women.

Termination of employment contracts with mothers having a child under the age of three, single mothers having a child under the age of 14 or a disabled child under the age of 18 or other persons taking care of a child under the age of 14 or caring for a disabled child under the age of 18 without a mother is also not permitted except in certain cases provided for in the Labour Code, including liquidation of an enterprise, systematic failure of the employee to fulfil his or her duties or any single gross violation by the employee of his or her duties. The Labour Code also sets forth some restrictions with respect to the termination of employment contracts with minors.

Any termination by an employer of an employment contract that is inconsistent with the Labour Code may be invalidated by a court, and the employee may be reinstated. Lawsuits resulting in the reinstatement of illegally-dismissed employees and the payment of damages for wrongful dismissal are increasingly frequent, and Russian courts tend to support employees' rights in most cases. Where an employee is reinstated by a court, the employer must compensate the employee for unpaid salary for the period between the illegal termination and reinstatement as well as for claimed moral damages.

Work Time

The Labour Code sets the regular working week at 40 hours for most occupations. Any time worked beyond 40 hours per week as well as work on public holidays and weekends must be paid for at a higher rate. Annual paid vacation leave under the law is generally 28 calendar days. The retirement age in the Russian Federation is 60 years for men and 55 years for women.

Salaries

The minimum monthly wage in Russia, as established by the applicable federal law, is RUB8,800 from 1 January 2017.

Strikes

The Labour Code defines a strike as the temporary and voluntary refusal of workers to fulfil their work duties with the intention of settling a collective labour dispute. Russian legislation contains several requirements relating to legal strikes. Participation in a legal strike may not be grounds for terminating an employment contract, although employers are generally not required to pay salaries to striking employees for the duration of the strike. Participation in an illegal strike may be adequate grounds for termination of an employment contract.

Other

On 1 January 2016, a new law came into force which prohibits the use of seconded labor, except for the temporary provision of employees by one employer to another under a labor (personnel) provision agreement from an accredited private employment agency, between affiliated parties or where there is a shareholder agreement. Private employment agencies may second employees to legal entities for the purposes of performing work related to a temporary (up to nine months) increase in production or operations.

Due to changes in legislation on seconded labor, most companies which provide temporary personnel to retail companies have replaced secondment agreements with agreements for the provision of services to formally comply with the law. However, there remains a risk that a services agreement will be considered invalid because its form does not correspond to its substance. Moreover, relations of a retail chain with temporary staff may be requalified as employment relations, and as a result the retail chain and its officials may incur administrative penalties under Article 5.27 of the Administrative Code for evading legal requirements for the signing of employment contracts with staff. The retail chain, agencies and their officials may incur penalties for breach of labor legislation where they provide staff not on the basis of a personnel outsourcing agreement, but rather on the basis of a services agreement.

Taking into account changes in labor legislation, the tax authorities may challenge existing service agreements of taxpayers (as being personnel provision agreements by nature) because their form does not correspond to their substance or challenge the existing personnel outsourcing agreements as incompliant with the law. As a result, the tax authorities may disallow deduction for profit tax purposes of the expenses related to personnel outsourcing agreements and may disallow offset of the respective input VAT.

Recent Amendments to the Russian Civil Code

On 30 December 2012, current Russian President Vladimir Putin signed the first set of amendments to the Russian Civil Code, which form part of a major reform to Russian civil legislation. The majority of these amendments, which became effective on 1 March 2013, relate primarily to certain basic concepts of civil law, such as limits on the exercise of civil rights, state registration of rights to certain types of property, and compensation for losses incurred as a result of unlawful acts of the state authorities.

The second set of amendments to the Russian Civil Code was signed by the President on 7 May 2013. These amendments affect, *inter alia*, the general rules on transactions, the grounds on which a transaction may be challenged and the rules governing representation and powers of attorney. The amendments became effective on 1 September 2013. The most significant ones provide for the following:

- a general presumption that a transaction violating applicable law is voidable (rather than void ab initio);
- a requirement that a person challenging a transaction be either a party to the transaction or another person specified by law. Furthermore, in order to prevent counterparties from challenging transactions

in bad faith on formal or technical grounds, the amendments provide that a claim on challenging transaction will not be upheld if the party making the claim acted in a way that allowed other parties to treat the transaction as valid;

- general rules for adopting and challenging decisions taken at meetings (such as creditors' meetings and other meetings which have legal consequences) were introduced. Such general rules should not apply to shareholders' meetings in a joint stock company or participants' meetings in a limited liability company or any other meetings to the extent they are otherwise regulated;
- a number of requirements regulating the matters of representation and powers of attorney were amended and updated. Among other things, the amendments lift the restriction on the maximum term of powers of attorney (previously, three years) thus allowing a power of attorney to be issued for a longer term and introduced a new type of a power of attorney (an irrevocable power of attorney), which requires notarization. Additional measures protecting the counterparty's rights under transactions entered into with unauthorized person were introduced. The amendments also provide for a new procedure of notification of third parties of revocation of a power of attorney by means of publication of the relevant termination notice;
- general rules for legal notices and notifications were introduced; and
- a final 10-year term for enforcing one's rights through the court was introduced in addition to the existing general three-year limitation period. In addition, pursuant to the amendments, the limitation period starts running from the day the respective person learned or should have learned (i) about the violation of his right and (ii) who is the competent defendant in respect of the claim for protection of the relevant right.

The third set of amendments was signed by the President on 2 July 2013, which primarily affects provisions of the Russian Civil Code dealing with securities. These amendments took effect on 1 October 2013. The most significant of these amendments provide for the following:

- differentiation of the regimes applicable to certificated and uncertificated securities: under the new classification certificated securities are treated as tangible property, while uncertificated securities are treated as "other property". Under the general rule, provisions governing registered certificated securities, records of which are maintained by a registrar or custodian, also apply to uncertificated securities. At the same time, a new section dedicated exclusively to uncertificated securities and dealing with specific aspects of their regulation was added to the Russian Civil Code. In particular, rules were introduced protecting holders of uncertificated securities in cases where the securities have been unlawfully debited from their accounts;
- a new concept of an "integrated immovable property complex", defined as a set of physically or technologically interconnected immovable property objects having the same designated use and treated as a single item of real property, was added to the Russian Civil Code; and
- a general rule that any benefit, output or proceeds resulting from the use of an asset belongs to the owner rather than its user.

The fourth set of amendments to the Russian Civil Code was signed by the President on 30 September 2013. These amendments became effective on 1 November 2013. The most significant of which provide for the following:

- a court may impose the duty of providing information on the content of foreign law rules only on the parties to the proceedings (before the introduction of the relevant amendment a court could vest the burden of proof of the content of foreign law rules in the parties);
- an exception from the general rule on lex personalis of legal entities was introduced providing that at the choice of the creditors either the Russian law or the personal law may apply to liability claims to a foreign legal entity's founders (participants) and other persons entitled to give instructions to be followed by a foreign legal entity predominantly carrying out its business activities within the territory of the Russian Federation; and
- parties to foundation agreements and participants agreements of a legal entity are now free to choose the governing law applicable to such agreements, as long as that choice does not affect the operation of the imperative requirements of the lex personalis of the respective legal entity.

The fifth set of amendments to the Russian Civil Code, primarily deals with rules related to pledges and mortgages.

The sixth set of amendments to the Russian Civil Code was also signed by the President on 21 December 2013 and introduced "nominee account agreements" and "escrow agreements" as contracts. These amendments became effective on 1 July 2014.

The seventh set of amendments to the Russian Civil Code was signed by the President on 12 March 2014, primarily deals with rules related to legal protection of intellectual activity and means of individualization. The majority of these amendments took effect on 1 October 2014. The most significant of these amendments provide for the following:

- rules regulating pledge of exclusive rights were introduced;
- the prohibition for a right holder to use a result of intellectual activity for which it granted an exclusive license;
- decrease up to five years of the effective term of an exclusive right to utility models;
- the imperative rule under which proceeds from joint disposal of an exclusive right should be distributed equally among the right holders.

The eighth set of amendments was signed by the President on 5 May 2014 and covers a wide range of corporate issues. These amendments took effect on 1 September 2014 and the most significant of them provide for the following:

- a new division of legal entities into corporations and unitary legal entities;
- replacement of open and closed joint stock companies by public and non-public entities;
- new opportunities for corporate structures;
- general principles of "corporate contracts" (shareholders' agreements and participants agreements);
- the scope of liability of the management bodies and persons who may determine a business entity's conduct;
- new types of reorganization;
- grounds for invalidating reorganization coupled with the relevant aftermath;
- the priority of creditors in terms of liquidation.

The ninth set of amendments was signed by the President on 8 March 2015 and covers primarily the law of obligations and contracts. These amendments entered into force on 1 June 2015 and the most significant of them provide for the following:

- extension of statute of limitations where the debtor accepts its debt in writing;
- an option for the creditors to enter into an agreement on the procedure and manner of satisfaction of their claims by the debtor;
- amendments of certain provisions relating to the place of the performance of an obligation and maturity thereof;
- amendments of certain provisions relating to security, including the introduction of a new type of security, security payment, to the Civil Code;
- change of the basis of calculation of interest for unauthorised use of monetary funds (i.e., determination by reference to the average retail deposits interest rate, unless otherwise set out by law or contractual arrangements);
- introduction of concepts similar to representations, warranties and indemnity; and
- amendments of certain provisions relating to pre-contractual obligations and liabilities.

In addition to the full scope amendments described above the Civil Code has been further amended on a case by case basis.

As of the date of this Offering Memorandum, there exists certain ambiguity in interpretation of the above amendments by state authorities (including the courts) and the full impact of the above amendments on the Group's activities and corporate governance, is unknown.

Russian Food Sanctions

On August 6, 2014, President Decree No. 560 “On Special Economic Measures to Protect Russia’s Security”, as amended, entered into force. It establishes a one-year ban on import of certain food and food products originating from countries that have imposed economic sanctions on Russian entities and (or) individuals (the United States, all European Union countries, Canada, Australia, Norway, Ukraine, Albania, Montenegro, Iceland and Liechtenstein). The list of banned goods is set out in Government Resolution No. 778 “On Measures Aimed at Implementation of President Decrees No. 560 as of August 6, 2014 and No. 320 as of 24 June 2015”, dated August 7, 2014, as amended (the “**Food Sanctions Regulation**”). The ban took effect on August 7, 2014 and was prolonged up to 31 December 2017 on 6 August 2016.

The Food Sanctions Regulation looks to the “country of origin” of foodstuffs, and not to the ultimate beneficial owner of such foodstuffs. The Food Sanctions Regulation expressly excludes baby food from its scope.

In November 2015, as a result of the incident with a Turkish fighter jet shooting down a Russian bomber aircraft near the Turkish-Syrian border, Russia imposed a number of economic sanctions against Turkey, including bans on import of certain goods from Turkey.

Starting from August 6, 2015, any banned goods transported to the territory of Russia shall be confiscated and destroyed (except for the goods transported by individuals for personal consumption and goods subject to customs transit procedure).

MANAGEMENT AND CORPORATE GOVERNANCE

Governance Bodies

Our governance bodies are the General Shareholders' Meeting, the Board of Directors, the Management Board and the General Director. We also have a number of committees of the Board of Directors with specialised functions. In addition, we are required to maintain an Internal Audit Commission as a matter of Russian law. Moreover, we have an Internal Control and Audit Department.

General Shareholders' Meeting

Powers of the General Shareholders' Meeting

The powers of a General Shareholders' Meeting are set out in the Joint Stock Companies Law and in our Charter. A General Shareholders' Meeting may not decide issues that are not included in the list of its authority under the Joint Stock Companies Law and the Charter. Among other things, the shareholders have the power to decide on:

- amendments to the Charter;
- the re-organisation or liquidation of the company and the appointment of the liquidation commission, and approval of interim and final liquidation balances;
- election of members of the Board of Directors and early termination of the tenure of the Board of Directors, approval of the amount of remuneration payable to members of the Board of Directors and/or the procedure for reimbursement of expenses to members of the Board of Directors;
- transfer of the powers of the General Director to a management company or an individual entrepreneur;
- determining the number, nominal value and class/type of the authorised shares and the rights attached to such shares;
- increasing share capital by increasing the nominal value of shares or issuing additional shares through open subscription for ordinary shares constituting more than 25% of the outstanding ordinary shares as well as through closed subscription;
- decreasing share capital by decreasing the nominal value of shares or reducing the number of shares, including by way of share repurchases or cancellations;
- the appointment and early termination of the tenure of the members of the Internal Audit Commission and approval of the amount of remuneration and compensation payable to the members of the Internal Audit Commission;
- appointment of the independent auditor;
- approval of certain interested party transactions and major transactions;
- distribution of profits, including approval of dividends (provided that the amount of any dividend cannot exceed the amount recommended by the Board of Directors);
- redemption of issued shares in circumstances provided for by the Joint Stock Companies Law;
- participation in financial and industrial groups, associations and other types of commercial organisations;
- approval of annual reports and financial statements;
- splitting and consolidation of our share capital;
- determining General Shareholders' Meeting procedure;
- approval of certain internal documents and regulations; and
- any other matter which, according to the Joint Stock Companies Law and the Charter, is within the powers of the General Shareholders' Meeting.

Voting and Quorum

Voting at a General Shareholders' Meeting is generally based on the principle of one vote per ordinary share, with the exception of the election of the Board of Directors, which is carried through cumulative voting. Decisions are generally passed by a majority vote of the ordinary shares present at a General Shareholders'

Meeting. However, Russian law requires a three-quarter majority vote of the ordinary shares present at a General Shareholders' Meeting to approve, *inter alia*, the following:

- Charter amendments;
- re-organisation or liquidation of the company and the appointment of the liquidation commission, and approval of interim and final liquidation balances;
- major transactions involving assets in excess of 50% of the balance sheet value of the assets of the Company;
- determination of the number, nominal value and type of authorised shares and the rights attached to such shares;
- repurchase of issued shares in cases provided for by the Joint Stock Companies Law;
- any issuance of shares or securities convertible into ordinary shares by closed subscription;
- issuance by open subscription of ordinary shares or securities convertible into ordinary shares, in each case, constituting more than 25% of the number of ordinary shares outstanding at the time;
- decrease of share capital by means of change of the nominal value of shares;
- application for delisting of shares or securities convertible into shares;
- application to the CBR with request to be exempted from disclosure obligations provided for by the laws of the Russian Federation.

The quorum requirement for our General Shareholders' Meeting is met if shareholders' (or their representatives) accounting for more than 50% of the issued ordinary shares are present. If the 50% quorum requirement is not met, another General Shareholders' Meeting with the same agenda may (and, in case of an annual General Shareholders' Meeting, must) be scheduled and the quorum requirement will be satisfied if shareholders' (or their representatives) accounting for at least 30% of the issued ordinary shares are present at that meeting.

According to the Joint Stock Companies Law, the Board of Directors must convene the annual General Shareholders' Meeting between 1 March and 30 June of each year, and the agenda must include the following items:

- election of the members of the Board of Directors;
- approval of the annual report and the annual financial statements, including the balance sheet and profit and loss statement;
- approval of distribution of profits, including approval of annual dividends (if any);
- approval of an independent auditor; and
- election of the members of the Internal Audit Commission.

A shareholder or a group of shareholders owning in the aggregate at least 2% of the issued ordinary shares may introduce proposals for the agenda of the annual General Shareholders' Meeting and may nominate candidates for the Board of Directors and the Internal Audit Commission. According to the Charter, any agenda proposals or nominations must be provided to the company no later than 100 days after the preceding financial year-end.

Under the Joint Stock Companies Law, certain shareholders' resolutions relating to a company's re-organisation, an increase or decrease of share capital or a splitting or consolidation of shares may provide that they only remain valid for a specific period of time (the "**Validity Period**"). However, in the event such shareholders' resolutions are not acted upon within the Validity Period and/or the effective Validity Period for such resolutions has expired, such resolutions become null and void; and subject to provisions of the Joint Stock Companies Law, are no longer enforceable.

Extraordinary General Shareholders' Meetings may be called by the Board of Directors on its own initiative, or at the request of the Internal Audit Commission, the independent auditor or a shareholder or group of shareholders owning in the aggregate at least 10% of the issued ordinary shares as of the date of the request.

A General Shareholders' Meeting may be held in a form of a meeting or by absentee ballot. In a meeting, the adoption of resolutions is carried out through the attendance of shareholders or their authorised representatives for the purpose of discussing and voting on issues of the agenda. General Shareholders' Meeting can also be held by absentee ballot, where the company collects ballots completed and mailed to it by its shareholders; in such cases no physical meeting is held.

The following issues cannot be decided by a General Shareholders' Meeting by absentee ballot:

- election of the members of the Board of Directors;
- election of the Internal Audit Commission;
- approval of the independent auditor; and
- approval of the annual report, the annual financial statements, including balance sheet, profit and loss statement, and any distribution of profits, including approval of annual dividends (if any).

Notice and Participation

Under our Charter, all shareholders entitled to participate in a General Shareholders' Meeting must be notified of the meeting, whether the meeting is to be held in a form of a meeting or by absentee ballot, not less than 30 days prior to the date of the meeting, and such notification shall specify the agenda for the meeting. Such notice period is extended to 40 days if the agenda of the meeting contains an item on reorganisation. However, if the meeting in question is an extraordinary General Shareholders' Meeting to elect the Board of Directors or early terminate the tenure of the Board of Directors, shareholders must be notified at least 70 days prior to the date of such a meeting. Only those items that were set out in the agenda sent to shareholders may be voted upon at a General Shareholders' Meeting. A General Shareholders' Meeting is not entitled to change its agenda.

The list of persons entitled to participate in a General Shareholders' Meeting is to be compiled on the basis of data in our shareholders' register on the date determined by the Board of Directors, which date shall neither be earlier than 10 days following the date of adoption of the resolution to hold a General Shareholders' Meeting nor more than 50 days before the date of the meeting (or, in the case of an extraordinary General Shareholders' Meeting to elect the Board of Directors, not more than 80 days before the date of such General Shareholders' Meeting).

Shareholders may exercise their right to participate in a General Shareholders' Meeting by:

- personal attendance;
- attendance of a duly authorised representative (by proxy);
- absentee ballot; or
- delegating the right to fill out the absentee ballot to a duly authorised representative.

Board of Directors

Composition of the Board of Directors

The Board of Directors is responsible for general management matters, with the exception of those matters that are designated by law and our Charter as being the exclusive responsibility of the General Shareholders' Meeting.

The Joint Stock Companies Law requires at least a five-member Board of Directors for all joint stock companies, at least a seven member Board of Directors for a joint stock company with more than 1,000 holders of ordinary shares, and at least a nine member Board of Directors for a joint stock company with more than 10,000 holders of ordinary shares. According to our Charter, our Board of Directors shall consist of at least five members and the exact number of members of the Board of Directors shall be determined by the General Shareholders' Meeting. As of the date of this Offering Memorandum, our Board of Directors consists of 10 members. Only natural persons (as opposed to legal entities) are entitled to sit on the Board of Directors. Members of the Board of Directors are not required to be our shareholders.

The Charter provides that the entire Board of Directors must be elected at each annual General Shareholders' Meeting and that the Board of Directors is elected through cumulative voting. Under cumulative voting, each shareholder may cast an aggregate number of votes equal to the number of shares held by such shareholder multiplied by the number of persons on the Board of Directors, and each shareholder may give all such votes to one candidate or distribute them among two or more candidates. Our current Board of Directors was elected at the General Shareholders' Meeting on 30 June 2016.

A majority vote of a General Shareholders' Meeting may at any time remove the directors as a group before the expiration of their term, without cause.

The Board of Directors elects the Chairman of the Board of Directors from its members and has the right to remove its Chairman at any time. However, our General Director may not be elected as the Chairman of the Board of Directors. The Chairman of our Board of Directors organises its work, calls and presides over meetings of the Board of Directors and performs other functions provided for by Russian law, the Charter and our internal documents. The Chairman of our Board of Directors also has the casting vote in the case of a tied vote.

Powers of the Board of Directors

The Joint Stock Companies Law generally prohibits the Board of Directors from acting on issues that fall within the exclusive authority of a General Shareholders' Meeting. Our Board of Directors has the power to perform the general management of the company, and to decide, among other things, the following issues:

- determination of our business priorities and developmental strategy;
- approval of our budget and significant amendments thereto;
- convening annual and extraordinary General Shareholders' Meetings, except in certain circumstances specified in the Joint Stock Companies Law;
- approval of the agenda of a General Shareholders' Meeting with a right to include additional questions in the agenda at its own discretion and determination of the record date which establishes the shareholders that are entitled to participate in a General Shareholders' Meeting;
- election of the General Director and the Management Board;
- establishment of committees of the Board of Directors and election of members of the committees;
- issuance of additional shares through open subscription for ordinary shares or securities convertible into ordinary shares constituting up to 25% of the outstanding ordinary shares;
- placement of bonds and other securities, in cases specified in the Joint Stock Companies Law;
- determination of the price of property and securities to be placed or repurchased, as provided for by the Joint Stock Companies Law;
- repurchase of shares, bonds and other securities in certain cases provided for by the Joint Stock Companies Law;
- determination of the amount of remuneration and compensation payable to our General Director and members of the Management Board and approval of the employment agreement with the General Director and members of the Management Board;
- recommendations to the General Shareholders' Meeting on the amount of remuneration and compensation to be paid to members of our Internal Audit Commission;
- determination of the fees payable for the services of an independent auditor;
- recommendations to the General Shareholders' Meeting on the amount of any dividend payable on shares and the payment procedure thereof and on the record date which establishes the shareholders that are entitled to receive dividends;
- use of our reserve fund and other funds;
- approval of our internal documents, except for those documents whose approval falls within the competence of the shareholders or our General Director;
- creation and liquidation of branches and representative offices;
- approval of major and interested party transactions in the cases provided for by the Joint Stock Companies Law;
- submission for consideration by the General Shareholders' Meeting of major transactions (i.e. matters involving assets with a value of 25% to 50% of the value of our assets) where no consensus has been reached with regard to the approval thereof by our Board of Directors;
- appointment of our share registrar;
- consideration and approval of candidates to governing bodies of subsidiaries;

- approval of our participation (or termination of such participation) in other organisations except when it falls within the competence of the General Shareholders' Meeting;
- application for listing of shares and/or other issued securities convertible into shares;
- approval of decisions on share issuances; and
- any other matter which, according to the Joint Stock Companies Law and the Charter, is within the competence of the Board of Directors.

Meetings: Voting and Quorum

The Board of Directors meets as needed, and generally once a month.

The Charter provides that a meeting of the Board of Directors generally has a quorum if at least half of the elected members of the Board of Directors are present at the meeting or have filed their voting ballots in case of absentee voting. Generally, a majority vote of the directors present at the meeting is required to adopt a decision.

Certain decisions require either the unanimous vote of all members of the Board of Directors (for example, major transactions with a value of 25% or more but equal to or less than 50% of our assets as reported under RAS must be approved unanimously by the Board or by a simple majority of the shareholders; major transactions with a value of more than 50% of our assets as reported under RAS must be approved by three quarters of the shareholders: for further details, see "*Description of Share Capital and Certain Requirements of Russian Law—Certain Requirements of Russian Legislation—Major Transactions*") or a majority vote of the disinterested and independent directors (for example, related-party transactions with a value of less than 10% of our assets must be approved by a majority of disinterested directors of the Board or, alternatively, if the number of disinterested directors renders the meeting inquorate, must be referred to disinterested shareholders for approval, and any related-party transactions with a value of 10% or more of our assets must be referred to our shareholders: for further details, see "*Description of Share Capital and Certain Requirements of Russian Law—Certain Requirements of Russian Legislation—Interested Party Transactions*").

Members of the Board of Directors

The table below shows our current Board of Directors. The business address of each such person in his or her capacity as a director of the Company is 1 Timiryazevskaya Street, Moscow 127422, Russian Federation.

Name	Year of Birth	Position
Christopher Alan Baxter	1963	Chairman
Vladimir Chirakhov	1974	General Director, Director
Sean Jan Glodek	1971	Director
Leonid Khanik	1970	Director, Independent Director
Valentin Korchunov	1982	Director
Oleg Mubarakshin	1968	Director
Nadezhda Nosova	1972	Director
Christopher Allan Parks	1963	Director, Independent Director
Gevork Sarkisyan	1982	Director, Independent Director
Lei Teng	1979	Director

Brief biographies of our directors are set out below.

- *Mr. Christopher Alan Baxter* has been a member of the Board of Directors since 2012 and the Chairman of the Board of Directors since 2013. Mr. Chris Baxter also served as the Senior Vice President of Sistema from 2012 until 2015 and is the Director of Mobile Decisioning Africa Limited. Mr. Chris Baxter was previously a member of the Board of Directors of the Tatu Citi Limited from 2008 until 2012. From 2008 until 2012, Mr. Chris Baxter was a member of the Board of Directors of the LLC "Ukrainian Agrarian Investments", a member of the Board of the Renaissance Group and also the Director of the Renaissance Partners. Mr. Chris Baxter received a Master of Engineering degree of in 1987 from the Imperial College London.

- *Mr. Vladimir Chirakhov* has been a member of the Board of Directors and our General Director since 2012. From 2010 until 2012, Mr. Vladimir Chirakhov was the General Director of the "Korablik" retail chain. From 2009 until 2010, Mr. Vladimir Chirakhov was the Commercial Director of the "Korablik". From 2005 until 2009, Mr. Vladimir Chirakhov was the Head of Small consumer electronics Division of the "M Video" retail chain. From 2001 to 2003, Mr. Vladimir Chirakhov was Head of Small consumer electronics of the "Partiya" retail chain. Mr. Vladimir Chirakhov received a degree in applied mathematics in 1996 from the Federal Security Service Academy, a degree in management in 2001 from the Academy of National Economy under the Government of the Russian Federation and an MBA degree in 2013 from the Moscow Management School of Skolkovo.

- *Mr. Sean Jan Glodek* Sean has been a member of the Board of Directors since 2016. Currently, Mr. Glodek also serves as senior advisor at LLC "RDIF Management Company" ("**RDIF**"). Prior to that, he was a director at Darby Private Equity, a subsidiary of Franklin Templeton, managing investment funds focused on Eastern Europe. Earlier, he was a senior M&A banker at Lehman Brothers and Deutsche Bank in New York, where he participated in a number of landmark transactions. He graduated from the Wharton School of the University of Pennsylvania (MBA) and from Stanford University (BA in Economics).

- *Mr. Leonid Khanik* has been a member of the Board of Directors since 2015. Mr. Khanik also served as Managing Partner at Concept Club from 2005 to 2014, and starting from 2014 he has acted as the Chairman of the Board of Directors at Concept Group. Mr. Khanik graduated from St. Petersburg University of Technology and Design.

- *Mr. Valentin Korchunov* has been a member of the Board of Directors since 2012. Currently, Mr. Valentin Korchunov also serves as the investment director of Sistema starting from 2012, and starting from 2015 he has acted as Vice President. From 2009 until 2012, Mr. Valentin Korchunov was the Associate Director, Head of Execution Group in the Credit, Leveraged Finance and Investments Department at CJSC "VTB Capital". From 2006 until 2009, Mr. Valentin Korchunov was senior manager of the corporate finance division in OJSC "Alfa-Bank". Mr. Valentin Korchunov received a Ph. D. in economics from the Saint Petersburg State University and an MBA degree from the Chicago School of Business.

- *Mr. Oleg Mubarakshin* has been a member of the Board of Directors since 2014. Mr. Mubarakshin also acts as Vice President and Head of Legal Affairs Division at Sistema PJSFC since 2013 and as a director at Binnopharm CJSC, East-West United Bank SA and Sistema Capital, LLC since 2015. Prior to joining the Group, he served as a member of the managing board and Head of Legal at Istvan LLC. Mr. Mubarakshin graduated from Moscow State Law Academy and from Finance Academy under the Government of the Russian Federation.

- *Mrs. Nadezhda Nosova* has been a member of the Board of Directors since 2015. Mrs. Nosova also serves as Director for risk-management and procurement at Sistema since 2010. She currently serves as a member of the boards of directors of JSC Jet Air Group, OJSC SG Trading, JSC Premier Avia, PJSC GK Kosmos and JSC Reestr. Mrs. Nosova graduated from London School of Economics.

- *Mr. Christopher Allan Parks* has been a member of the Board of Directors since 2014. Earlier in his carrier, he acted as CFO at PJSC "Company "M.video" from 2006 to 2015. Mr. Parks has a BBA degree from Simon Fraser University.

- *Mr. Gevork Sarkisyan* has been a member of the Board of Directors since 2015. Mr. Sarkisyan also serves as General Director at Innova Systems LLC since 2006. He also acts as a member of the board of directors at Mechtarium and Rambler & Co. Mr. Sarkisyan graduated from the Russian Plekhanov Academy of Economics.

- *Mr. Lei Teng* has been a member of the Board of Directors since 2016. Currently, Mr. Teng serves as Senior Vice President at Russia-China Investment Fund ("**RCIF**"). Prior, he served as Vice President at China Investment Corporation from 2008 to 2013. Mr. Teng graduated from Maastricht School of Management.

On 23 December 2016, the Board of Directors convened an extraordinary General Shareholders' Meeting for 3 March 2017 to approve a new composition of the Board of Directors. Our shareholder or a group of shareholders owning in the aggregate at least 2% of the Ordinary Shares are entitled to nominate candidates for the Board of Directors by 3 February 2017. Sistema nominated, among others, Mr. James McArthur (independent non-executive director).

A brief biography of Mr. James McArthur is set out below:

- *Mr. James McArthur*. Mr. McArthur currently serves as adviser to a number of entrepreneurs in the luxury, fashion, retailing and food sectors. He has served as CEO of a number of businesses in the global fashion and retailing sectors, including Anya Hindmarch in 2011-2015 and Harrods in 2008-2009. He was Executive Vice President of Gucci Group from 2000-2007, during which time he also served as President and CEO of Balenciaga and of Yves Saint Laurent, as well as board director of several other global fashion brands. Earlier in his career, Mr. McArthur worked at Morgan Stanley and Reserve Bank of New Zealand. Mr. McArthur received an MBA from Harvard Business School in 1987 and a Bachelor of Commerce and Administration with Honours from Victoria University of Wellington in 1981.

Management Board

Details of the Management Board

The Management Board is a collective executive body responsible for our day-to-day management. Our Charter provides that our Board of Directors elects the members of our Management Board from among candidates proposed by the General Director for a term of three years. Our Board of Directors may at any time terminate the powers of any member of the Management Board. Under the Joint Stock Companies Law, no more than 25% of the members of the Board of Directors are allowed to be members of the Management Board. The number of members of the Management Board is not fixed and is determined by the Board of Directors on a case-by-case basis. Currently, the Management Board consists of eleven members. The Management Board's activity is determined in our Management Board regulation. According to our Charter, the duties of our Management Board include, among other things:

- coordination and control over the business of our subsidiaries and other subdivisions;
- preliminary review of large innovative and investment projects and programmes of the Group;
- discussing our draft budget;
- review of transactions with value exceeding 5% of the balance sheet value of the Company's assets under RAS;
- approval and realisation of capital raising programmes;
- approval of internal documents of the Group proposed for the Management Board's review by the General Director;
- participation in resolving labour disputes and nomination of our representative for out-of-court settlement procedures in relation to such disputes;
- taking decisions as a superior governing body in subsidiaries which we wholly own; and
- other issues related to day-to-day management of our business.

Our Management Board regulation requires a majority vote of the members of the Management Board present for an action to pass, provided that minimum half of the elected members are present at the meeting.

The Management Board meets regularly. The General Director is the Chairman of the Management Board.

Members of the Management Board

The table below shows our current Management Board. The business address for the members of the Management Board is 1 Timiryazevskaya Street, Moscow 127422, Russian Federation.

Name	Year of Birth	Date of Election	Expiry of Term	Position
Vladimir Chirakhov	1974	12 October 2012	10 October 2018	General Director
Maria Davydova	1974	13 March 2015	12 March 2018	Deputy CEO for Commercial Affairs
Anna Garmanova	1976	1 November 2015	31 October 2018	Chief Financial Officer
Farid Kamalov	1980	11 March 2014	10 March 2017	Chief Operating Officer
Tatyana Mudretsova	1973	25 November 2014	24 November 2017	Head of Marketing
Maria Volodina	1973	16 April 2014	15 April 2017	Clothing and Shoes Commercial Director
Anastasia Yaroshevskaya	1984	5 September 2016	6 September 2019	Head of HR
Vladimir Ilmetov	1958	3 February 2015	2 February 2018	Head of Corporate Security
Alexander Shlyapochnikov	1973	1 January 2017	31 December 2019	Head of IT
Vyacheslav Khvan	1983	15 November 2013	14 November 2019	Deputy CEO for Business Development
Anatoly Mokhov	1981	13 March 2015	12 March 2018	Head of E-Commerce

For biography of Mr. Vladimir Chirakhov, see "—*Board of Directors—Members of the Board of Directors*".

Brief biographies of other members of our senior management are set out below.

- *Mrs. Maria Davydova* has been a member of the Management Board and Deputy CEO for Commercial Affairs since 2015. In 2006-2011 she served as Commercial Director in the direction of exclusive contracts and own brands at NTS Gradient. Prior to joining the Group in 2013, she acted as Commercial Director at "Enter Svyaznoy". Mrs. Davydova graduated from the Institute of Humanities with a degree in Economy.
- *Mrs. Anna Garmanova* has been a member of the Management Board and Chief Financial Officer of the Company since 2015. Prior to joining the Group in 2008, she acted as Chief Financial Officer of "Podruzhka" retail chain and Head of Financial Department at Mutual Understanding and Reconciliation Fund. Mrs. Garmanova has graduated from Lomonosov Moscow State University and Russian Plekhanov Academy of Economics.
- *Mr. Farid Kamalov* has been a member of the Management Board since 11 March 2014 and our Head of Trade Department since November 2012. In 2012, Mr. Farid Kamalov was Head of branch of the LLC "Media-Markt Saturn". From 2010 until 2012, Mr. Farid Kamalov was retail sales manager, head of division and head of retail sales of the LLC "Korablik-R". From 2003 until 2010, Mr. Farid Kamalov was salesman, section manager and Director of hypermarket of the "M.Video" retail chain. Mr. Farid Kamalov received a degree in engineering in 2003 from the Moscow State Institute of Electronics and degree in MBA in 2015 from the Moscow International Higher School of Business (Institute).
- *Mrs. Tatyana Mudretsova* has been a member of the Management Board and Head of Marketing since 2014. Prior to joining the Group, she served as director of marketing in Russia at Osnova Telecom. From 2005 to 2011, she worked in marketing department of Beeline, eventually as a director of marketing for Russian mass market, and from 1999 to 2005 at creative agency DDB and Publicis. Mrs. Mudretsova graduated from the Faculty of International Economic Relations of the State Academy of Management with a degree in "Information Technologies in Management".
- *Mrs. Maria Volodina* has been a member of the Management Board and Clothing and Shoes Commercial Director since 2014. Prior to joining the Group in 2011, she acted as Head of assortment planning department at Sela, Director of Product Department at "Kira Plastinina Style" LLC, Head of Clothing and accessories at "Sport End Fashion Group" (exclusive distributor of Reebok sportswear brand in the CIS). From 2000 to 2005 she served as Head of wholesale and retail sales of clothing in the "TJ Retail" LLC. Mrs. Volodina graduated from the Moscow Design and Technology University and the State University—Higher School of Economics with a degree in "Brand management in the fashion industry". She graduated from the MBA program at the Plekhanov School of Business with a degree in Strategic Management.
- *Mr. Alexey Voskoboinik* has been a Deputy CEO for Strategy since 2016. Prior, he served as senior executive in the Company's marketing and strategy departments. He holds a degree in applied mathematics and an MBA in "Business Management" from Moscow State Technical University.

- *Mrs. Anastasia Yaroshevskaya* has been a member of the Management Board and Head of Human Recourses since 2016. Prior to joining the Group, she served as Deputy HR Director at Domashniy Interier LLC from 2008 to 2016. Mrs. Yaroshevskaya graduated from Moscow City Psychological-Pedagogical University.
- *Mr. Vladimir Ilmetov* has been a member of the Management Board and Head of Corporate Security since 2015. Prior, from 2011 to 2014 Mr. Ilmetov held the position of Senior Vice President, Head of the Security Service of MTS Bank. From 2010 to 2011, he worked as a deputy director at JSC "OGK-3". In 2008, he served as deputy presidential envoy in the Far Eastern Federal District. From 2005 to 2008 Mr. Ilmetov acted as Vice President of Novikombank. He graduated from Kuibyshev State University.
- *Mr. Alexander Shlyapochnikov* has been a member of the Management Board and Head of Information Technology since January 2017. Between 2012 and January 2017, he acted as the head of the Company's business applications department. Prior to joining the Group, Mr. Shlyapochnikov served in various information technology positions at OJSC Megafon Retail (2010-2012); CJSC National Media Group (2008-2010) and RRC+ LLC (2006-2008). Mr. Shlyapochnikov graduated from Moscow State Institute of Radio Engineering, Electronics and Automation.

On 24 January 2017, the Board of Directors (i) approved the resignation from the Management Board of Mr. Vyacheslav Khvan with effect from 10 February 2017 and Mr. Anatoly Mokhov with effect from 1 February 2017, and (ii) elected Mr. Pavel Pischikov as a member of the Management Board with effect from 2 February 2017.

A brief biography of Mr. Pavel Pischikov is set out below:

- *Mr. Pavel Pischikov*. On 24 January 2017, Mr. Pavel Pischikov was elected by the Board of Directors as a member of the Management Board and Head of E-Commerce with effect from 2 January 2017. Prior to joining the Group, Mr. Pischikov served as the Head of Internet projects at Karnaval LLC (Dochki-Sinochki brand). He also served as the Head of online platform procurement for IT-Business LLC in 2009-2011 and as a Director at Omni LLC in 1995-2008. Mr. Pischikov graduated from the Dnepropetrovsk State University with a degree in Chemistry.

General Director

The Company's General Director is our chief executive officer and chairman of the Management Board, and is responsible for our day-to-day activities. The General Director exercises executive authority over all our activities, except for issues specifically reserved for the exclusive authority of the General Shareholders' Meeting, Board of Directors and the Management Board. Under the Charter, the Board of Directors appoints the General Director for a term of three years and may re-appoint him or her an unlimited number of times. The term of the current General Director, Mr. Vladimir Chirakhov, expires in 10 October 2018.

Under the Charter, the powers of the General Director include, among other things, the following:

- operational management of our activities;
- entering into transactions on our behalf, disposal of our property except when it falls within the competence of the General Shareholders' Meeting or the Board of Directors;
- acting on our behalf without the need to obtain specific authorisation, representing us vis-à-vis public authorities, organisations, legal entities and third parties in general, opening bank accounts, and executing powers of attorney;
- coordination of work of our departments, and approval of administrative and organisation structure and staff schedules;
- execution of labour contracts with our employees;
- approval of all our internal documents except when it falls within the competence of the General Shareholders' Meeting or the Board of Directors; and
- making decisions and issuing orders, regulations and other documents within his or her competence.

Committees of the Board of Directors

We have also established the following committees of the Board of Directors:

Audit Committee

Our Audit Committee, consisting of three members oversees our financial reporting activity. The committee reviews, on an independent basis, the financial information provided by our management as well as the systems of internal controls that concern financial and accounting compliance. The committee also supervises our auditing, accounting and financial reporting processes more generally. Members of the Audit Committee are elected by the Board of Directors at its first meeting following the election of the Board of Directors at the annual General Shareholders' Meeting. Powers of the members of the Audit Committee expire upon expiry of powers of the Board of Directors. The current members of the Audit Committee are Mr. Christopher Allan Parks (Chairman), Mrs. Nadezhda Nosova and Mr. Gevork Sarkisyan.

Strategy Committee

Our Strategy Committee, consisting of five members, oversees our investment activity. The committee reviews and participates in the preparation of business and investment plans relating to all major capital expenditures. Members of the Strategy Committee are elected by the Board of Directors at its first meeting following the election of the Board of Directors at the annual General Shareholders' Meeting. Powers of the members of the Strategy Committee expire upon expiry of powers of the Board of Directors. The current members of the Strategy Committee are Mr. Valentin Korchunov (Chairman), Mr. Vladimir Chirakhov, Mr. Christopher Alan Baxter, Mr. Gevork Sarkisyan and Mr. Leonid Khanik.

Nomination and Remuneration Committee

Our Nomination and Remuneration Committee, consisting of three members, oversees our remuneration and human resources activity. The committee advises the Board of Directors on determining the base salary and other compensation for the General Director and the officers reporting directly to the General Director, and on establishing performance targets for senior management and variable pay schemes for other employees. The committee also reviews our personnel policy and human resources processes including those relating to recruitment and benchmarking. Members of the Nomination and Remuneration Committee are elected by the Board of Directors at its first meeting following the election of the Board of Directors at the annual General Shareholders' Meeting. Powers of the members of the Nomination and Remuneration Committee expire upon expiry of powers of the Board of Directors. The current members of the Nomination and Remuneration Committee are Mr. Gevork Sarkisyan (Chairman), Mr. Christopher Allan Parks and Mr. Valentin Korchunov.

Internal Audit Commission

The principal duties of the Internal Audit Commission are to verify the accuracy of our financial reporting under Russian law and generally supervise our financial activity. Our Internal Audit Commission consists of four members.

The Internal Audit Commission's role is mainly limited to reporting to the Board of Directors and our shareholders with respect to our RAS annual financial statements. In particular, opinions of the Internal Audit Commission are provided to our shareholders before and during each annual General Shareholders' Meeting.

At the General Shareholders' Meeting members of the Internal Audit Commission are elected for a term of one year. Members of the Board of Directors, Management Board and the General Director may not serve on the Internal Audit Commission. The current members of the Internal Audit Commission are Mrs. Marina Zhuravleva, Mr. Stanislav Kriminskiy, Mrs. Natalia Chernik and Mrs. Nadezhda Voskresenskaya.

Internal Control and Audit Department

The Internal Control and Audit Department's main function is to assist our shareholders and management to consistently improve and develop the Group's operational efficiency and value and to systematically, consistently and independently from our management assess and improve our Group's risk management, internal control and corporate governance systems. The activities of the Internal Control and Audit Department are governed by a bylaw on the Internal Control and Audit Department. The Department is functionally subordinated to the Audit Committee of the Board of Directors, and administrated by our General Director.

Interest of Directors and Officers

Compensation

In the nine months ended 30 September 2016, the aggregate amount of remuneration paid (including contingent or deferred compensation), and benefits in kind granted, to the members of the Board of Directors and Management Board for services in all capacities provided to us was RUB413 million.

Share-based Compensation of the General Director

In December 2014, the Board of Directors approved payment of one-off stock based compensation to the Chief Executive Officer, Mr. Vladimir Chirakhov. Compensation of RUB373 million was paid in cash and used by Mr. Chirakhov to acquire 1.08% of the Company's ordinary shares from Sistema. In December 2015, in connection with the sale by Sistema of a 23.1% stake in the Company to RCIF, the Board of Directors approved payment of compensation to Mr. Vladimir Chirakhov consisting of two parts: (i) compensation of RUB378 million, which was paid in cash in December 2015; and (ii) compensation of RUB426 million used by Mr. Chirakhov to acquire 0.71% of the Company's ordinary shares in June 2016.

Long-Term Incentive Plan

Long-Term Incentive Plan adopted in 2014

In August 2014, the Board of Directors approved the long-term incentive plan (the "**Incentive Plan 1**") (a share-based, long-term motivation and retention programme for certain key executive and senior level employees). Under the conditions of the Incentive Plan 1, our senior level employees were entitled to share-based compensation ("phantom" shares).

In 2015, upon the sale of a 23.1% stake in the Company to RCIF, in accordance with the terms of the Incentive Plan 1, the phantom shares vested and the employees were granted with a the right to redeem their phantom shares and receive the Company's ordinary shares or cash compensation in exchange for the phantom shares. As at 31 December 2015 and 30 September 2016, the Company had reported liabilities of RUB278 million and RUB139 million, respectively, in connection with the Incentive Plan 1, representing the fair value of unredeemed phantom shares at respective dates .

Long-Term Incentive Plan for the General Director

In January 2017, the General Shareholders' Meeting approved a long-term incentive plan for the General Director ("**Incentive Plan for the General Director**"), Mr. Vladimir Chirakhov. Under the conditions of the plan, the General Director is entitled to share-based compensation ("phantom" shares). The "phantom" shares are accrued in annual tranches over 2017-2019, subject to continued employment with the Group and certain established targets relating to the increase in the market value of one Ordinary Share. The "phantom" shares vest automatically upon either of the following events: (i) initial public offering of the Company; (ii) Sistema's stake (direct and/or indirect) in the Company falls below 50% of the charter capital, and/or third party's stake (direct and/or indirect) in the Company exceeds Sistema's stake (direct and/or indirect) in the Company; or (iii) sale by Sistema of a certain stake in the Company to a third party. The General Director will be entitled to redeem "phantom" shares upon the occurrence of any of the following events: (i) initial public offering of the Company; (ii) sale by Sistema of a certain stake in the Company to a third party; or (iii) the Group's market value exceeds certain established targets. Upon redemption of "phantom" shares, the share-based compensation to the General Director will be paid in equal parts in the form of (i) cash consideration computed on the basis of the value of one ordinary share approved by the Board of Directors, and (ii) the Ordinary Shares, provided that certain established targets relating to the market value of the Ordinary Shares are met.

Long-Term Incentive Plan adopted in 2016

In September 2016, the Board of Directors approved a new employee long-term incentive plan (the "**Incentive Plan 2**"). Under the conditions of the Incentive Plan 2, certain senior-level employees are entitled to share-based compensation ("phantom" shares), that are accrued in annual tranches in 2016-2018. The phantom shares vest on 31 December 2018 contingent on continued employment with the Group and certain established targets relating to the increase in the Group's market value. The phantom shares accrued to date vest automatically upon a successful initial public offering by the Company or upon the sale by the Company's controlling shareholder of a certain stake in the Company to a third-party investor. Upon redemption of phantom shares, the Company is to provide a participant either a number of shares in the Company or cash consideration computed on the basis of the value of one ordinary share of the Company approved by the Board of Directors at respective reporting date. This settlement choice is at the Company's discretion. In September 2016 the Company granted 1,934,238 phantom shares to 18 participants in the Incentive Plan 2. The Incentive Plan 2 was classified as cash-settled share-based payment in our Financial Statements and we booked liabilities of RUB121 million as at 30 September 2016.

As a result of the Offering, in accordance with the terms of Incentive Plan for the General Director and Incentive Plan 2, the phantom shares under the respective plans will vest. The aggregate amount of payments (in the form of the Ordinary Shares and/or cash consideration) is expected to be approximately three per cent. of the valuation increase as at the date of the Offering as compared to the 2015 sale of a 23.1% stake in the Company to RCIF. Payments are expected to be made during 2017 (approximately 85-90%), while the remaining part is expected to be paid in 2018-2019.

Following the Offering, the Company intends to adopt a new employee long-term incentive plan. In line with best international practices for public companies, share-based compensation under the new long-term incentive plan will be subject to certain targets relating to the increase in the market value of the Ordinary Shares and is expected to be approximately three per cent. of the valuation increase for the period of three years from the date of the Offering.

The Company does not hold Ordinary Shares to settle its obligations as they come due under the long-term incentive plans, and may therefore need to acquire (directly or indirectly) Ordinary Shares in the open market from time to time.

Shareholdings of Directors and Officers

As of the date of this Offering Memorandum, our General Director and members of our Board of Directors and Management Board held the following equity interest in the Company:

- General Director, Mr. Vladimir Chirakhov, held 13,254,627 Ordinary Shares in the Company;
- Members of the Board of Directors, Mr Christopher Alan Baxter, Mr. V.A. Korchunov and Mr. V.M. Ilmetov, held 6,442,100, 7,769,730 and 27,603 Ordinary Shares in the Company, respectively; and
- Members of the Management Board of the Company, Mr. F.Sh. Kamalov, Mrs. A.S. Garmanova, Mrs. M.S. Davydova, Mrs. M.V. Volodina and Mrs. T.P. Mudretsova, held 275,654, 23,002, 41,632, 48,327 and 20,932 Ordinary Shares in the Company, respectively.

Loans to Directors and Executive Officers

As of the date of this Offering Memorandum, there were no outstanding loans granted by us to our directors and executive officers and no guarantees provided for their benefit.

Conflict of Interest

Our directors Messrs. Valentin Korchunov, Nadezhda Nosova and Oleg Mubarakshin, have executive positions at Sistema, our controlling shareholder, which could influence their decisions. Our directors Messrs. Sean Jan Glodek and Lei Teng have executive positions at RDIF and RCIF, respectively, which could influence their decisions. As a result of these individuals holding such positions, a potential conflict of interest may arise (i) between their duties owed to us and their duties owed to Sistema, RDIF and China Investment Corporation, as the case may be, and (ii) between their duties owed to us and their private interests arising from the positions they hold at Sistema, RDIF and China Investment Corporation.

Other than as set out immediately above, there are no actual or potential conflicts of interest between the duties that any member of the Board of Directors or the Management Board owes to the Company and such member's private interests or other duties.

Service and Employment Contracts

We do not enter into service contracts with the members of our Board of Directors.

The members of our Management Board have entered into employment contracts with the Company, which set out their compensation and contain standard terms and conditions (including as to severance and other benefits typically granted) in compliance with Russian law. Our senior management is entitled to (i) a bonus based on KPIs (such as revenue, EBITDA and net profit) and (ii) an individual functional KPIs. We do not provide pension, retirement or similar benefits which are available only to our directors or executive officers.

Litigation Statement about the Members of the Board of Directors and the Management Board

None of the members of our Board of Directors or our Management Board, for at least the previous five years:

- has had any convictions in relation to fraudulent offences; nor
- has held an executive function in the form of a senior manager or a member of the administrative, management or supervisory bodies, of any company at the time of or preceding any bankruptcy, receivership or liquidation; nor
- has been subject to any official public incrimination and/or sanction by any statutory or regulatory authority (including any designated professional body) nor has ever been disqualified by a court from acting as a member of the administrative, management or supervisory bodies of a company or from acting in the management or conduct of the affairs of any company.

Corporate Governance

As at the date of this Offering Memorandum, the Company is in compliance with the corporate governance requirements applicable to us as a Russian public company listed on Moscow Exchange.

Shareholders' Agreement and Corporate Agreement

There has been a shareholders' agreement and a corporate agreement in place since 2015 between Sistema, FLOETTE HOLDINGS LIMITED, EXARZO HOLDINGS LIMITED and certain members of the Company's management holding Ordinary Shares regarding, *inter alia*, the corporate governance of the Company. These agreements will terminate upon completion of the Offering. The shareholders' agreement and corporate agreement provide, *inter alia*, for Sistema to coordinate with FLOETTE HOLDINGS LIMITED in connection with voting on certain key matters by the Company's general meeting of shareholders or Board of Directors, such as the introduction of changes to the Company's charter, liquidation and/or reorganisation of the Company and its subsidiaries, dividend payments, and entry into related party transactions. Under the shareholders' agreement FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED have been granted put options with respect to their respective equity stakes in the Company at fair value in case of non-occurrence of prescribed future events. Such put options will terminate upon completion of the Offering.

TRANSACTIONS WITH RELATED PARTIES

In the ordinary course of business we enter into transactions with related parties. Parties are considered related if they are under common control, or one party has the ability to control the other party, exercise significant influence over decisions on matters of economic and financial activity, or can exercise joint control. In considering each possible related party, the management paid special attention to the substance of the relationship and not merely the legal form. Transactions with related parties may be on terms that are not always accessible to third parties.

The following is a summary of our transactions with related parties for the period from 31 December 2013 to the date of this Offering Memorandum. For further details, see note 16 to the Interim Financial Statements, note 25 to the 2015 Annual IFRS Financial Statements and note 20 to the 2014 Annual US GAAP Financial Statements.

***Rent and utility expenses*—**During the nine months ended 30 September 2016 and the years ended 31 December 2015, 2014 and 2013, the Group incurred costs payable to JSC Detsky mir—Retail Assets, a subsidiary of Sistema, of RUB21 million, RUB41 million, RUB44 million and RUB44 million, respectively.

***Communication expenses*—**During the nine months ended 30 September 2016 and the years ended 31 December 2015, 2014 and 2013, the Group incurred costs payable to PJSC MTS, a subsidiary of Sistema, of RUB14 million, RUB20 million, RUB40 million and RUB26 million, respectively.

***Advertising and marketing expenses*—**During the nine months ended 30 September 2016 and the years ended 31 December 2015, 2014 and 2013, the Group incurred advertising and marketing expenses to PA Maxima, an affiliate of Sistema, of RUB2 million, RUB10 million, RUB19 million and RUB16 million, respectively. PA Maxima provided advertising and marketing services. The Group also incurred advertising and marketing expenses to PJSC MTS, a subsidiary of Sistema, of RUB29 million, RUB44 million and RUB269 million, during the nine months ended 30 September 2016 and the years ended 31 December 2015 and 2014, respectively. In 2014, as part of joint arrangement with PJSC MTS to procure TV advertisement, the Group paid related expenses to PJSC MTS which in turn had agreements with TV advertisement sellers, while in subsequent periods the Group entered into agreements directly with TV advertisement sellers, although the joint arrangement with PJSC MTS continued.

***Security expenses*—**During the years ended 31 December 2015 and 2014, the Group incurred security expenses to LLC PSE AB-Security, a subsidiary of Sistema, of RUB88 million and RUB13 million, respectively.

***Acquisition of property, plant and equipment*—**During the nine months ended 30 September 2016 and the years ended 31 December 2015, 2014 and 2013, the Group purchased property, plant and equipment from CJSC NVision Group, a subsidiary of Sistema, in the amount of RUB22 million, RUB9 million, RUB17 million and RUB28 million, respectively.

***Medical services*—**During the years ended 31 December 2015 and 2014, the Group incurred expenses under an agreement with CJSC Medsi Group, a subsidiary of Sistema, in the amount of RUB4 million and RUB403 thousand, respectively.

***Event organisation expenses*—**During the nine months ended 30 September 2016 and the year ended 31 December 2015, the Group incurred expenses under an agreement with VAO "Intourist", a subsidiary of Sistema, in the amount of RUB18 million and RUB1 million, respectively.

***Repayment of loans receivable*—**During the nine months ended 30 September 2016, the Group received a repayment of RUB4,875 million in respect of a loan granted to CJSC "DM-Finance" (subsidiary of Sistema).

***Interest income*—**During the nine months ended 30 September 2016 and the years ended 31 December 2015 and 2014, the Group earned interest income from subsidiaries of Sistema in the amount of RUB118 million, RUB629 million and RUB1 million, respectively.

As at 30 September 2016, accounts payables to subsidiaries of Sistema amounted to RUB123 million.

No part of the revenues of the Group is from sales to related parties.

Compensation of key management personnel

During the nine months ended 30 September 2016 and the years ended 31 December 2015 and 2014, the Group's directors and other members of key managements received as remuneration RUB413 million, RUB1,187 million and RUB817 million, respectively.

PRINCIPAL AND SELLING SHAREHOLDERS

Our shareholders are not required to give us notice of transfers of our ordinary shares and we are only able to verify the exact status of our shareholdings by making a specific request of our independent registrar in connection with a matter requiring a shareholder vote. See "*Description of Share Capital and Certain Requirements of Russian Law—Description of Share Capital—Registration and Transfer of Shares*".

Principal Shareholders

The following table sets out the shareholders of the Company (i) as at the latest practicable date, (ii) immediately following the Offering (assuming that all Shares are sold and no exercise of the Over-Allotment Option) and (iii) immediately following the Offering (assuming that all Shares are sold and the Over-Allotment Option is exercised in full):

	As at the latest practicable date		**Immediately following the Offering (assuming that all Shares are sold and no exercise of the Over-Allotment Option)**		**Immediately following the Offering (assuming that all Shares are sold and the Over-Allotment Option is exercised in full)**	
Shareholder	**Number of Ordinary Shares**	**Shareholding**	**Number of Ordinary Shares**	**Shareholding**	**Number of Ordinary Shares**	**Shareholding**
Sistema(1)	536,314,100	72.57%	391,258,362	52.94%	369,500,001	50.00%
FLOETTE HOLDINGS LIMITED(2)	85,361,583	11.55%	53,231,148	7.20%	48,411,583	6.55%
EXARZO HOLDINGS LIMITED (2)	85,361,583	11.55%	53,231,148	7.20%	48,411,583	6.55%
Management(3)	27,951,415	3.78%	21,003,808	2.84%	21,003,808	2.84%
Other	4,011,319	0.54%	220,275,534	29.81%	251,673,025	34.06%
	739,000,000	**100%**	**739,000,000**	**100%**	**739,000,000**	**100%**

(1) Sistema is a Russian public company with a listing of GDRs on the London Stock Exchange. Mr. Vladimir Evtushenkov, who beneficially owns 64.18% of Sistema, is the controlling shareholder of Sistema. The business address of Sistema is Mokhovaya Street 13, Building 1, Moscow 125009, Russian Federation.

(2) RCIF is a private equity fund established in 2012 as two parallel funds by two government-backed investment vehicles—RDIF and China Investment Corporation. RCIF's stake is held through its funds' two wholly-owned subsidiaries, FLOETTE HOLDINGS LIMITED (wholly-owned by the fund of China Investment Corporation) and EXARZO HOLDINGS LIMITED (wholly-owned by the fund of RDIF). The business address of each of FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED is 1082 Cyprus, Nicosia, Agioi Omologites, Kyriakou Matsi, 16, EAGLE HOUSE, 10th floor.

(3) Includes Ordinary Shares held by: (i) the General Director, Mr. Vladimir Chirakhov (13,254,627 Ordinary Shares before the Offering), (ii) members of the Board of Directors, Mr Christopher Alan Baxter (6,442,100 Ordinary Shares before the Offering), Mr. V.A. Korchunov (7,769,730 Ordinary Shares before the Offering) and Mr. V.M. Ilmetov (27,603 Ordinary Shares), and (ii) members of the Management Board, Mr. F.Sh. Kamalov (275,654 Ordinary Shares before the Offering), Mrs. A.S. Garmanova (23,002 Ordinary Shares), Mr. A.V. Mokhov (47,808 Ordinary Shares), Mrs. M.S. Davydova (41,632 Ordinary Shares), Mrs. M.V. Volodina (48,327 Ordinary Shares before the Offering) and Mrs. T.P. Mudretsova (20,932 Ordinary Shares before the Offering). See "*Management and Corporate Governance—Interest of Directors and Officers*".

One of our shareholders, EXARZO HOLDINGS LIMITED, is indirectly owned by Vnesheconombank. In 2014, Vnesheconombank was included in a sectoral sanctions list by U.S. and the EU. The U.S. sanctions provide for prohibitions on transactions by U.S. persons or within the U.S. with respect to engaging in all transactions in, provision of financing for, and other dealings in, new debt of longer than 90 days maturity or new equity issued on or after 16 July 2014 or new debt of longer than 30 days maturity issued on or after 12 September 2014 by, or on behalf of, or for the benefit of named persons (including Vnesheconombank), their property, or their interests in property. The EU sanctions provide for prohibitions on assisting in the issuance of or otherwise dealing with transferable securities or money market instruments issued between 1 August to 12 September 2014 (with a maturity exceeding 90 days) or after 12 September 2014 (with a maturing exceeding 30 days), by named persons (including Vnesheconombank), their more than 50% owned non-EU subsidiaries or other persons acting on their behalf or at their direction. The EU sanctions also include restrictions on making new loans or credit (with a maturity exceeding 30 days) to such entities after 12 September 2014. Exarzo Holdings Limited is established in the EU. See "*Risk Factors—Risks Relating to the Political, Economic and Social Situation in Russia—The current political instability relating to Ukraine and related sanctions may affect our business*".

We are not aware of any arrangements in place that may result in a change of control of the Company. None of our shareholders has any voting rights that are different from any other holders of our ordinary shares, save for the voting rights and obligations of the shareholders which are parties to the shareholders' agreement entered into in 2015. See "*Management and Corporate Governance—Shareholders' Agreement and Corporate Agreement*".

Selling Shareholders

The following table sets out the names of the shareholders who are expected to be selling Shares in the Offering:

Selling Shareholder	**Maximum number of Shares**
Sistema	166,814,099
FLOETTE HOLDINGS LIMITED	36,950,000
EXARZO HOLDINGS LIMITED	36,950,000
Mr. Vladimir Chirakhov(1)	3,313,656
Mr. Christopher Alan Baxter(2)	1,610,525
Mr. Valentin Korchunov(2)	1,942,432
Mrs. Maria Volodina(3)	12,081
Mr. Andrey Churilov	12,081
Mr. Farid Kamalov(3)	68,913
Mr. Sergey Altukhov	7,860
Mr. Maxim Sapozhnikov	230,513
	247,912,160

(1) General Director of the Company, Chairman of the Management Board and a member of the Board of Directors of the Company.

(2) Member of the Board of Directors of the Company.

(3) Member of the Management Board of the Company.

DESCRIPTION OF SHARE CAPITAL AND CERTAIN REQUIREMENTS OF RUSSIAN LAW

We describe below our share capital, the material provisions of our Charter in effect at the date hereof and certain requirements of Russian law. This description, however, is not complete and is qualified in its entirety by reference to our Charter and any applicable Russian law.

Corporate Purpose

Pursuant to Article 2.1 of our Charter, our primary purpose is to earn profit by carrying out business activities.

Description of Share Capital

General Matters

Our company was incorporated on 3 September 1997 as an open joint stock company. In 2016, in accordance with amendments to Russian law, the Company was re-registered as a public joint stock company.

Pursuant to the Joint Stock Companies Law, we have the right to issue registered ordinary shares, preferred shares and other securities. Under Russian law, share capital refers to the aggregate nominal value of the issued and outstanding shares. Our share capital currently consists of 739,000,000 issued, fully paid and outstanding ordinary shares, each with a nominal value of RUB 0.0004. In addition, we are authorised by the Charter to issue an additional 14,250,000 ordinary shares. When issued, such ordinary shares will be identical to, and fully fungible with, the Company's currently issued and outstanding ordinary shares. No preferred shares are currently authorised or outstanding. Preferred shares may only be issued if amendments have been made to the Charter pursuant to a resolution of the General Shareholders' Meeting.

The Joint Stock Companies Law requires us to dispose of any of our treasury shares that we acquire within one year of their acquisition or, failing that, reduce our share capital by the respective amount. Russian legislation does not allow voting rights or payment of dividends in relation to treasury shares. Currently we do not have any treasury shares (as referred to herein). Any shares that are owned by our subsidiaries are not considered treasury shares under Russian law (i.e., they are considered outstanding shares), and such subsidiaries are able to exercise voting rights and receive dividends relating to such shares and dispose of such shares without the need for any further corporate actions by our shareholders or the Board of Directors.

History of our share capital

The following table sets forth the changes in our share capital that have occurred from the date of our incorporation to the date hereof.

Date of event	Type of shares	Par value	Number of shares	Event
24 November 1997	Ordinary shares	RUB 100,000	900	Distribution among the founders in relation to our incorporation
7 April 2005	Ordinary shares	RUB 100	460	Closed subscription
28 June 2007	Ordinary shares	RUB 100	216	Closed subscription
1 April 2010	Ordinary shares	RUB 100	637	Closed subscription
30 November 2010	Ordinary shares	RUB 100	743	Closed subscription
11 February 2014	Ordinary shares	RUB 0.0004	739,000,000	Share split of our ordinary shares with a split ratio of 1:250,000. As a result of the Share split, each our pre-split ordinary share was converted into 250,000 post-split ordinary shares.

Rights Attaching to Ordinary Shares

Holders of our ordinary shares have the right to vote at all General Shareholders' Meetings. As required by the Joint Stock Companies Law and the Charter, all of our ordinary shares have the same nominal value and grant to their holders identical rights. Each fully paid ordinary share, except for treasury shares, gives its holder the right to:

- freely transfer the ordinary shares without the consent of other shareholders;
- receive dividends;
- participate in General Shareholders' Meetings and vote on all matters within the competence of General Shareholders' Meetings;
- transfer rights to vote in a General Shareholders' Meeting to a representative pursuant to a power of attorney;
- if holding, alone or with other holders, 1% or more of the ordinary shares, to access the list of persons entitled to participate in the General Shareholders' Meeting and to sue in court, on our behalf, members of the Board of Directors, the General Director and members of the Management Board for damages incurred by us as a result of their wrongful actions or failures to act;
- if holding, alone or with other holders, 2% or more of the ordinary shares, within 100 days after the end of our fiscal year, make proposals for the annual General Shareholders' Meeting and nominate candidates to the Board of Directors and the Internal Audit Commission;
- if holding, alone or with other holders, 10% or more of the ordinary shares, demand that the Board of Directors call an extraordinary General Shareholders' Meeting or an unscheduled audit by the Internal Audit Commission;
- demand repurchase by us of all or some of the ordinary shares in the Company held by the shareholder if that shareholder voted against or did not participate in the voting on, the decision approving any of the following actions:
  - a corporate re-organisation,
  - a conclusion of a major transaction involving assets valued in excess of 50% of the balance sheet value of our assets;
  - amendments to the Charter or the adoption of a new version of the Charter in a manner that restricts shareholders' rights; or
  - an application for delisting of shares and/or securities convertible into shares.
- upon our liquidation, receive an amount of our residual assets (after fulfilment of our obligations to creditors) proportionate to their shareholding;
- have access to certain of our documents, receive copies for a reasonable fee, and if holding alone or with other shareholders, 25% or more of the ordinary shares, have free access to minutes of our Management Board and accounting documents; and
- exercise other shareholder rights, provided by our Charter, Russian legislation or duly approved decisions of General Shareholders' Meetings.

Any decision determining the maximum number, nominal value, category (i.e., type) of authorised shares and the rights attached to such shares must be approved by 75% of the shareholders holding ordinary shares participating in the General Shareholders' Meeting.

Pre-emptive Rights

We have the right to issue shares or securities convertible into shares by way of offering them to the public (an open subscription) or by way of offering them to our shareholders and/or certain third parties determined in the decision on share issuance (a closed subscription). The Joint Stock Companies Law provides existing shareholders with a pre-emptive right to purchase shares or securities convertible into shares issued through an open subscription in an amount proportionate to their existing shareholdings. In addition, the Joint Stock Companies Law provides our shareholders with a pre-emptive right to purchase new shares or securities convertible into shares issued through a closed subscription if the shareholders voted against or did not participate in the voting on the decision approving such subscription. Pre-emptive rights are not available in relation to a closed subscription to existing shareholders, provided that such shareholders may each acquire a whole number of shares (or securities convertible into shares) in proportion to their existing shareholdings. In both cases we must provide our shareholders with written notice of the proposed placement at least 45 days prior to the beginning of the placement period, during which time shareholders may exercise their pre-emptive rights. If the price of the new issue is determined after expiration of the pre-emptive right period, we must provide shareholders with written notice of the proposed placement at least 20 days prior to the beginning of the placement period, during which time shareholders may exercise their pre-emptive rights. If information contained in the written notice of the proposed placement is subject to disclosure requirements under Russian securities law, the period during which shareholders may exercise their pre-emptive rights must be at least 8 working days following the date of the information disclosure.

Dividends

The Joint Stock Companies Law and the Charter set out the procedure for determining the dividends that we distribute to our shareholders.

Under the Charter, we may declare dividends based on our first quarter, six-month, nine-month or annual results. The majority of the members of the Board of Directors present at a meeting must recommend to a General Shareholders' Meeting the amount of the proposed distribution and the record date for determining the list of entities entitled to receive dividends (the "**Dividend Payment Record Date**"). Upon the recommendations of the Board of Directors, the General Shareholders' Meeting must approve such amount and Dividend Payment Record Date by a majority vote. The distribution amount cannot be more than that recommended by the Board of Directors. A decision on quarterly, six-month and nine-month dividends must be taken within three months of the end of the respective quarter at a General Shareholders' Meeting; a decision on annual dividends must be taken at the annual General Shareholders' Meeting. We pay dividends to shareholders and the Central Depository entitled to receive dividends as of the Dividend Payment Record Date. Under the Securities Market Law, upon receipt of the dividends the Central Depository must transfer them to depo account holders who are entitled to receive dividends as of the Dividend Payment Record Date. Dividends are not paid on treasury shares.

Under the Joint Stock Companies Law, the Dividend Payment Record Date shall not be earlier than 10 days prior to and not later than 20 days following the date of the shareholders' decision on dividend payments. The dividends must be paid to the Central Depository within 10 working days and to shareholders within 25 working days following the Dividend Payment Record Date. Dividends are paid by way of wire transfer to bank accounts of the shareholders and the Central Depository. If there is no request from the shareholders-physical persons to transfer dividends to their bank accounts, the dividends must be paid in cash by postal orders.

The Charter provides that the dividends shall be paid in cash except when other form is prescribed by a decision of the General Shareholders' Meeting.

On 16 December 2016 our Board of Directors adopted a dividend policy. See "*Dividend Policy*" for further details.

The Joint Stock Companies Law allows dividends to be declared only out of net profits calculated under RAS and as long as the following conditions have been met:

- the share capital of the company has been paid in full;
- the company has repurchased all shares from shareholders who have exercised their right to demand repurchase;
- the company is not insolvent on the date of adoption of the decision to pay dividends (and would not become insolvent as a result of the proposed dividend payment);
- the value of the company's net assets, calculated under RAS, on the date of adoption of the decision to pay dividends is not less (and would not become less as a result of the proposed dividend payment) than the sum of the company's share capital, the company's reserve fund and the difference between the liquidation value and the nominal value of the issued and outstanding preferred shares of the company; and
- other requirements of Russian legislation have been fulfilled.

In addition, a Russian company is prohibited from paying dividends (even if they have been declared) if:

- the company is insolvent on the date of payment or would become insolvent as a result of the proposed dividend payment;

- the value of the company's net assets, calculated under RAS, on the date of payment, is less (or would become less as a result of the proposed dividend payment) than the sum of the company's share capital, the company's reserve fund and the difference between the liquidation value and the nominal value of the issued and outstanding preferred shares of the company; and
- otherwise prohibited by the Russian legislation.

Distributions to Shareholders on Liquidation

Under Russian legislation, liquidation of a company results in its termination without the transfer of rights and obligations to other persons as legal successors. The Joint Stock Companies Law and the Charter allow a company to be liquidated:

- by a three-quarters majority vote of a General Shareholders' Meeting; or
- by a court order.

Following a decision to liquidate the company, the right to manage its affairs would pass to a liquidation commission which, in the case of voluntary liquidation, is appointed by a General Shareholders' Meeting and, in an involuntary liquidation, is appointed by the court. Creditors may file claims within a period to be determined by the liquidation commission, but such period must not be less than two months from the date of publication of notice of liquidation by the liquidation commission.

The Civil Code gives creditors the following order of priority during liquidation:

- first priority—to individuals owed compensation for injuries or deaths or moral damages;
- second priority—to employees and copyright claims;
- third priority—to federal and local governmental authorities claiming taxes and similar payments to the budgets and non-budgetary funds; and
- fourth priority—to other creditors in accordance with Russian legislation.

Claims of creditors in obligations secured by a pledge of the company's property shall be satisfied from the sale proceeds of the pledged property prior to claims of any other creditors, save for the creditors of the first and second orders of priority, provided that claims of those creditors of the first and second orders of priority arose before the respective pledges have been entered into. Any residual claims of secured creditors that remain unsatisfied after the sale of the pledged property rank *pari passu* with claims of the fourth priority creditors.

The remaining assets of a company are distributed among shareholders in the following order of priority:

- payments to repurchase shares from shareholders having the right to demand repurchase;
- payments of declared but unpaid dividends on preferred shares and the liquidation value of the preferred shares, if any; and
- distribution of the remaining assets of a company between the holders of ordinary and preferred shares on a *pro rata* basis.

Liability of Shareholders

The Civil Code and the Joint Stock Companies Law generally provide that shareholders in a Russian joint stock company are not liable for the obligations of a joint stock company and only bear the risk of loss of their investments. However, this may not be the case, when one person or entity (the "effective parent") is capable of determining decisions made by another entity (the "effective subsidiary") by way of giving binding instructions to the effective subsidiary. If the effective subsidiary is a joint stock company, the effective parent bears joint and several liability for a transaction concluded by the effective subsidiary if:

(i) the effective parent caused the effective subsidiary to conclude the transaction; and

(ii) the ability of the effective parent to give binding instructions is provided for in the charter of the effective subsidiary or in a contract between such entities.

If the effective subsidiary is a Russian limited liability company, the effective parent bears joint and several liability if the effective parent caused the effective subsidiary to conclude the transaction (regardless of how the effective parent's ability to determine decisions of the effective subsidiary arises).

Thus, a shareholder of an effective parent is not itself liable for the debts of the effective parent's effective subsidiary, unless that shareholder is itself an effective parent of the effective parent.

Accordingly, the shareholders will not be personally liable for our debts or those of our effective subsidiaries unless such shareholders control our business and/or its effective subsidiaries, and the conditions set out above are met.

In addition, an effective parent may be held secondarily liable for the debts of an effective subsidiary if the latter becomes insolvent or bankrupt as a result of the action or inaction of the former. This is the case no matter how the effective parent's capability to determine decisions of the effective subsidiary arises, such as through ownership of voting securities or by contract. If the effective subsidiary is a joint stock company, then the effective parent will have secondary liability only if the effective parent caused the effective subsidiary to take any action or fail to take any action knowing that such action or failure to take action would result in insolvency of the effective subsidiary. If the effective subsidiary is a limited liability company, then the effective parent will be held secondarily liable if the effective subsidiary's insolvency is caused by the wilful misconduct or negligence of such effective parent, subject to the insufficiency of the effective subsidiary's assets to cover its obligations.

Shareholders of an effective subsidiary that is a joint stock company may also claim compensation for the effective subsidiary's losses from the effective parent if: (i) the effective parent caused the effective subsidiary to take any action or fail to take any action that resulted in a loss and (ii) the effective parent knew that such action or failure to take such action would result in the effective subsidiary's loss. Participants of an effective subsidiary that is a limited liability company may claim compensation for the effective subsidiary's losses from the effective parent if the effective parent through its wilful misconduct or negligence caused the effective subsidiary to take any action, or fail to take any action, that resulted in a loss.

Share Capital Increase

We may increase our share capital by:

- issuing new shares, or
- increasing the nominal value of our previously issued shares.

A decision on any issuance of shares or securities convertible into shares by closed subscription, or an issuance by open subscription of ordinary shares or securities convertible into ordinary shares constituting more than 25% of the number of issued ordinary shares, requires a three quarters majority vote of the General Shareholders' Meeting. A decision on the issuance by open subscription of ordinary shares or securities convertible into ordinary shares constituting 25% or less of the number of issued ordinary shares, requires unanimous approval by the Board of Directors. A decision to increase the share capital by increasing the nominal value of issued shares requires a majority vote of the General Shareholders' Meeting. In addition, the issuance of shares above the number of authorised and non-issued shares provided in our Charter necessitates a Charter amendment, which requires a three quarters majority vote of the General Shareholders' Meeting.

The Joint Stock Companies Law requires that the placement price of the newly issued shares be determined by the Board of Directors based on their market value but not less than their nominal value. Placement price for existing shareholders exercising a pre-emptive right to purchase shares may be less than the price paid by third parties, but in any event no more than by 10% of the price paid by third parties. Fees of an intermediary participating in the placement of shares cannot exceed 10% of the share price. The Board of Directors may, but is not required to, involve an independent appraiser to set the placement price of the shares. There is a specific requirement for determining the placement price of securities, for which prices are regularly published, that the Board of Directors shall take into account such prices. The Board of Directors shall value any in-kind contributions for new shares, based on the appraisal report of an independent appraiser.

Russian securities laws and regulations set out detailed procedures for the issuance and registration of shares of a Russian joint stock company. These procedures require:

- adoption of a decision to increase capital by placing additional shares;
- adoption of a decision on share issuance (and in certain cases of a prospectus);
- prior registration of a share issuance (and in certain cases of a prospectus) with the CBR;

- placement of the shares;
- registration of the report or filing of the notice on the results of the share issuance; and
- public disclosure of information at the required stages of the issuance.

Share Capital Decrease and Share Repurchases

We have the right to, and under certain circumstances, are statutorily required to, decrease our share capital.

The Joint Stock Companies Law does not allow a company to reduce its share capital below the minimum share capital required by law, which is RUB 100,000 (approximately U.S.$1,500) for an open joint stock company. The Joint Stock Companies Law requires that any decision to reduce the share capital of the company, whether through the repurchase and cancellation of shares or a reduction in the nominal value of the shares, be made by a General Shareholders' Meeting. In addition, within three business days of a decision to reduce the company's share capital, the company should notify the competent authority on adoption of such decision, and then twice publish a notification on the decrease of the share capital in specially designated mass media with regularity of once in a month.

The Joint Stock Companies Law allows a company to decrease the share capital through a reduction in the nominal value of the shares only if the following conditions have been met:

- the company's share capital has been paid in full;
- the company has repurchased all shares from shareholders who have exercised their right to demand repurchase of their shares;
- the company is not insolvent on the date of adoption of the decision to decrease the share capital and would not become insolvent, as a result of the proposed decrease of share capital;
- the value of a company's net assets on the date of adoption of the decision to decrease the share capital is not less (and would not become less, as a result of the proposed decrease of share capital) than the sum of its share capital, the reserve fund and the difference between the liquidation value and nominal value of the company's issued and outstanding preferred shares;
- the company has paid all declared and unpaid dividends; and
- other requirements of Russian legislation have been fulfilled.

Russian legislation provides that a company's shareholders may demand repurchase of all or some of their shares so long as the shareholder demanding repurchase voted against or did not participate in the voting on the decision approving any of the following actions:

- a re-organisation of the company;
- a conclusion of a major transaction involving assets in excess of 50% of the balance sheet value of the assets of the company;
- amendments to the charter or approval of a new version of the charter in a manner that restricts the shareholder's rights; or
- an application for delisting of shares and/or securities convertible into shares

The company may spend up to 10% of its net assets calculated under RAS for a share redemption demanded by the shareholders. If the value of shares in respect of which the shareholders have exercised their right to demand repurchase exceeds 10% of net assets of the company, the company will repurchase shares from each such shareholder on a *pro rata* basis.

The decision on applying for the delisting of shares and/or securities convertible into shares requires a three quarters majority vote of the General Shareholders' Meeting. Under the Joint Stock Companies Law, the decision of the General Shareholders' Meeting on applying for the delisting of shares and/or securities convertible into shares enters into force if the aggregate number of shares in respect of which the shareholders have exercised their right to demand repurchase does not increase the number of shares that can be repurchased by the company given that the company may spend only up to 10% of its net assets calculated under RAS. Otherwise, the decision of the General Shareholders' Meeting does not enter into force and the application for delisting is not approved.

Registration and Transfer of Shares

Our shares comprise our ordinary shares in registered form. Russian legislation requires that a joint stock company hold a register of its shareholders. Under the amendments to the Civil Code that entered into force on 1 October 2013, a register of shareholders must be held by a specialised licensed registrar. Companies which hold the register of shareholders themselves must transfer the register to the specialised licensed company until 1 October 2014. The Joint Stock Companies Law and the Securities Market Law require that a register of shareholders of (i) a joint stock company with more than 50 shareholders or (ii) a joint stock company that has a statutory obligation to disclose information in connection with placement and (or) circulation of shares be held by a specialised registrar. Ownership of our shares is evidenced by entries made in the shareholders' register, on the books of the Central Depository or a Russian licensed depositary.

Pursuant to the Central Depository Law which sets out a legal framework for establishment and operation of the Central Depository, the sole nominal holder who can be registered in the shareholders' register. NSD, having the status of the Central Depository, opened its nominal holder account in our register of shareholders in 2013. The Central Depository Law provides that other nominal holders (depositaries) must open depo accounts with the Central Depository to carry out operations with securities.

Any of our shareholders may obtain an extract from the register of our shareholders maintained by the registrar or from their respective depositary, as the case may be, certifying the number of shares that such shareholder holds. We are also entitled to obtain an extract from our shareholders' register which sets out all of our shareholders registered directly therein. In addition, we are entitled to obtain a list of nominal holders that opened depo accounts with the Central Depository as well as a list of entities that have accounts opened with the nominal holders, given that such list is provided by the relevant nominal holder. In particular, the Securities Market Law provides that a foreign depositary of GDR programmes or its Russian custodian must provide an issuer with a list of GDR holders for the purposes of the General Shareholders' Meeting. However, we are currently unable to monitor transfers of our shares that are held on the books of depositaries registered with the Central Depository, because underlying shareholders have no obligation to reveal and such depositaries have no obligation to notify us about such transfers. As a result, we can currently only identify our actual shareholders in a limited number of cases when such possibility is provided for by Russian law, including when requesting our registrar and the Central Depository to compile a list of shareholders of record for the General Shareholders' Meeting.

However, our shareholders and beneficial owners of our shares shall notify us and the CBR of an acquisition of 5% or more of our ordinary shares or of an acquisition of the right to vote on 5% or more of our ordinary shares by virtue of an agreement or otherwise, and of any subsequent change in the number of such ordinary shares above or below certain thresholds, and we are required to disclose such information in accordance with Russian securities regulations. See "*—Certain Requirements of Russian Legislation—Notification of Acquisition of Significant Interest" and also "—Disclosure of Information*".

Since 1 February 2007, JSC "Reestr" located at 3 Zubovskaya Square, block 2, Moscow 119021, Russian Federation, has maintained our shareholder register.

The purchase, sale or other transfer of shares is accomplished through the registration of the transfer in the shareholders' register, or the registration of the transfer with a depositary if shares are held through a depositary. The registrar or depositary may not require any documents in addition to those required by Russian legislation in order to register a transfer of shares in the register. Refusal to register the shares in the name of the transferee or, upon request of the beneficial holder, in the name of a nominee holder, is not allowed, and such refusals may be challenged in court.

See also "*Risk Factors—Risks Relating to the Shares and the Trading Market*".

Listing

In accordance with Regulation of the CBR No. 534-P dated 24 February 2016 and Moscow Exchange listing rules, there are three listing levels for securities: premium Level 1 with quotation, Level 2 with quotation and Level 3 without quotation. Listing rules set forth, among others, certain trading, reporting and corporate governance requirements to each of Level 1 and Level 2 listings.

Reserve Fund

Russian legislation requires each joint stock company to establish a reserve fund to be used only to cover the company's losses, redeem the company's bonds and repurchase the company's shares in cases when other funds are not available. The Joint Stock Companies Law and the Charter provide for a minimum reserve fund of 5% of our share capital, funded through mandatory annual transfers of at least 5% of net profits of the company until the reserve fund has reached the above target 5% requirement. We also may establish special purpose funds upon a decision of a General Shareholders' Meeting. Decisions on use of such funds shall be approved by our Board of Directors.

Disclosure of Information

In accordance with Russian securities regulations, as a public company, we are required to make the following public disclosures and filings on a periodical basis:

- publishing on the website quarterly issuer's reports containing information about us, our shareholders, the structure of our management bodies, the members of the Board of Directors and Management Board, our branches and representative offices, our shares, bank accounts and statutory auditors, important developments during the reporting quarter, and other information about our financial and business activity;
- filing with the CBR and publishing in newswire as well as on our website any information concerning material facts and changes in our financial and business activity, including among other things:
  - our re-organisation;
  - certain changes in the amount of our assets;
  - certain facts related to share issuances;
  - decisions of the General Shareholders' Meetings;
  - acquisition by a person of 5% or more of our ordinary shares or an acquisition of the right to vote on 5% or more of the ordinary shares by virtue of an agreement or otherwise, and any subsequent change in the number of such ordinary shares above or below any of 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75% or 95% threshold;
  - the information on the receipt of any of (i) a voluntary offer (including any competing offer), (ii) a mandatory offer (including any competing offer), (iii) notice of the right of shareholders to sell their shares to the person that has acquired more than 95% of the ordinary shares, and (iv) a demand that minority shareholders sell their shares to the person that has acquired more than 95% of the ordinary shares;
- disclosing information at various stages of share issuances through publication of certain data as required by securities regulations;
- disclosing our annual report and annual financial statements;
- disclosing on our website on a quarterly basis a list of our affiliated persons; and
- other information as required by applicable Russian securities legislation.

Certain Requirements of Russian Legislation

Interested Party Transactions

The Joint Stock Companies Law contains special requirements with respect to entrance into the interested party transactions. "Interested party transactions" include transactions involving a member of the Board of Directors or member of any executive body of the company (including members of the Management Board and the General Director) and controlling person of the company(as defined by the Joint Stock Companies Law) or any person who is able to direct the actions of the company, if that person and/or that person's spouse, parents, children, adoptive parents or children, brothers or sisters or persons or entities under their control, is/are:

- a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary;
- are the controlling person of a legal entity that is a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary; or
- a member of any management body of a company that is a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary, or a member of any management body of a management organisation of such a company.

The Joint Stock Companies Law requires that the Company notifies (i) its board of directors, (ii) members of the management board; and (iii) shareholders (in case all the members of the board of directors are interested, the company does not have the board of directors or the company's charter provides for notification of the shareholders) on the planned execution of the interested party transaction at least 15 days prior to execution.

Upon receipt of such notification, the company's CEO, member of the board of directors, member of the management board or shareholder owning at least 1% of the voting shares of the company, are entitled to call for consent for execution of the transaction by the board of directors or general shareholders' meeting.

Consent is to be provided by a majority of shareholders present of the meeting who are not interested in the transaction if:

- the value of such transaction or a number of interrelated transactions is 10% or more of the balance sheet value of the company's assets calculated under RAS;
- the transaction or a number of interrelated transactions involves the placement by subscription or secondary market sale of shares in the amount exceeding 2% of the company's issued ordinary shares and ordinary shares, in which issued convertible securities may be converted;
- the transaction or a number of interrelated transactions involves the placement by subscription of issued securities convertible into shares that may be converted into ordinary shares constituting more than 2% of the company's issued ordinary shares and ordinary shares, in which issued convertible securities may be converted;
- the number of directors who are not interested in the transaction is not sufficient to constitute a quorum; or
- all the members of the Board of Directors of the company are interested parties, or none of them is an independent director.

The notification on execution and consent in respect of an interested party transaction is not required if:

- transactions are conducted in the ordinary course of business of the company on the terms similar to terms of previous non-interested transactions on this type;
- the company has only one shareholder that simultaneously performs the functions of the company's sole executive body;
- all shareholders of the company are deemed interested in the transaction;
- transactions are conducted in connection with offering of the company's shares and other securities, convertible to shares;
- transactions are conducted in connection with public offering of bonds or repurchase of issued bonds;
- the company is repurchasing its issued shares;
- transactions are conducted in connection with reorganisation of the company;
- the company is required by law to enter into the transaction, and settlements under such transactions are made pursuant to prices set by the Russian government on or pursuant to tariffs and prices established by appropriate state authorities authorised by the Russian government;
- transactions are concluded on the terms of preliminary agreement, provided such preliminary agreement was duly approved;
- transactions are concluded on the open organised market or under an open tender, provided that terms of company's participations in such trades were prior approved by the board of directors; or
- transactions involve the acquisition or disposal of property having the value of less than 0.1% of the balance sheet value of the assets of a company calculated under RAS.

Upon a claim by a company, member of the board of directors or shareholder owning at least 1% of the voting shares of the company, a court may invalidate any interested party transaction, provided that: (i) the transaction is executed at the expense of the company's interests; and (ii) the counterparty has been proven to have known and should have known that the transaction constituted an interested party transaction to the company and the respective consent has not been received. However, pursuant to Joint Stock Companies Law, a court shall dismiss the claim seeking to invalidate an interested party transaction entered into in breach of the abovementioned requirement in certain instances.

Major Transactions

The Joint Stock Companies Law defines a major transaction as a transaction, or a series of interrelated transactions, conducted outside the ordinary course of business of the company and involving the acquisition or disposal (including temporary transfer), the possibility of disposal directly or indirectly of property having the value of 25% or more of the balance sheet value of the assets of a company calculated under RAS, with the exception of:

- transaction performed by the company which has only one shareholder that simultaneously performs the functions of the company's sole executive body;
- transactions in connection with the placement (public offering) and/or organisation of placement of shares through a subscription (sale of shares), or with the placement of securities convertible into shares;
- transactions in connection with reorganisation of the company;
- transactions which are mandatory for a company pursuant to Russian law requirements, and settlements under which transactions are made pursuant to prices set by the Russian government or pursuant to tariffs and prices established by appropriate state authorities authorised by the Russian government;
- transactions aimed at acquisition of securities under the mandatory offer terms; and
- transactions concluded on the terms of preliminary agreement, provided such preliminary agreement was duly approved.

Major transactions involving the acquisition or disposal (including temporary transfer), or the possibility of disposal, directly or indirectly, of assets ranging from 25% to 50% of the balance sheet value of the assets of a company requires unanimous consent of all the members of the Board of Directors. If the transaction fails to receive such consent, it can be provided by a simple majority vote of the shareholders present at the General Shareholders' Meeting. Major transactions involving assets in excess of 50% of the balance sheet value of the assets of a company require a three-quarter majority vote of shareholders present at the General Shareholders' Meeting.

Any major transaction entered into in breach of the above requirements may be invalidated by a court following an action brought by the company, its directors or its shareholders owning at least 1% of the company's voting shares.

Shareholders' Agreements

The Joint Stock Companies Law provides for the possibility to enter into shareholders' agreements in respect of Russian joint stock companies. Thus, the Joint Stock Companies Law stipulates that shareholders may enter into an agreement under which they undertake to exercise their shareholder rights in a certain manner or to refrain from exercising their shareholder rights, including, *inter alia*:

(i) to vote in a certain manner at a General Shareholders' Meeting;

(ii) to coordinate voting with other shareholders;

(iii) to acquire or dispose of shares at a pre-determined price or upon occurrence of certain circumstances;

(iv) to refrain from disposing of shares until occurrence of certain circumstances; and

(v) to perform jointly other actions relating to the company's management, activities, re-organisation and liquidation.

Provisions of the Joint Stock Companies Law in respect of shareholders' agreements are very generic, rather vaguely drafted and remain largely untested. It is still to be seen how this new regulation is implemented and enforced in practice.

Approval of the Russian Federal Antimonopoly Service

Pursuant to the Competition Law, acquisitions of voting shares of a joint-stock company, involving companies with a combined value of assets or annual revenues, exceeding a certain threshold under RAS, or companies registered as having more than a 35% share of a certain commodity market, and which would result in a shareholder (or a group of shareholders defined under Russian law) holding more than 25%, 50% or 75% of the voting capital stock of such company, or in a transfer between such companies of assets or rights to assets, the value of which exceeds a certain amount, or obtaining rights to determine the conditions of business activity of an entity or to exercise the authorities of its executive body must be approved in advance by the FAS. Such transactions executed between members of a group of companies may require only a subsequent notification to the FAS if prior notification about the members of the group of companies has been filed with the FAS and the information contained in this notification is still accurate as of the date of the relevant transaction and had not been changed within 30 days from the date of group's disclosure and prior to the date of the transaction's settlement. See "*Regulation of the Russian Retail Sector—Russian Antimonopoly Regulation*."

Foreign Ownership

The Federal Law No. 160-FZ "On Foreign Investments in the Russian Federation" dated July 9, 1999, as amended (the "**Foreign Investments Law**"), provides that any acquisition (whether direct or indirect) by a foreign state or international organisation or entities controlled by them of (1) more than 25% of voting shares of a Russian company; or (2) any powers to block decisions of the management bodies of a Russian company, requires a prior approval of the governmental commission in accordance with the procedures set out in Federal Law No. 57-FZ "On the Procedure for Foreign Investment in Companies with Strategic Impact on National Defence and Security of the Russian Federation" dated 29 April 2008, as amended.

In addition, foreign persons registered as individual entrepreneurs in the Russian Federation and foreign companies (regardless of whether they are registered with the Russian tax authorities) that acquire shares in a Russian joint stock company may need to notify the Russian tax authorities within one month following such acquisition.

Notification of Acquisition of Significant Interest

Pursuant to Russian securities legislation, each holder of ordinary shares of a joint stock company that has issued securities and registered a prospectus in respect of such securities in the Russian Federation must notify the company and the CBR of an acquisition of 5% or more of the company's ordinary shares or of an acquisition of the right to vote on 5% or more of the ordinary shares by virtue of an agreement or otherwise, and of any subsequent change in the number of such ordinary shares above or below any of 5%, 10%, 15%, 20%, 25%, 30%, 50%, 75% or 95% thresholds. Each notification should contain the name of the acquirer, the name of the company and the number of the ordinary shares acquired (or votes that can be cast). Such notifications must be generally given within ten days after the ordinary shares have been transferred to such shareholder's securities account or after the acquisition of the right to cast votes attached to such ordinary shares.

Change of Control and Anti-takeover Protection

The Joint Stock Companies Law provides for anti-takeover protection measures applicable under the Russian law.

A person intending to acquire more than 30% of an open joint stock company's ordinary shares, including shares already owned by such person and its affiliates, has the right to make a public offer to purchase the remaining shares from other shareholders (voluntary offer). A voluntary offer may be made at any price (although the price should be the same for all tendering shareholders).

Within 35 days after acquisition by any means of more than 30%, 50% or 75% of ordinary shares or 35 days from the date when the acquirer learned or should have learned that it, either independently or together with its affiliates, owns such number of shares, the acquirer is required to make a public offer to purchase the remaining shares from other shareholders (mandatory offer). A mandatory offer should be made at a price that is the higher of: (i) the highest acquisition value that the offeror or its affiliate paid or agreed to pay for the target securities in any transaction in the six months preceding the date of the mandatory offer launch, or (ii) in the case of a publicly traded open joint stock company, the weighted average price of the target securities on the Russian stock exchange during the six months preceding the date of the mandatory offer filing with the CBR and, if the company is not publicly traded or is traded for less than six months, the price determined as "market value" by a certified independent appraiser.

While the offeror is required to make an all-cash voluntary or mandatory offer, it may also offer securities or a mix of cash and securities as an alternative, in which case tendering shareholders have the right to choose between the cash consideration and the consideration in the form of securities (or mixed consideration).

If, as a result of either the voluntary or the mandatory offer, the acquirer purchases more than 95% of the ordinary shares, including shares owned by its affiliates, it is required to (i) notify all the other shareholders (within 35 days after acquisition of shares above such threshold) of their right to sell their shares and other securities convertible into such shares, and (ii) purchase their shares upon request of each minority shareholder at a price equal to the highest of: (i) the highest acquisition value that the offeror or its affiliate paid or agreed to pay for the target securities in any transaction in the six months preceding the date of the respective notification (including the price paid in the voluntary offer or mandatory offer that resulted in passing the 95% threshold), (ii) in the case of a publicly traded company, the weighted average price of the target securities on the Russian stock exchange during the six months preceding the date of filing of the respective notification with the CBR and, if the company is not publicly traded or is traded for less than six months, the price determined as "market value" by a certified independent appraiser, and (iii) the highest price that the 95% shareholder or its affiliates paid or agreed to pay for the target securities after the end of the voluntary offer or mandatory offer that resulted in passing the 95% threshold.

Instead of giving notice, the acquirer may deliver a buy-out demand, binding on the minority shareholders, that they sell their shares if the acquirer crossed the 95% threshold by acquiring at least 10% of the ordinary shares in a voluntary or mandatory offer at a price that may not be lower than: (i) the price paid in the voluntary offer or the mandatory offer that resulted in passing the 95% threshold, and (ii) determined as "market value" by a certified independent appraiser, and (iii) the highest price that the 95% shareholder or its affiliates paid or agreed to pay for securities after the end of the voluntary offer or the mandatory offer that resulted in passing the 95% threshold.

An offer of the kind described in either of the preceding four paragraphs must be accompanied by an irrevocable bank guarantee of payment (except for a buy-out demand) and certain other documents. If the company is publicly traded, prior notice of the offers must be filed with the CBR; otherwise, such offers must be filed with the CBR no later than the date of the offer. The CBR may require revisions to be made to the terms of the offer (including the price) in order to bring them into compliance with the rules.

At any time after the company receives a voluntary or a mandatory offer and until 25 days prior to the expiration of the relevant acceptance period, any person will have the right to make a competing offer (that satisfies the requirements for a voluntary or mandatory offer, respectively) to purchase shares in the quantity of and at the price that is greater than or equal to the quantity and the price offered in the initial voluntary or mandatory offer. Any shareholder may revoke its previous acceptance of the respective offer and accept the competing offer. A copy of the competing offer shall be sent to the person who made the initial voluntary or mandatory offer so that such person can amend its offer by increasing the purchase price and/or shortening the settlement period. As soon as the voluntary or mandatory offer has been received by a company and until expiration of a 20-day period after the expiration of the period for acceptance of the voluntary or mandatory offer, only the General Shareholders' Meeting will have the exclusive power to make decisions on a share capital increase through an additional share issuance, on approval of interested party and certain other transactions and on certain other significant matters. The Joint Stock Companies Law provides for instances when the mandatory offer may not be made, which include, *inter alia*, the following:

- acquisition of the company's shares was performed within the course of its establishment or re-organisation;
- partial redemption of its shares by the company;
- acquisition of shares by a company's shareholder as a result of using respective pre-emptive rights;
- shares of the company were earlier acquired under the voluntary offer;
- shares of the company were earlier acquired under another mandatory offer;
- transfer of shares between shareholder of the company and its affiliates;
- acquisition of shares by contribution thereof to the share capital of the company by the Russian Federation, its subject or municipality provided the Russian Federation, its subject or municipality is or becomes owner of more than 50% of the company's share capital as a result of such transaction; and
- acquisition of shares by contribution thereof as a payment for the newly issued shares placed under the closed subscription of an open joint stock company included in the list of strategic enterprises and strategic joint stock companies approved by the President of the Russian Federation by Order No. 1009 On Approval of the List of Strategic Enterprises and Strategic Joint Stock Companies of 4 August 2004, as amended.

Currency control

Russian currency control restrictions with regard to such instruments as ordinary shares are set out in the Currency Law and respective regulations of the CBR.

Pursuant to the Currency Law, currency operations with ordinary shares between residents and non-residents may be conducted without limitations in both roubles and in foreign currencies.

Under the Currency Law, currency operations with securities between non-residents may be conducted either in roubles or in foreign currencies, subject to compliance with Russian securities and competition laws and regulations.

Finally, non-residents may receive dividends declared by Russian companies both in foreign currencies (confirmed by the CBR in its Information Letter No. 31 dated 31 March 2005) and roubles. Dividends declared and paid in roubles may be freely converted through Russian authorised banks and remitted outside of the Russian Federation.

PLAN OF DISTRIBUTION

Description of the Distribution

The Offering comprises (i) an offering of Shares outside the United States in reliance on Regulation S and (ii) an offering of Shares within the United States to certain QIBs and in reliance on Rule 144A of the Securities Act.

The Company, the Selling Shareholders and the Joint Bookrunners are expected to enter into the underwriting agreements and the underwriting support agreements (collectively, the "**Underwriting Agreement**") on or about the date of the announcement of the Share Price. Under the terms of, and subject to, the conditions contained in the Underwriting Agreement, the Joint Bookrunners have agreed to under the terms of, and subject to, the conditions contained in the Underwriting Agreement, purchase, at the Offer Price, the number of Shares in the amount as indicated below. The Selling Shareholders have agreed to make available, at the Offer Price, to the Joint Bookrunners, the applicable number of Shares for such purpose (assuming all Shares are sold and the Over-Allotment Option is exercised in full):

Joint Bookrunners	Maximum number of Shares
Credit Suisse Securities (Europe) Limited	61,978,040
Goldman Sachs International	61,978,040
Morgan Stanley & Co. International plc	61,978,040
JSC Sberbank CIB and SIB (Cyprus) Limited	30,989,020
UBS Limited	30,989,020
Total	**247,912,160**

The Joint Bookrunners will receive aggregate underwriting fees and commissions equal to approximately RUB294.4 million (assuming the Offer Price at the mid-point of the Offer Price Range and assuming all Shares are sold and the Over-Allotment Option is exercised in full) in connection with the Offering. The Joint Bookrunners may also receive a discretionary fee, payable by and to be determined in the sole discretion of Sistema, FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED, of up to approximately RUB588.8 million (assuming the Offer Price at the mid-point of the Offer Price Range and assuming all Shares are sold and the Over-Allotment Option is exercised in full) in connection with the Offering. The estimated expenses payable by the Selling Shareholders in connection with the Offering, other than the Joint Bookrunners' fees and commissions, are estimated to be approximately RUB92 million.

The Joint Bookrunners propose to resell the Shares at the Offer Price within the United States to QIBs in reliance on Rule 144A and outside the United States in reliance on Regulation S. See "*Selling and Transfer Restrictions*". The price at which the Shares are offered may be changed at any time without notice.

The Shares have not been and will not be registered under the Securities Act or any state securities laws and may not be offered or sold within the United States except in transactions exempt from, or not subject to, the registration requirements of the Securities Act. See "*Selling and Transfer Restrictions*".

In addition, until 40 days after the commencement of this Offering, an offer or sale of Shares within the United States by a dealer that is not participating in this Offering may violate the registration requirements of the Securities Act if that offer or sale is made otherwise than in accordance with Rule 144A.

Underwriting Agreement

In the Underwriting Agreement, the Company and the Selling Shareholders have made certain representations and warranties and have agreed to indemnify the Joint Bookrunners against certain liabilities, including liability under the Securities Act.

The obligation of the Joint Bookrunners pursuant to the terms of the Underwriting Agreement is subject to the satisfaction of certain conditions precedent contained in the Underwriting Agreement, such as the receipt by the Joint Bookrunners of officers' certificates and customary legal opinions. The Underwriting Agreement may be terminated upon written notice by the Joint Global Coordinators, upon the occurrence of certain events, including the suspension or limitation of trading on the Moscow Exchange or breach of the representations and warranties given by the Company and/or the Selling Shareholders.

Lock-up Provisions

The Company and the Selling Shareholders have each agreed in respect of themselves, their subsidiaries from time to time (in the case of the Company, Sistema, FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED) and any person acting on their behalf, for a period of 180 days, and members of management of the Company, including those participating in the Offering as Selling Shareholders, have each agreed in respect of themselves and any person acting on their behalf, for a period of 365 days, after the Share Delivery Date, subject to certain limited exceptions, not to, without the consent of the Joint Global Coordinators on behalf of the Joint Bookrunners (such consent not to be unreasonably withheld):

(i) issue, offer, sell, lend, mortgage, assign, contract to sell, pledge, charge, contract to sell or issue any option or contract to purchase, purchase any option or contract to sell or issue, grant any option, right or warrant to purchase, lend, or otherwise transfer or dispose of (or publicly announce any such action), directly or indirectly, any Ordinary Shares or any securities convertible or exchangeable into or exercisable for, or substantially similar to, any Ordinary Shares or any security or financial product whose value is determined directly or indirectly by reference to the price of the underlying Ordinary Shares, including equity swaps, forward sales and options or global depositary receipts representing the right to receive any such Ordinary Shares; or

(ii) enter into any swap or other agreement that transfers, in whole or in part, any of the economic consequences of ownership of the Ordinary Shares; or

(iii) enter into any transaction with the same economic effect as, or agree to, or publicly announce any intention to enter into any transaction described above,

whether such transaction described above is to be settled by delivery of the Ordinary Shares or such other securities in cash or otherwise.

Stabilisation

In connection with the Offering, Sistema, FLOETTE HOLDINGS LIMITED and EXARZO HOLDINGS LIMITED have granted the Joint Bookrunners the Over-Allotment Option to cover over-allotments in connection with the Offering, if any, and short positions resulting from any such over-allotments.

In connection with the Offering, Goldman Sachs, acting as stabilising manager (the "**Stabilising Manager**") will procure that its affiliate OOO Goldman Sachs shall, to the extent permitted by applicable laws, regulations and rules of the CBR and/or the Moscow Exchange, effect transactions in relation to the Ordinary Shares, with a view to supporting the market price of the Ordinary Shares at a level higher than that which might otherwise prevail in the open market for a limited period after the Share Delivery Date as set out in this Offering Memorandum and in accordance with the market-making agreement entered into between OOO Goldman Sachs, the Company and the Moscow Exchange on or about the Share Delivery Date.

The Stabilising Manager is not required to enter into such transactions and such transactions may be effected on any securities market, over-the-counter market, stock exchange or otherwise and may be undertaken at any time during the stabilization period commencing on the date of pricing of the Offering and ending no later than 30 calendar days thereafter. However, there will be no obligation on the Stabilising Manager or any of its agents to effect stabilising transactions and there is no assurance that stabilizing transactions will be undertaken. Such stabilisation, if commenced, may be discontinued at any time without prior notice. Except as required by law or regulation, neither the Stabilising Manager nor any of its agents intends to disclose the extent of any over-allotments made and/or stabilisation transactions conducted in relation to the Offering.

Other relationships

The Joint Bookrunners are full service financial institutions engaged in various activities, which may include securities trading, commercial and investment banking, financial advisory, investment management, principal investment, hedging, financing and brokerage activities. The Joint Bookrunners and their respective affiliates have in the past performed commercial banking, investment banking and advisory services for us from time to time for which they have received customary fees and reimbursement of expenses and may, from time to time, engage in transactions with and perform services for us in the ordinary course of their business for which they may receive customary fees and reimbursement of expenses. In the ordinary course of their various business activities, the Joint Bookrunners and their respective affiliates may make or hold a broad array of investments and actively trade debt and equity securities (or related derivative securities) and financial instruments (which may include bank loans and/or credit default swaps) for their own account and for the accounts of their customers and may at any time hold long and short positions in such securities and instruments. Such investment and securities activities may involve our securities and instruments. In particular, the Joint Bookrunners may enter into FX hedging transactions with certain Selling Shareholders with respect to the proceeds received by such Selling Shareholders from the Offering.

MATERIAL CONTRACTS

The following is a summary of each contract (not being a contract entered into in the ordinary course of business) which has been entered into by any member of our Group: (i) within the two years immediately preceding the date of this document and which is, or may be, material; or (ii) which contains any provision under which any member of the Group has any obligation or entitlement which is material to the Group as at the hereof.

Agreements Relating to the Offering

Underwriting Agreement

On or about the date of the announcement of the Offer Price, the Company, the Selling Shareholders and the Joint Bookrunners entered into the Underwriting Agreement providing for, *inter alia,* the underwriting of the Offering. See "*Plan of Distribution—Underwriting Agreement*".

Other Agreements

Long-term lease agreement No. 3A DM/0409 DDA with LLC Fenix-K

The long-term lease agreement was entered into between the Company (as tenant) and LLC Fenix-K (as lessor) on 1 April 2009. Under the lease agreement the Company leases the warehouse located at Terminalny sideway, building 4, Krekshino village, Marushkinskoye settlement, Naro Fominsk district, Moscow. The total rentable area is 21,105.5 square meters.

The term of the agreement is 10 years until 21 December 2019 and the agreement does not contain an automatic extension clause or a pre-emptive right to renew the lease. The rent consists of: (i) fixed rent for using the premises and common premises and (ii) variable rent including utility payments (for electricity, heating, water and sewage) and operational expenses. The lessor may unilaterally terminate the lease agreement out of court proceedings if:

- The tenant delays rent payments for 20 or more calendar days;
- The tenant deliberately and significantly deteriorates conditions of the warehouse;
- The tenant fails to provide a security deposit or a bank guarantee;
- The tenant materially breaches other obligations under the lease agreement (including assignment of lease to a third party); or
- The tenant is subject to liquidation or bankruptcy proceedings.

The lessor is entitled to terminate the lease agreement on the basis of the above reasons (except the last one) if (i) the lessor sends a written notice to the tenant requesting to remedy the violations within a reasonable period of time (not less than 10 business days for payment obligations and not less than 30 business days for other violations) and (ii) the tenant fails to remedy the violations within the given period of time in due course. If the lease agreement is terminated by the lessor due to the tenant's breach, the tenant shall (i) pay to the lessor a penalty equal to the amount of annual fixed rent; (ii) compensate lessor's documented expenses for legal, broker and realtor services related to finding a new tenant and any other reasonable expenses caused by termination of the lease agreement but in any case in the amount not exceeding one monthly fixed rent; and (iii) compensate damages caused to the warehouse due to the tenant's fault.

TAXATION

The following summary of certain U.S. federal income and estate and Russian tax consequences of ownership of the Shares based upon laws, regulations, decrees, rulings, income tax conventions (treaties), administrative practice and judicial decisions in effect at the date hereof. Legislative, judicial or administrative changes or interpretations may, however, be forthcoming. Any such changes or interpretations could affect the tax consequences to holders of the Shares, possibly on a retroactive basis, and could alter or modify the statements and conclusions set forth herein. This summary does not purport to be a legal opinion or to address all tax aspects that may be relevant to a holder of the Shares. Each prospective holder is urged to consult its own tax advisor as to the particular tax consequences to such holder of the ownership and disposition of the Shares, including the applicability and effect of any other tax laws or tax treaties, of pending or proposed changes in applicable tax laws as at the date hereof, and of any actual changes in applicable tax laws after such date.

Russian Tax Considerations

The following is a general description of certain Russian tax considerations relating to the Shares. It does not purport to be a complete analysis of all tax considerations relating to the Shares.

Prospective holders of the Shares should consult their tax advisers as to which countries' tax laws could be relevant to acquiring, holding and disposing of Shares and receiving payments of dividends and the consequences of such actions under the tax laws of those countries. This summary is based upon the law as in effect as at the date hereof. The information and analysis contained in this section are limited to issues relating to taxation, and prospective holders should not apply any information or analysis set out below to other issues, including (but not limited to) the legality of transactions involving the Shares.

General

The following is a summary of certain Russian tax considerations relevant to the purchase, ownership and disposal of the Shares by Russian resident and non-resident investors, as well as the taxation of dividend income and is based on the laws of the Russian Federation in effect at the date hereof, which are subject to change (possibly with retroactive effect).

The summary does not seek to address the applicability of, and procedures in relation to, taxes levied by the regions, municipalities or other non-federal authorities of the Russian Federation. Nor does the overview seek to address the availability of double tax treaty relief in respect of the Shares, and it should be noted that there may be practical difficulties, including satisfying certain documentation requirements, involved in claiming relief under an applicable double tax treaty. Prospective holders should consult their own professional advisors regarding the tax consequences of investing in the Shares. No representations with respect to the Russian tax consequences to any particular holder are made hereby.

The provisions of the Russian Tax Code applicable to holders of and transactions involving the Shares are ambiguous and lack interpretive guidance. Both the substantive provisions of the Russian Tax Code applicable to financial instruments and the interpretation and application of those provisions by the Russian tax authorities may be subject to more rapid and unpredictable change and inconsistency than in jurisdictions with more developed capital markets or more developed taxation systems. In particular, the interpretation and application of such provisions will in practice rest substantially with local tax inspectorates.

In practice, interpretation by different tax inspectorates may be inconsistent or contradictory and may involve the imposition of conditions, requirements or restrictions not provided for by the existing legislation. Similarly, in the absence of binding precedents, court rulings on tax or related matters by different Russian courts relating to the same or similar circumstances may also be inconsistent or contradictory.

For the purposes of this summary, a "**Russian Resident Holder**" means:

- an individual investor holding the Shares that actually presents in the Russian Federation for an aggregate period of 183 days (including days of arrival in the Russian Federation and days of departure from the Russian Federation) or more in a period comprising 12 consecutive months (days of medical treatment and education outside the Russian Federation are also counted as days spent in the Russian Federation if the individual departed from the Russian Federation for these purposes for less than six months). The interpretation of this definition by the Ministry of Finance suggests that for tax withholding purposes an individual's tax residence status should be determined on the date of the income payment (based on the number of days in the Russian Federation in the 12-month period preceding the date of payment). The individual's final tax liability in the Russian Federation for the reporting calendar year should be determined based on his/her tax residence status for such calendar year, i.e., based on the number of days spent in the Russian Federation in the 12-month period as of the end of such calendar year;

- an investor that is a Russian legal entity;
- a legal entity or an organisation, in each case organised under a foreign law, that purchases, holds and/or disposes of the Shares through its permanent establishment in the Russian Federation;
- a legal entity or an organisation, in each case organised under a foreign law, that is recognized as a Russian tax resident based on Russian domestic law (in case the Russian Federation is recognized as the place of effective management of such legal entity or organization as determined in the Russian Tax Code unless otherwise envisaged by an applicable double tax treaty); or
- a legal entity or an organisation, in each case organised under a foreign law, that is, in the case of conflicting tax residency statuses based on the relevant foreign law and Russian law, recognized as a Russian tax resident based on the provisions of an applicable double tax treaty (for the purposes of application of such double tax treaty).

For the purposes of this summary, a "**Non-Resident Holder**" is a holder of the Shares which is not qualified to be a Russian resident holder as discussed above.

Holders of the Shares should seek professional advice on their tax status in Russia.

Taxation of Acquisition of the Shares

No Russian tax implications generally should arise for holders, whether they are Russian Resident Holders or Non-Resident Holders, upon purchase of the Shares.

However, in certain circumstances, taxable income in the form of a material benefit (deemed income) may arise for individual holders if the Shares are purchased at a price below market value. If the acquisition price of the Shares is below the lower threshold of the range of fair market value calculated under a specific procedure for the determination of market prices of securities for tax purposes, the difference may be subject to the Russian personal income tax at a rate of 30% for individuals who are non-resident holders (arguably, this would be subject to reduction or elimination under an applicable double tax treaty) and 13% for individuals who are Russian resident holders.

Under Russian tax legislation, taxation of the income of non-resident holders who are individuals will depend on whether this income would be assessed as received from Russian or non-Russian sources. Although Russian tax legislation does not contain any provisions on how the relevant material benefit should be sourced, the tax authorities may infer that such income should be considered as Russian source income if the Shares are purchased "in the Russian Federation". In the absence of any additional guidance as to what should be considered as the purchase of securities "in the Russian Federation", the Russian tax authorities may apply various criteria in order to determine the source of the related material benefit, including consideration of the place of conclusion of the acquisition transaction, the location of the issuer, or other similar criteria.

Also, in certain circumstances, Russian resident holders that are legal entities or organisations acquiring the Shares must fulfil the responsibilities of a Russian tax agent (i.e., a legal entity resident in the Russian Federation for tax purposes paying taxable Russian source income to non-resident legal persons, organisations and non-resident individuals being responsible for withholding Russian tax) with respect to withholding tax from the sales proceeds for the Shares to be transferred to a Non-Resident Holder disposing of Shares. Holders of Shares should consult their own tax advisers with respect to the tax consequences of acquiring the Shares.

Taxation of Dividends

Russian tax on dividends is withheld and remitted to the Russian budget by a Russian company that, in accordance with the provisions of the Russian Tax Code, is regarded as a tax agent. The applicable withholding tax rate will depend on the status of the dividend's recipient unless the Shares are held on either foreign nominal holder depo account, foreign authorised holder depo account or depositary receipt programme depo account opened with a Russian custodian, in which case an applicable withholding tax rate will also depend on the disclosure of information to such Russian custodian in respect of the persons executing rights attached to the relevant Shares and on the jurisdiction where such persons are tax residents.

The following sections summarise taxation of dividends paid by us on the Shares.

Russian Resident Holders

Payments of dividends by us to a Russian Resident Holder who is an individual, a legal entity or organisation resident in the Russian Federation for tax purposes should generally be subject to Russian withholding tax, and such tax should not exceed 13% of the gross dividend amount payable to each Russian Resident Holder.

The effective rate of this tax may be lower than 13%, owing to the fact that generally Russian tax agent should calculate this tax based on the formula that takes into consideration the difference between (i) the dividends to be distributed by the issuer to its shareholders (other than to non-resident companies and non-resident individuals) and (ii) dividends collected by the issuer in the current tax (reporting) period and preceding tax (reporting) period (except for dividends taxable at a rate of 0%, under the current Russian tax law) provided that these amounts have not previously been taken into consideration when calculating tax on dividends.

Dividends received by Russian legal entities from the qualified Russian and foreign subsidiaries are taxable at a rate of 0%. This participation exemption is available with respect to subsidiaries in which (1) the recipient organisation owns at least 50% of the share capital of the paying company either in the form of shares or depositary receipts representing such shares, which give a right to their holder to receive dividends equal to at least 50% of the total amount of dividends payable by such company; (2) at the date the decision to pay dividends is made the recipient organisation owns such shares or depositary receipts for a period of not less than 365 calendar days continuously, and (3) the subsidiary is not a resident of one of the jurisdictions included into the list of tax havens by the Ministry of Finance of the Russian Federation. The same exemption applies to foreign legal entities that are Russian tax residents, provided that they have voluntarily registered themselves with the Russian tax authorities as Russian tax residents.

There is some uncertainty in respect of the rate of withholding tax that should apply to payments of dividends to a holder of the Shares that is a Russian permanent establishment of a foreign legal entity or organisation. Currently, the Russian Tax Code stipulates the rate of 15% for such a case. A holder that is a foreign legal entity or organisation that holds the Shares through a permanent establishment in the Russian Federation is entitled to pay this tax to the Russian budget on its own behalf subject to providing the Russian entity distributing the dividends with special documentary evidence confirming the fact that these dividends are attributable to a permanent establishment of such a holder of the Shares in the Russian Federation. Such documentary evidence includes (a) a notarised copy of the form confirming registration of the holder with the Russian tax authorities and (b) notification from the holder stating that such dividends are attributable to the permanent establishment of such holder in the Russian Federation. The Russian Tax Code does not provide any formal guidance as to the required format of the notification.

It is possible that payments of dividends on the Shares made by us to a Russian permanent establishment may be subject to Russian withholding tax, not at 15%, but at a rate of up to 13% of the gross dividend amount. This lower rate could apply to each holder that holds the Shares through a permanent establishment in the Russian Federation if the applicable double tax treaty between the Russian Federation and the country of tax residence of such holder provides for the non-discrimination of tax residents of such country as compared to Russian tax residents. However, as the Russian Tax Code does not specifically provide for the application of the reduced tax rate in such situations and the application of treaty-based non-discrimination provisions is still rare in Russian tax practice, no assurance can be given that the claims for the application of the 13% tax rate would not be challenged by the Russian tax authorities, hence it is likely that a 15% withholding tax rate would be applied in such situation.

Russian Resident Holders should therefore consult their own tax advisers with respect to the tax consequences of their receipt of dividend income with respect to the holding of the Shares.

Non-Resident Holders

Payments of dividends by a Russian entity to Non-Resident Holders are generally subject to Russian withholding tax at a rate of 15%, which a tax agent will withhold. Such Russian withholding tax may be subject to reduction pursuant to the terms of any applicable double tax treaty between the Russian Federation and the country of tax residence of the Non-Resident Holders to the extent such Non-Resident Holders are entitled to benefit from a double tax treaty and the corresponding tax treaty reliefs provided by such treaty. Accordingly, it is possible that payments of dividends on the Shares to Non-Resident Holders may be subject to withholding taxation at a reduced rate if such reduction is provided for by an applicable double tax treaty, provided the requirements set out by the Russian tax legislation in relation to advance treaty relief are satisfied. See "*Taxation—Russian Tax Considerations—Withholding of tax on capital gains (Resident and Non-Resident Holders who are individuals—Tax Treaty Procedures*".

If Non-Resident Holders do not obtain double tax treaty relief at the time the dividend income under the Shares is paid to such Non-Resident Holders and income tax is withheld by a Russian tax agent, such Non-Resident Holders may apply for a refund within three years from the date the tax was withheld. The documentation requirements to obtain such a refund are prescribed by the Russian Tax Code (see "*Taxation—Russian Tax Conditions—Withholding of tax on capital gains (Resident and Non-Resident Holders who are individuals—Refund of Tax Withheld*").

However, there can be no assurance that such double tax treaty relief (or refund of any taxes withheld) will be available for such Non-Resident Holders.

Taxation of dividends on the Shares registered in foreign nominal holder, foreign authorised holder or foreign depositary receipt programme depo accounts

The new regime of taxation of dividends on shares of Russian issuers has been effective since 1 January 2014. These rules introduce a new regime of taxation of income on securities issued by Russian issuers and held in certain types of accounts with Russian custodians as described below, including shares held in special accounts for foreign nominal holder (i.e. foreign custodians, depositaries, foreign authorised holder (e.g. foreign brokers) or depositary receipt programmes. This new regime, inter alia, introduces the new information disclosure requirements in respect of persons executing rights attached to the shares issued by Russian issuers held with Russian custodians in foreign nominal holder depo accounts, foreign authorised holder depo accounts and foreign depositary receipt programme depo accounts. When a Russian custodian transfers dividends on the Shares registered in the above accounts opened with such Russian custodian, Russian withholding tax is calculated and withheld by such Russian custodian based on the disclosure of the aggregated information about the persons executing rights attached to relevant Shares and information about the persons in whose interests a foreign asset manager exercises the rights attached to the Shares, unless the exercise of rights attached to such Shares is performed by such asset manager on behalf of a foreign investment fund which is in accordance with its bylaws is classified as a mutual collective scheme.

If the required information is properly disclosed in accordance with the Russian Tax Code, the Russian custodian should withhold Russian withholding tax at a tax rate envisaged either by the Russian Tax Code or by a relevant double tax treaty, provided that application of such rate is not subject to conditions connected with ownership interest, or (and) amount of investment, or (and) period of owning a share in the capital of a Russian issuer (the reduced tax rate that is subject to the said conditions will only be available in the form of a tax refund). Since the Russian custodian should rely on the disclosed aggregated information on the above persons as required by the Russian Tax Code and described above, in the absence of proper disclosure, the Russian custodian has to withhold a standard 15% tax on the distributable dividends (i.e. relevant double tax treaty reliefs would not apply).

The recipient of dividend income who is entitled to the reduced tax rates on dividends attached to the Shares under either the Russian Tax Code or the relevant double tax treaty may apply for a refund in accordance with the general tax refund procedure envisaged by the Russian Tax Code (see "*Taxation—Russian Tax Considerations—Withholding of tax on capital gains (Resident and Non-Resident Holders who are individuals—Refund of Tax Withheld*").

Non-resident holders should consult their own tax advisers with respect to the tax consequences of their receipt of dividend income on the Shares registered in the above accounts.

Taxation of Capital Gains

The following sections summarise the taxation of capital gains in respect of the disposition of the Shares.

Taxation of Legal Entities and Organisations

Russian Resident Holders

Capital gains arising from the sale or other disposal of Shares by a Russian Resident Holder which is a legal entity or an organisation will be taxable at the regular Russian corporate profits tax rate of 20%. According to the current Russian tax legislation, the financial result (profit or loss) arising from activities connected with securities quoted on a stock exchange may be accounted for together with the financial result arising from other operations (i.e. may be included into the general tax base). Therefore, Russian Resident Holders that are legal entities may be able to offset losses incurred on operations in the quoted shares against other types of income (excluding income from non-quoted securities and derivatives). Special tax rules apply to Russian organisations that hold a broker and/or dealer licence as well as certain other licences related to securities market. The Russian Tax Code also establishes special rules for the calculation of the tax base for the purposes of transactions with securities, which are subject to TP control in Russia.

Russian Tax Code contains certain exemptions from capital gains taxation for non-quoted shares as well for shares in high-technology companies acquired after 1 January 2011. Such exemptions are not expected to be relevant for the Shares.

Russian Resident Holders of the Shares who are legal entities or organisations should in all events consult their own tax advisers with respect to the tax consequences of gains derived from the disposal of the Shares.

Non-Resident Holders

Capital gains arising from the sale, exchange or other disposal of the Shares by legal entities and organisations that are Non-Resident Holders should not be subject to tax in the Russian Federation if the immovable property located in the Russian Federation constitutes directly or indirectly 50% or less of the Company's assets and/or the Shares qualify as "quoted" on a registered stock exchange (recognised as such according to the applicable legislation) based on the requirements set in the Russian tax legislation. A security will be deemed "quoted" security if the market quote (determined in accordance with the applicable law) for such security is available on any date that is not more than three months prior to the date of the transaction in such security and if either such market quotes are publicly available through media or such registered stock exchange is able to provide information in respect of quotes during the three years following the transaction. If more than 50% of the Company's assets were to consist of immovable property located in the Russian Federation and the Shares were not recognised as quoted, legal entities and organisations that are Non-Resident Holders holding the Shares should be subject to a 20% withholding tax. Alternatively, the difference between the sales, exchange or other disposal price and the acquisition costs of the Shares should be subject to a 20% withholding tax provided that relevant documentary evidence related to the purchase of these Shares (including the cost of the securities and the expenses associated with the purchase, keeping and sale of these securities) is available.

There can be no assurance that immovable property owned directly or indirectly by the Company and located in the Russian Federation will not constitute more than 50% of the Company's assets as of the date of the sale of Shares by non-residents. Certain international double tax treaties may provide for protection from the Russian taxation in the case in question. There is no assurance that double tax treaty relief will be available.

Russian Tax Code contains certain exemptions from capital gains taxation for non-quoted shares as well for shares in high-technology companies acquired after 1 January 2011. Such exemptions are not expected to be relevant for the Shares.

Non-Russian Holders of the Shares who are legal entities or organisations should in all events consult their own tax advisers with respect to the tax consequences of gains derived from the disposal of the Shares.

Taxation of Individuals

Russian Resident Holders

Capital gains arising from the sale, exchange or other disposal of the Shares by individuals who are Russian Resident Holders must be declared on the holder's tax return and are subject to personal income tax at a rate of 13% unless the tax was properly withheld at source by a tax agent. The income in respect of sale of the Shares by an individual is calculated as the sale proceeds less expenses proved by documentary evidence related to the purchase of these Shares (including the cost of the securities and the expenses associated with the purchase, keeping and sale of these Shares and amounts on which personal income tax was accrued and paid on acquisition (receipt) of the Shares and the amount of tax paid).

Russian tax legislation contains a requirement that a financial result in respect of activities connected with securities quoted on a stock exchange must be calculated separately from a financial result in respect of trading in non-quoted securities. Amount of loss from transactions with securities quoted on a stock exchange may be deducted against tax base for operations with derivatives quoted on a stock exchange where underlying asset are securities, stock indexes or derivatives with securities or stock indexes as underlying assets.

Russian Resident Holders may carry forward losses arising from dealing with quoted securities to offset future capital gains from the sale, exchange or other disposal of other quoted securities for the period of up to 10 years. No loss carry-forward is available for non-quoted securities and derivatives.

The Russian Tax Code contains certain exemptions from capital gains taxation for non-quoted shares as well for shares in high-technology companies acquired after 1 January 2011. Such exemptions are not expected to be relevant for the Shares.

The Russian Tax Code also contains certain tax deductions that may be applied by Russian Resident Holders who are individuals in respect of income from the sale of the Shares given that at the moment of sale the Shares qualify as quoted and are held by a Russian Resident Holder for at least 3 years. The amount of such deduction is determined using a specific formula and depends on how long the Shares were held by a Russian Resident Holder.

Russian Resident Holders who are individuals should in all events consult their own tax advisers with respect to the tax consequences of gains derived from the disposal of the Shares.

Non-Resident Holders

If income from a sale, redemption or disposition of the Shares is received from a source within the Russian Federation, a Non-Resident Holder who is an individual will generally be subject to Russian personal income tax at a rate of 30% on the gain from such disposal (the gain generally being calculated as the gross proceeds from such disposal less any available cost deduction which includes the purchase price of the Shares (if tax was paid on purchase of Shares the amount that was subject to tax and the tax itself could be deducted from the gross proceeds), subject to any available double tax treaty relief. Substantiation of expenses associated with purchasing the Shares for purposes of the gain calculation may be connected with certain practical difficulties. According to Russian tax legislation, income received from a sale, redemption or disposition of the Shares should be treated as having been received from a Russian source if such sale, redemption or disposition occurs in the Russian Federation. Russian tax law gives no clear indication as to how to identify the source of income received from a sale, redemption or disposition of securities except that income received from the sale of securities "in the Russian Federation" will be treated as having been received from a Russian source.

Russian Tax Code contains certain exemptions from capital gains taxation for non-quoted shares as well for shares in high-technology companies acquired after 1 January 2011. Such exemptions are not expected to be relevant for the Shares.

Non-Resident Holders should in all events consult their own tax advisers with respect to the tax consequences of disposition of the Shares.

Withholding of tax on capital gains (Resident and Non-Resident Holders who are individuals)

The tax may be withheld at source of payment or, if the tax is not withheld, the Resident or Non-Resident Holder who is an individual may be liable to declare its income in the Russian Federation and to pay the tax. According to the Russian Tax Code, a licensed broker or an asset manager that is a Russian legal entity, that carries out operations under a brokerage service agreement, agency agreement, asset management agreement, commission agreement or commercial mandate agreement should withhold the tax from payments associated with disposition of the Shares to a Resident and non-Resident Holder who are individuals. Such tax agent will be required to withhold the tax at the end of the reporting period, date of termination of the brokerage, management or other similar agreement, or the date of the actual payment of relevant income to the Holder who is individual, and pay relevant amounts to the budget within a month after the end of the reporting year or the date of the payment of income. If it is impossible to withhold the tax, tax agents have an obligation to notify the tax authorities.

Tax Treaty Procedures

The Russian Federation has concluded double tax treaties with a number of countries and honours some double tax treaties concluded by the Soviet Union. These tax treaties may contain provisions that allow reduction or elimination of Russian withholding tax due, with respect to income received by a Non-Resident Holders, from a source within the Russian Federation, including income from disposition of the Shares and dividends. In order to obtain benefits available under the respective tax treaty, a Non-Resident Holder must comply with the certification, information, and reporting requirements in force in the Russian Federation (where applicable).

The Russian Tax Code does not require a Non-Resident Holder, which is a legal entity or organisation, to obtain tax treaty clearance from the Russian tax authorities prior to receiving any income, in order to qualify for benefits under an applicable tax treaty. However, a non-resident legal entity seeking to obtain relief from Russian withholding tax under a tax treaty must satisfy the conditions of relevant double tax treaty to apply its benefits (including but not limited to beneficial ownership requirements) and satisfy requirements of the Russian Tax Code, under which such legal entity or organisation should provide to a tax agent (i.e. the entity paying income to a non-resident or other Russian entity as defined by the Russian Tax Code), a confirmation of its tax treaty residence that complies with the applicable requirements (i.e., certificate of tax residency) in advance of receiving the relevant income. In particular, the certificate should confirm that the respective Non-Resident Holder, which is a legal entity, is the tax resident of the relevant double tax treaty country in a particular calendar year during which the income is paid. This certificate should be apostilled or legalised and needs to be renewed on an annual basis. A notarised Russian translation of the certificate may be required.

Starting from 1 January 2015 there is an explicit requirement in the Russian Tax Code, that in order to enjoy benefits under an applicable double tax treaty, the person claiming such benefits must be the beneficial owner of the relevant income. Starting from 1 January 2017, in addition to a certificate of tax residency, the Russian Tax Code requires the tax agent to obtain a confirmation from the non-resident holder—legal entity that it is the beneficial owner of the relevant income. There has been no guidance on the form of such confirmation yet. Due to introduction of these changes, there can be no assurance that treaty relief at source will be available in practice.

In accordance with the Russian Tax Code, in order to enjoy benefits of the applicable tax treaty a Non-Resident Holder, who is an individual, must present to the tax agent a document confirming his or her residency in his or her home country (a tax residency certificate issued by the competent authorities in his or her country of residence for tax purposes).

The treaty relief procedure as described above does not apply if dividends are paid on the Shares which are registered in special accounts (i.e. foreign nominal holder depo account or foreign authorised holder depo account) opened with a Russian custodian. In this case a foreign holder of the above accounts should present aggregated information to a Russian tax agent (in the format and within the deadlines established by the Russian Tax Code) as regarding the persons who exercise rights attached to such Shares or regarding the persons in whose interests the asset manager exercises the rights attached to such Shares, unless the exercise of rights attached to such Shares is performed on behalf of a foreign investment fund which is in accordance with its applicable law is classified as a mutual collective scheme. Subject to receipt of such information, the Russian custodian should apply Russian withholding tax at a tax rate envisaged under the relevant double tax treaty without applying any reduced tax rates which are subject to special conditions under the relevant double tax treaty (the reduced tax rate that is subject to certain conditions such as share of ownership, amount of investments and term of holding the investment could only be available through a mechanism of tax refund).

Refund of Tax Withheld

If the Russian withholding tax on income derived from Russian sources by a Non-Resident Holder, which is a legal entity or an organisation was withheld at the source, and such Non-Resident Holder, which is a legal entity or an organisation, is entitled to benefits of an applicable double tax treaty allowing such legal entity or organisation not to pay the tax in the Russian Federation or allowing it to pay the tax at a reduced rate in relation to such income, a claim for a refund of the tax withheld at the source can be filed with the Russian tax authorities within three years following the tax period in which the tax was withheld.

To process a claim for a refund, the Russian tax authorities require: (i) a confirmation of the tax treaty residence of the non-resident at the time the income was paid (this confirmation should be apostilled or legalised and should be provided for the year when the income in which respect the refund is claimed was paid); (ii) a document confirming that the applicant satisfies any additional conditions envisaged under the Russian Tax Code or the relevant double tax treaty for application of the reduced tax rate; and (iii) an application for the refund of the tax withheld in a format provided by the Russian tax authorities. Where tax is withheld in respect of dividends on the Shares which are registered in special accounts (i.e. foreign nominal holder, foreign authorised holder or foreign depositary receipt programme depo accounts) opened with a Russian custodian, the following documents are required in addition to those listed under (i) and (ii) above: (a) a document confirming the exercise of rights (or confirming the exercise of rights in the interests of the applicant by a trustee or other similar person) attached to the Shares on which the dividend income was paid, as at the date of the decision to distribute dividends by a Russian entity; (b) a document confirming the amount of dividend income on the Shares; (c) information on the custodian (custodians) that transferred the amount of dividend income to the foreign company (holder of the relevant account in the Russian custodian).

The Russian tax authorities will require a Russian translation of the above documents if they are prepared in a foreign language. The decision regarding the refund of the tax withheld should be taken within one month of the filing of the required documents with the Russian tax authorities. However, procedures for processing such claims have not been clearly established and there is significant uncertainty regarding the availability and timing of such refunds.

If the Russian personal income tax on the income derived from Russian sources by a Non-Resident Holder who is an individual was withheld at source and such individual Non-Resident Holder is entitled to rely on benefits of the applicable double tax treaty allowing such individual not to pay the tax in the Russian Federation or allowing such individual to pay the tax at a reduced rate in relation to such income, a claim for a tax treaty benefit and further refund of the tax withheld can be filed with the Russian tax authorities within three years following the tax period in which the tax was withheld.

In practice, the Russian tax authorities require a wide variety of documentation confirming the right of a Non-Resident Holder to obtain tax relief available under the applicable double tax treaty. Such documentation may not be explicitly required by the Russian Tax Code.

Obtaining a refund of Russian taxes that were withheld at source is likely to be a time-consuming process and no assurance can be given that such a refund will be granted in practice.

Non-Resident Holders (and in certain limited cases Russian Resident Holders) should consult their own tax advisers regarding possible tax treaty relief and/or tax refund as applicable and the procedures required to be fulfilled in order to obtain such treaty relief or refund with respect to any Russian taxes imposed on the income received in connection with the acquisition, ownership and disposition of the Shares.

Stamp Duties

No Russian stamp duty should be payable by the holders upon any of the transactions with the Shares discussed in this section of this Offering Memorandum (e.g., on a purchase or sale of the Shares), except for transactions involving the receipt of Shares by way of inheritance.

Certain U.S. Federal Income Tax Considerations

The following discussion is a summary of certain U.S. federal income tax consequences generally applicable to U.S. Holders (as defined below) of the acquisition, ownership and disposition of Shares. This discussion is based on the U.S. Internal Revenue Code of 1986, as amended (the "**Code**"), the U.S. Treasury Regulations promulgated thereunder, administrative guidance and court decisions and the income tax treaty between the United States and the Russian Federation (the "**Treaty**"), in each case as of the date hereof, all of which are subject to change, possibly with retroactive effect, and to differing interpretations. This discussion addresses only those U.S. Holders that purchase their Shares in the Offering and will hold their Shares as "capital assets" within the meaning of Section 1221 of the Code (generally, property held for investment). This discussion does not address any aspect of non-U.S. tax law or U.S. state, local, alternative minimum, net investment, estate, gift or other tax law that may be applicable to a U.S. Holder. This discussion does not constitute tax advice and does not address all aspects of U.S. federal income taxation that may be relevant to particular U.S. Holders in light of their personal circumstances, or to any U.S. Holders subject to special treatment under the Code, such as:

- banks, mutual funds and other financial institutions;
- real estate investment trusts and regulated investment companies;
- traders in securities who elect to apply a mark-to-market method of accounting;
- tax-exempt organizations or governmental organizations;
- insurance companies;

- dealers or brokers in securities or foreign currency;
- individual retirement and other deferred accounts;
- U.S. Holders whose functional currency is not the U.S. dollar;
- former citizens or long-term residents of the United States;
- persons subject to the alternative minimum tax;
- persons that actually or constructively own 10% or more of the total voting power or value of all of the Company's outstanding stock;
- persons that are resident or ordinarily resident in or have a permanent establishment in a jurisdiction outside the United States;
- persons who hold their Shares as part of a straddle, hedging, conversion, constructive sale or other risk reduction transaction;
- persons who purchase or sell their Shares as part of a wash sale for tax purposes;
- "S corporations," partnerships or other entities or arrangements classified as partnerships for U.S. federal income tax purposes, or other pass-through entities (and investors therein); and
- persons who received their Shares through the exercise of employee stock options or otherwise as compensation or through a tax-qualified retirement plan.

For purposes of this discussion, a "**U.S. Holder**" means a beneficial owner of Shares that for U.S. federal income tax purposes is: (A) (i) an individual who is a citizen or resident of the United States; (ii) a corporation (or other entity taxable as a corporation for U.S. federal income tax purposes) created or organized in the United States, any state thereof or the District of Columbia; (iii) an estate the income of which is subject to U.S. federal income taxation regardless of its source; or (iv) a trust if (a) a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or (b) the trust has a valid election in effect under applicable U.S. Treasury Regulations to be treated as a U.S. person for U.S. federal income tax purposes; and (B) a resident of the United States for purposes of the Treaty that is fully eligible for the benefits of the Treaty pursuant to the "Limitations on Benefits" provisions of the Treaty.

If a partnership, including for this purpose any arrangement or entity that is treated as a partnership for U.S. federal income tax purposes, holds or disposes of Shares, the tax treatment of a partner in the partnership will generally depend upon the status of the partner and the activities of the partnership. Prospective purchasers that are partnerships for U.S. federal income tax purposes and the partners in such partnerships are urged to consult their tax advisors about the U.S. federal income tax consequences of the acquisition, ownership and disposition of Shares.

This discussion is for informational purposes only and is not tax advice. U.S. Holders of Shares should consult their tax advisors with respect to the U.S. federal income tax consequences to them of the acquisition, ownership and disposition of Shares in light of their particular circumstances, as well as any tax consequences of such matters arising under the U.S. federal tax laws other than those pertaining to income tax, including estate or gift tax laws, or under any state, local or non-U.S. tax laws or under any applicable income tax treaty.

Dividends

Subject to the discussion below under "*—Passive Foreign Investment Company*," the gross amount of distributions paid with respect to the Shares (other than certain pro rata distributions of shares to all shareholders), including the amount of any taxes withheld, will be treated as dividends to the extent paid out of the Company's current or accumulated earnings and profits (as determined under U.S. federal income tax principles). To the extent, if any, that the amount of any such distribution exceeds the Company's current or accumulated earnings and profits, it will be treated first as a tax-free return of the U.S. Holder's tax basis in the Shares and thereafter as capital gain. However, the Company does not intend to calculate its earnings and profits under U.S. federal income tax principles. Therefore, a U.S. Holder should expect that a distribution will generally be treated as a dividend even if that distribution would otherwise be treated as a non-taxable return of capital or as capital gain under the rules described above. The dividends will not be eligible for the dividends-received deduction generally available to corporations in respect of dividends received from other U.S. corporations.

With respect to certain non-corporate U.S. Holders, including individual U.S. Holders, dividends will be taxed at the lower capital gains rate applicable to "qualified dividend income," provided that (i) the Company is eligible for the benefits of the Treaty, which the Company expects to be, (ii) the Company is not a passive foreign investment company (as discussed below under "—*Passive Foreign Investment Company*") for its taxable year in which the dividend is paid and the preceding taxable year, and (iii) certain holding period and other requirements are met.

Dividends paid in a currency other than U.S. dollars will be included in a U.S. Holder's income in a U.S. dollar amount determined by reference to the exchange rate in effect on the date of actual or constructive receipt, whether or not the non-U.S. currency is converted into U.S. dollars at that time. If a dividend paid in non-U.S. currency is converted into U.S. dollars on the day the dividend is received, the U.S. Holder generally will not recognize foreign currency gain or loss on such conversion. If it is not converted into U.S. dollars on the date of receipt, such U.S. Holder will have a basis in the non-U.S. currency equal to the U.S. dollar value on the date of receipt. Any gain or loss on a subsequent conversion or other distribution of such non-U.S. currency generally will be treated as ordinary income or loss to such U.S. Holder and generally will be income or loss from sources within the United States for foreign tax credit limitation purposes.

Subject to applicable limitations, Russian taxes withheld from dividends on the Shares at a rate not exceeding the rate provided in the Treaty (if applicable) will be creditable against the U.S. Holder's U.S. federal income tax liability (or at a U.S. Holder's election, may be deducted in computing taxable income if the U.S. Holder has elected to deduct all foreign income taxes for the taxable year). The limitation on foreign taxes eligible for the U.S. foreign tax credit is calculated separately with respect to specific "baskets" of income. For this purpose, the dividends should generally constitute "passive category income," or in the case of certain U.S. Holders, "general category income." The rules governing foreign tax credits are complex, and U.S. Holders should consult their tax advisers regarding the creditability of foreign taxes based on their particular circumstances.

Dispositions

Subject to the discussion below under "—*Passive Foreign Investment Company*," a U.S. Holder will generally recognize capital gain or loss on any sale, exchange, redemption, or other taxable disposition of its Shares in an amount equal to the difference between the amount realized for the Shares and such U.S. Holder's tax basis in the Shares, each determined in U.S. dollars. Any such capital gain or loss will be long-term if the U.S. Holder's holding period in the Shares exceeds one year. However, regardless of a U.S. Holder's actual holding period, any loss may be a long-term capital loss to the extent the U.S. Holder receives a dividend that (i) qualifies for the reduced rate described above under "*Dividend Policy*", and (ii) exceeds 10 per cent. of the U.S. Holder's basis in its Shares. Long-term capital gains of non-corporate taxpayers are generally eligible for reduced rates of taxation. Any gain or loss generally will be treated as U.S. source gain or loss. In the case of a disposition of Shares that is subject to Russian tax, because the Treaty provides for a zero rate on capital gains the U.S. Holder will not be able to use the foreign tax credit (and will not be able take a deduction) for that Russian tax but may be able to claim a refund provided that the required information is timely furnished to the Russian tax authorities. See *"—Russian Tax Considerations—Withholding of tax on capital gains (Resident and Non-Resident Holders who are individuals)—Refund of Tax Withheld*." The deductibility of capital losses is subject to limitations under the Code.

A U.S. Holder's tax basis in the Shares generally will be the U.S. dollar value of the non-U.S. currency amount paid to purchase the Shares determined by reference to the exchange rate on the date of purchase. If the Shares are treated as traded on an "established securities market," a cash basis U.S. Holder (or, if it elects, an accrual basis U.S. Holder) will determine the U.S. dollar value of the cost of such Shares by translating the amount paid at the spot rate of exchange on the settlement date of the purchase.

A U.S. Holder that receives a currency other than U.S. dollars on the sale or other disposition of the Shares generally will realize an amount equal to the U.S. dollar value of the non-U.S. currency received determined by reference to the exchange rate on the date of sale or other disposition (or in the case of Shares traded on an "established securities market" that are sold by a cash basis or electing accrual basis taxpayer, the settlement date). A U.S. Holder will recognize currency gain or loss if the U.S. dollar value of the currency received at the spot rate on the settlement date differs from the amount realized. A U.S. Holder will have a tax basis in the currency received equal to the U.S. dollar value of the currency on the settlement date. Any gain or loss realized on a subsequent conversion or other disposition of the non-U.S. currency for a different U.S. dollar amount will be exchange gain or loss and generally will be treated as U.S. source ordinary income or loss for foreign tax credit limitation purposes.

Passive Foreign Investment Company

A non-U.S. corporation will be classified as a passive foreign investment company ("**PFIC**") for U.S. federal income tax purposes in any taxable year in which the corporation satisfies either of the following requirements:

- at least 75% of its gross income is "passive income"; or
- at least 50% of the average gross fair market value of its assets is attributable to assets that produce "passive income" or are held for the production of "passive income."

Passive income for this purpose generally includes dividends, interest, royalties, rents and gains from commodities and securities transactions. In addition, there is a look-through rule for investments in subsidiary corporations. Under this rule, if a non-U.S. corporation owns (directly or indirectly) at least 25% of another corporation, the non-U.S. corporation is treated as owning a proportionate share of the assets of the other corporation and earning its proportionate share of the income of the other corporation for purposes of determining if the non-U.S. foreign corporation is a PFIC.

Based upon the composition of its income, its assets and the nature of its business, the Company believes that it did not qualify as a PFIC for the tax year ending 31 December 2016, and expects that it will not be classified as a PFIC for its current taxable year or the foreseeable future. There can be no assurance, however, that the Company will not be considered to be a PFIC for any particular year because PFIC status is factual in nature, depends upon factors not wholly within the Company's control, generally cannot be determined until the close of the taxable year in question, and is determined annually. If the Company were a PFIC in any taxable year, materially adverse U.S. federal income consequences could result for U.S. Holders. If the Company were a PFIC for any taxable year during which a U.S. Holder owned Shares, gains recognized by such U.S. Holder on a sale or other disposition of the Shares would be allocated ratably over the U.S. Holder's holding period for such shares. The amount allocated to the taxable year of the sale or other disposition and to any year before the Company became a PFIC would be taxed as ordinary income. The amount allocated to each other taxable year would be subject to tax at the highest rate in effect for ordinary income in such year and an interest charge would be imposed on the amount allocated to each such taxable year. Further, any distribution on the Shares in excess of 125% of the average of the annual distributions on such Shares received by a U.S. Holder during the preceding three years or the U.S. Holder's holding period, whichever is shorter, would be subject to taxation in the same manner as gain, as described immediately above. If the Company is classified as a PFIC in any year that a U.S. Holder is a shareholder, the Company generally will continue to be treated as a PFIC for that U.S. Holder in all succeeding years, even if the Company ceases to satisfy the requirements of being a PFIC. U.S. Holders should consult their tax advisers regarding the application of the PFIC rules to their investment in the Shares and any elections that may be available to them to mitigate the adverse affects of the PFIC rules.

Backup Withholding and Information Reporting

Payments of dividends to a U.S. Holder and proceeds from the sale or other disposition of Shares may, under certain circumstances, be subject to information reporting and backup withholding, unless the U.S. Holder provides proof of an applicable exemption or, in the case of backup withholding, furnishes its taxpayer identification number and otherwise complies with all applicable requirements of the backup withholding rules. Backup withholding is not an additional tax and generally will be allowed as a refund or credit against the U.S. Holder's U.S. federal income tax liability, provided that the required information is timely furnished to the IRS.

Foreign Asset Reporting

Certain U.S. Holders are required to report information relating to an interest in the Shares, subject to certain exceptions (including an exception for Shares held in accounts maintained by certain financial institutions) by filing IRS Form 8938 (Statement of Specified Foreign Financial Assets) with their U.S. federal income tax return. U.S. Holders are urged to consult their tax advisors regarding their information reporting obligations, if any, with respect to their ownership and disposition of Shares.

SELLING AND TRANSFER RESTRICTIONS

Selling Restrictions

General

No action has been or will be taken in any jurisdiction that would permit a public offering of the Shares, or possession or distribution of this Offering Memorandum or any other offering material in any country or jurisdiction where action for that purpose is required. Accordingly, the Shares may not be offered or sold, directly or indirectly, and neither this Offering Memorandum nor any other offering material or advertisement in connection with the Shares may be distributed or published in or from any country or jurisdiction except under circumstances that will result in compliance with any and all applicable rules and regulations of any such country or jurisdiction. Persons into whose possession this Offering Memorandum comes should inform themselves about and observe any restrictions on the distribution of this Offering Memorandum and the offer and sale of the Shares offered in the Offering, including those in the paragraphs below. Any failure to comply with these restrictions may constitute a violation of the securities laws of any such jurisdiction. This Offering Memorandum does not constitute an offer to subscribe for or buy any of the Shares offered in the Offering to any person in any jurisdiction to whom it is unlawful to make such offer or solicitation in such jurisdiction.

United States

The Shares have not been and will not be registered under the Securities Act, and may not be offered or sold within the United States except in certain transactions exempt from the registration requirements of the Securities Act. The Shares are being offered and sold outside of the United States in reliance on Regulation S. The Underwriting Agreement provides that certain of the Joint Bookrunners may directly or through their respective U.S. broker-dealer affiliates, arrange for the offer and resale of the Shares within the United States only to QIBs in reliance on Rule 144A.

In addition, until 40 days after the commencement of the Offering of the Shares, an offer or sale of Shares within the United States by a dealer (whether or not participating in the Offering) may violate the registration requirements of the Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A.

United Kingdom

Each of the Joint Bookrunners has represented and agreed that: (i) it has only communicated or caused to be communicated and will only communicate or cause to be communicated an invitation or inducement to engage in investment activity (within the meaning of section 21 of the FSMA) received by it in connection with the issue or sale of any Shares in circumstances in which section 21(1) of the FSMA does not apply to the Company; and (ii) it has complied and will comply with all applicable provisions of the FSMA with respect to anything done by it in relation to the Shares in, from or otherwise involving the United Kingdom.

European Economic Area

Each of the Joint Bookrunners has represented and agreed in relation to each Member State of the European Economic Area (each, a "**Relevant Member State**"), with effect from and including the date on which the Prospectus Directive is implemented in that Relevant Member State (the "**Relevant Implementation Date**") that neither it nor any of its affiliates has made nor will make an offer to the public of any Shares which are the subject of the Offering contemplated herein in that Relevant Member State, except that it may make an offer of Shares to the public in that Relevant Member State with effect from and including the Relevant Implementation Date under the following exemptions under the Prospectus Directive, if they have been implemented in that Relevant Member State:

(a) to legal entities which are qualified investors as defined in the Prospectus Directive;

(b) to fewer than 100 or 150, natural or legal persons (other than qualified investors as defined in the Prospectus Directive), as permitted under the Prospectus Directive, subject to obtaining the prior consent of the Joint Bookrunners for any such offer; or

(c) in any other circumstances falling within Article 3(2) of the Prospectus Directive,

provided that no such offer of Shares shall result in a requirement for the publication by the Company or any Joint Bookrunner of a prospectus pursuant to Article 3 of the Prospectus Directive or supplement a prospectus pursuant to Article 16 of the Prospectus Directive.

For the purposes of this provision, the expression an "*offer of any Shares to the public*" in relation to any Shares in any Relevant Member State means the communication in any form and by any means of sufficient information of the terms of the offer and any Shares to be offered so as to enable an investor to decide to purchase any Shares, as the same may be varied in that Relevant Member State by any measure implementing the Prospectus Directive in that Relevant Member State; the expression "**Prospectus Directive**" means Directive 2003/71/EC and includes any relevant implementing measure in each Relevant Member State.

In the case of any Shares being offered to a financial intermediary, as that term is used in Article 3(2) of the Prospectus Directive, such financial intermediary will also be deemed to have represented, acknowledged and agreed that the Shares acquired by it have not been acquired on a non-discretionary basis on behalf of, nor have they been acquired with a view to their offer or resale to persons in circumstances which may give rise to an offer of any Shares to the public other than their offer or resale in a Relevant Member State to qualified investors who are not financial intermediaries as so defined or in circumstances in which the prior consent of the Joint Bookrunners has been obtained to each such proposed offer or resale. The Company, the Selling Shareholders, the Joint Bookrunners and their respective affiliates, and others will rely (and the Company and the Selling Shareholders each acknowledges that the Joint Bookrunners and their respective affiliates and others will rely) upon the truth and accuracy of the foregoing representations, acknowledgements and agreements. Notwithstanding the above, a person who is not a qualified investor and who has notified the Joint Bookrunners of such fact in writing may, with the consent of the Joint Bookrunners, be permitted to subscribe for or purchase Shares.

Canada

The Shares may be sold in Canada only to purchasers resident or located in the Provinces of Ontario, Québec, Alberta and British Columbia, purchasing, or deemed to be purchasing, as principal that are accredited investors, as defined in National Instrument 45-106 Prospectus Exemptions or subsection 73.3(1) of the Securities Act (Ontario), and are permitted clients, as defined in National Instrument 31-103 Registration Requirements, Exemptions and Ongoing Registrant Obligations. Any resale of the Shares must be made in accordance with an exemption from, or in a transaction not subject to, the prospectus requirements of applicable securities laws.

Securities legislation in certain provinces or territories of Canada may provide a purchaser with remedies for rescission or damages if this offering memorandum (including any amendment thereto) contains a misrepresentation, provided that the remedies for rescission or damages are exercised by the purchaser within the time limit prescribed by the securities legislation of the purchaser's province or territory. The purchaser should refer to any applicable provisions of the securities legislation of the purchaser's province or territory for particulars of these rights or consult with a legal advisor.

Pursuant to section 3A.3 (or, in the case of securities issued or guaranteed by the government of a non-Canadian jurisdiction, section 3A.4) of National Instrument 33-105 Underwriting Conflicts ("**NI 33-105**"), the Joint Bookrunners are not required to comply with the disclosure requirements of NI 33-105 regarding underwriter conflicts of interest in connection with this offering.

Cyprus

Each Joint Bookrunner has represented, warranted and agreed and each further Joint Bookrunner appointed will be required to represent, warrant and agree that:

(a) it has not offered or sold and will not offer or sell any Shares, except in conformity with the provisions of the Public Offer and Prospectus Law, Law 114(I)/2005 and the provisions of the Cyprus Companies Law, Cap. 113 (as amended);

(b) it has not and will not offer or sell any Shares other than in compliance with the provisions of the Investment Services and Activities and Regulated Markets Law, Law 144(I)/2007 (the "**Cyprus Investment Services Law**"); and

(c) it has not and will not distribute copies of the Underwriting Agreement or this Offering Memorandum or any other offering material to the information distribution channels or the public in Cyprus, nor (when distributed by a duly licensed investment firm established or operating through a branch in Cyprus) to any person in Cyprus other than a "professional client" as defined in the Cyprus Investment Services Law;

(d) it has not used the material and disclosure statements in the Underwriting Agreement or in this Offering Memorandum for solicitation purposes for or in connection with the acquisition of the Shares in circumstances under which is unlawful under Cyprus laws to make such an offer or solicitation; and

(e) it will not be providing from or within Cyprus any "investment services", "investment activities" and "non-core services" (as such terms are defined in the Cyprus Investment Services Law) in relation to the Shares or will be otherwise providing investment services, investment activities and non-core services to residents or persons domiciled in Cyprus and will not be concluding in Cyprus any transaction relating to such investment services, investment activities and non-core services in contravention of the Cyprus Investment Services Law and/or any applicable regulations adopted pursuant thereto or in relation thereto.

Japan

(a) The Shares have not been and will not be registered under the Final Instruments and Exchange Law, as amended (the "**FIEL**"). This Offering Memorandum is not an offer of securities for sale, directly or indirectly, in Japan or to or for the benefit of, any resident of Japan (which term as used herein means any person resident in Japan, including any corporation or entity organised under the laws of Japan) or to others for reoffer or resale, directly or indirectly, in Japan or to, or for the benefit of, any resident of Japan, except pursuant to an exception from the registration requirements under the FIEL, and otherwise in compliance with, the FIEL and other relevant laws and otherwise in compliance with such law and any other applicable laws, regulations or ministerial guidelines of Japan.

Australia

(a) No prospectus or other disclosure document has been lodged with, or registered by the Australian Securities and Investments Commission in relation to the offering of the Shares. This Offering Memorandum does not constitute a prospectus or other disclosure document under the Corporations Act 2001 (the "**Corporations Act**") and does not purport to include the information required for a prospectus or other disclosure document under the Corporations Act.

(b) This document is being distributed in Australia by the Joint Bookrunners to persons (the "**Exempt Investors**") who are "sophisticated investors" (within the meaning of section 708(8) of the Corporations Act, to "professional investors" (within the meaning of section 708(11) of the Corporations Act) and/or otherwise pursuant to one of more exemptions contained in section 708 of the Corporations Act. The entity receiving this document represents and warrants that if it is in Australia, it is either a professional or a sophisticated investor or a person to whom it is lawful to offer the Shares without disclosure to investors under Chapter 6D of the Corporations Act and that it will not distribute this document to any other person.

(c) Any of the Shares applied for by Exempt Investors in Australia must not be offered for sale in Australia for 12 months from the date of issue, except in circumstances where disclosure to investors under Chapter 6D of the Corporations Act would not be required pursuant to an exemption under section 708 or 708A of the Corporations Act. This document is not supplied in connection with any offering or proposed offering of securities or financial products that require disclosure in accordance with Chapter 6D or Part 7.9 of the Corporations Act. Chapters 6D and 7 of the Corporations Act are complex. Any person acquiring the Shares must observe such Australian on-sale restrictions and if in any doubt as to the application or effect of this legislation, should confer with its professional advisors.

Transfer Restrictions

Rule 144A Offering

Each purchaser of Shares in the Rule 144A Offering, by its acceptance of delivery of this Offering Memorandum, will be deemed to have represented, agreed and acknowledged as follows:

1. The purchaser (i) is a QIB as that term is defined by Rule 144A under the Securities Act, (ii) is aware that, and each beneficial owner of such Shares has been advised that, the sale to it is being made in reliance on Rule 144A under the Securities Act or another exemption from, or transaction not subject to, the registration requirements of the Securities Act, (iii) is acquiring such Shares for its own account or for the account of one or more QIBs and (iv) if it is acquiring such Shares for the account of one or more QIBs, has sole investment discretion with respect to each such account and has full power to make the acknowledgements, representations and agreements herein on behalf of each such account.

2. The purchaser is aware that the Shares, purchased pursuant to Rule 144A under the Securities Act or another exemption from, or transaction not subject to, the registration requirements of the Securities Act, have not been and will not be registered under the Securities Act and are being offered in the United States only in transactions not involving any public offering in the United States and are "restricted securities" as defined in Rule 144(a)(3) under the Securities Act ("**Restricted Securities**").

3. For so long as the Shares are Restricted Securities, it will not deposit such Shares into any depositary receipt facility in respect of Shares established and maintained by a depositary bank other than a Rule 144A restricted depositary receipt facility.
4. The Company, the Selling Shareholders, the Joint Bookrunners, their affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

Prospective purchasers are hereby notified that sellers of the Shares purchased within the United States pursuant to Rule 144A may be relying on the exemption from the provisions of Section 5 of the Securities Act provided by Rule 144A under the Securities Act.

Regulation S Offering

Each purchaser of the Shares in the Regulation S Offering, by its acceptance of the delivery of this Offering Memorandum, will be deemed to have represented and agreed as follows (terms used in this paragraph that are defined in Regulation S are used herein as defined therein):

1. the purchaser is, at the time of the offer to it of the Shares and at the time the buy order originated, outside the United States for the purposes of Rule 903 under the Securities Act;
2. the purchaser is aware that the Shares have not been and will not be registered under the Securities Act and are being offered outside the United States in reliance on Regulation S;
3. any offer, sale, pledge or other transfer made other than in compliance with the above-stated restrictions shall not be recognised by the Company; and
4. The Company, the Selling Shareholders, the Joint Bookrunners and their affiliates and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements.

If a purchaser of Shares is acquiring such Shares as a fiduciary or agent for one or more investor accounts, it represents that it has sole investment discretion with respect to each such account and it has full power to make the foregoing representations and agreements on behalf of each account.

SETTLEMENT AND DELIVERY

The Shares will be priced in Russian Roubles. It is expected that delivery of the Shares to purchasers thereof and payment for the Shares by the purchasers will commence on or about the Share Delivery Date. Potential purchasers of the Shares must indicate their payment currency at the time of placing an order with the Joint Bookrunners, which cannot be changed after the order book has been closed. Each purchaser of the Shares must pay for such Shares by the date agreed with the Joint Bookrunners. Subject to Russian currency control requirements, the Shares may be paid for in Russian Roubles or in US Dollars using the WM/Reuters closing spot rate at 16:00 London time effective on the day preceding the day on which the Offer Price is announced minus 15 kopecks. The Shares will be delivered to purchasers through the settlement facilities of the NSD. Therefore, to take delivery of the Shares, purchasers must have a depositary account with the NSD or any other depositary that has an account with the NSD.

LEGAL MATTERS

Certain legal matters with respect to the Offering will be passed upon for us and Sistema in respect of the laws of England and the United States by White & Case LLP and in respect of the laws of the Russian Federation by White & Case LLC. Certain legal matters with respect to the Offering will be passed upon for the Joint Bookrunners in respect of the laws of England and the United States by Linklaters LLP and in respect of the laws of the Russian Federation by Linklaters CIS.

INDEPENDENT AUDITORS

The Financial Statements included in this Offering Memorandum have been audited or reviewed, as the case may be, by ZAO Deloitte & Touche CIS, independent auditors. The address of ZAO Deloitte & Touche CIS is 5 Lesnaya Street, Moscow 125047, Russian Federation. ZAO Deloitte & Touche CIS is a member of the Russian Union of Auditors. ZAO Deloitte & Touche does not have a material interest in the Company.

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DETSKY MIR GROUP

Interim Condensed Consolidated
Financial Information (Unaudited)
Three Months and Nine Months Ended
30 September 2016

DETSKY MIR GROUP

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Management is responsible for the preparation of the interim condensed consolidated financial information that presents fairly the consolidated financial position of Public Joint Stock Company "Detsky Mir" (the "Company") and its subsidiaries (the "Group") as at 30 September 2016, the consolidated results of its operations for the three months and the nine months then ended, cash flows and changes in equity for the nine months then ended, in compliance with International Accounting Standard 34 "Interim Financial Reporting".

In preparing the interim condensed consolidated financial information, management is responsible for:

- properly selecting and applying accounting policies;
- presenting information, including accounting policies, in manner that provides relevant, reliable, comparable and understandable information;
- providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance;
- making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- designing, implementing and maintaining an effective and sound system of internal controls throughout the Group;
- maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the interim condensed consolidated financial information of the Group complies with IFRS;
- maintaining statutory accounting records in compliance with local legislation and accounting standards of Russian Federation;
- taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- preventing and detecting fraud and other irregularities.

The interim condensed consolidated financial information was approved on 23 November 2016.

V.S. Chirakhov	**A.S. Garmanova**
Chief Executive Officer	Chief Financial Officer
PJSC Detsky Mir	PJSC Detsky Mir

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INDEPENDENT AUDITOR'S REPORT ON REVIEW OF THE INTERIM CONDENSED CONSOLIDATED FINANCIAL INFORMATION

To: Shareholders and Board of Directors of Public Joint Stock Company "Detsky Mir"

Introduction

We have reviewed the accompanying interim condensed consolidated statement of financial position of Public Joint Stock Company "Detsky Mir" (the "Company") and its subsidiaries (the "Group") as at 30 September 2016 and the related interim condensed consolidated statements of profit or loss and other comprehensive income for the three months and the nine months then ended, changes in equity and cash flows for the nine months then ended, and a summary of significant accounting policies and other explanatory notes (the "interim condensed consolidated financial information"). Management is responsible for the preparation and presentation of this interim condensed consolidated financial information in accordance with International Accounting Standard 34 "Interim Financial Reporting" ("IAS 34"). Our responsibility is to express a conclusion on this interim condensed consolidated financial information based on our review.

Scope of Review

We conducted our review in accordance with International Standard on Review Engagements 2410 "Review of Interim Financial Information Performed by the Independent Auditor of the Entity". A review of interim condensed consolidated financial 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 information is not prepared, in all material respects, in accordance with IAS 34.

DELOITTE & TOUCHE

Moscow
23 November 2016

INTERIM CONDENSED CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE THREE MONTHS AND THE NINE MONTHS ENDED 30 SEPTEMBER 2016 (UNAUDITED)

(in millions of Russian Rubles, except earnings per share)

		For the nine months ended		For the three months ended	
	Notes	30 September 2016	30 September 2015	30 September 2016	30 September 2015
REVENUE	4	54,226	39,967	20,490	15,222
COST OF SALES		(36,151)	(26,125)	(13,622)	(9,819)
GROSS PROFIT		18,075	13,842	6,868	5,403
Selling, general and administrative expenses	5	(14,618)	(11,534)	(5,056)	(4,001)
Share of profit of associate, net of income tax		9	5	-	5
Other operating expenses, net		(19)	(11)	(5)	(12)
OPERATING PROFIT		3,447	2,302	1,807	1,395
Finance income	16	148	535	32	206
Finance expense	6	(1,418)	(1,251)	(453)	(576)
Gain on acquisition of controlling interest in associate	3	16	-	16	-
Foreign exchange loss, net		(10)	(595)	(56)	(543)
PROFIT BEFORE TAX		2,183	991	1,346	482
Income tax expense	7	(498)	(334)	(288)	(193)
PROFIT FOR THE PERIOD		**1,685**	**657**	**1,058**	**289**
Other comprehensive income/(loss)					
Items that may be reclassified subsequently to profit or loss					
Effect of translation to presentation currency		36	16	(35)	8
TOTAL COMPREHENSIVE INCOME for the period		**1,721**	**673**	**1,023**	**297**
Earnings per share					
Weighted average number of shares outstanding, basic and diluted		739,000,000	739,000,000	739,000,000	739,000,000
Earnings per share, basic and diluted (in Russian Rubles per share)		2.28	0.89	1.43	0.39

The Notes on pages 7 to 17 form an integral part of this interim condensed consolidated financial information.

INTERIM CONDENSED CONSOLIDATED STATEMENT OF FINANCIAL POSITION AS AT 30 SEPTEMBER 2016 (UNAUDITED)
(in millions of Russian Rubles)

	Notes	30 September 2016	31 December 2015
ASSETS			
NON-CURRENT ASSETS:			
Property, plant and equipment	8	6,552	6,791
Intangible assets		1,289	1,300
Investment in associate	3	-	56
Long-term loans receivable	9	1,049	5,807
Deferred tax assets, net		1,307	1,151
Other non-current assets		260	247
Total non-current assets		**10,457**	**15,352**
CURRENT ASSETS:			
Inventories	10	20,744	17,346
Trade receivables		2,661	2,710
Advances paid and other receivables		2,148	1,850
Other taxes receivable		3	2
Cash and cash equivalents	11	455	1,934
Total current assets		**26,011**	**23,842**
TOTAL ASSETS		**36,468**	**39,194**
EQUITY AND LIABILITIES			
EQUITY:			
Share capital		1	1
Additional paid-in capital		5,793	5,793
Accumulated deficit		(5,378)	(5,448)
Currency translation reserve		85	49
Total equity		**501**	**395**
NON-CURRENT LIABILITIES:			
Long-term loans and borrowings	13	4,265	5,465
Deferred tax liabilities		32	63
Total non-current liabilities		**4,297**	**5,528**
CURRENT LIABILITIES:			
Trade accounts payable		18,714	16,718
Short-term loans and borrowings and current portion of long-term loans and borrowings	13	8,737	12,894
Advances received, other payables and accrued expenses	14	3,642	2,952
Deferred revenue		473	278
Income tax payable		104	429
Total current liabilities		**31,670**	**33,271**
Total liabilities		**35,967**	**38,799**
TOTAL EQUITY AND LIABILITIES		**36,468**	**39,194**

The Notes on pages 7 to 17 form an integral part of this interim condensed consolidated financial information.

DETSKY MIR GROUP

INTERIM CONDENSED CONSOLIDATED STATEMENT OF CHANGES IN EQUITY FOR THE NINE MONTHS ENDED 30 SEPTEMBER 2016 (UNAUDITED)

(in millions of Russian Rubles)

	Notes	Share capital	Additional paid-in capital	Accumula-ted deficit	Currency translation reserve	Total
Balance as at 1 January 2015		**1**	**6,536**	**(3,878)**	**(13)**	**2,646**
Profit for the period		-	-	657	-	657
Effect of translation to presentation currency		-	-	-	16	16
Total comprehensive income for the period		-	-	657	16	673
Dividends declared		-	-	(839)	-	(839)
Balance as at 30 September 2015		**1**	**6,536**	**(4,060)**	**3**	**2,480**
Balance as at 1 January 2016		**1**	**5,793**	**(5,448)**	**49**	**395**
Profit for the period		-	-	1,685	-	1,685
Effect of translation to presentation currency		-	-	-	36	36
Total comprehensive income for the period		-	-	1,685	36	1,721
Dividends declared	12	-	-	(1,308)	-	(1,308)
Settlement of share based payments	15	-	-	(307)	-	(307)
Balance as at 30 September 2016		**1**	**5,793**	**(5,378)**	**85**	**501**

The Notes on pages 7 to 17 form an integral part of this interim condensed consolidated financial information.

INTERIM CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE NINE MONTHS ENDED 30 SEPTEMBER 2016 (UNAUDITED)
(in millions of Russian Rubles)

	For the nine months ended	
	30 September 2016	**30 September 2015**
OPERATING ACTIVITIES:		
Profit for the period	1,685	657
Adjustments for:		
Income tax expense	498	334
Share based compensation	-	40
Finance income	(148)	(535)
Finance expense	1,418	1,251
Loss on disposal of fixed assets and intangible assets	-	57
Bad debts written off and change in allowance for doubtful accounts	10	16
Shrinkage and merchandise inventories obsolescence expenses	1,102	714
Depreciation and amortization	1,176	638
Foreign exchange loss, net	10	595
Gain on acquisition of controlling interest in associate	(16)	-
Interest in earnings of associates, net of tax	(9)	(5)
Changes in working capital:		
Decrease/(increase) in trade receivables	47	(2,106)
Increase in advances paid and other receivables	(146)	(1,150)
Increase in inventories	(4,483)	(3,684)
Increase in trade accounts payable	2,012	2,088
Increase in advances received, other payables and accrued expenses	474	193
Increase in deferred revenue	195	-
Cash received from / (used in) operations	**3,825**	**(897)**
Interest paid	(1,423)	(1,390)
Interest received	29	-
Income taxes paid	(893)	(771)
Net cash received from / (used in) operating activities	**1,538**	**(3,058)**
INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(749)	(3,450)
Purchase of intangible assets	(196)	(887)
Issuance of loans	-	(26)
Dividends received from associates	9	3
Net inflow of cash and cash equivalents on acquisition of controlling interest in associate (Note 3)	15	-
Proceeds from repayment of loans issued	4,876	5
Net cash received from / (used in) investing activities	**3,955**	**(4,355)**
FINANCING ACTIVITIES:		
Proceeds from loans and borrowings	13,570	25,496
Repayment of loans and borrowings	(18,927)	(17,101)
Dividends paid	(1,308)	(839)
Share-based payments	(307)	-
Net cash (used in) / received from financing activities	**(6,972)**	**7,556**
NET (DECREASE) / INCREASE IN CASH AND CASH EQUIVALENTS	**(1,479)**	**143**
CASH AND CASH EQUIVALENTS, at the beginning of the period	**1,934**	**1,670**
CASH AND CASH EQUIVALENTS, at the end of the period	**455**	**1,813**

The Notes on pages 7 to 17 form an integral part of this interim condensed consolidated financial information.

(in millions of Russian Rubles)

1. GENERAL INFORMATION

PJSC Detsky Mir (the "Company") together with its subsidiaries (the "Group" or "Detsky Mir Group") is the largest retail chain in the children's products market in the Russian Federation ("RF"). The Company is registered in the Unified State Register of Legal Entities under the laws of the Russian Federation (State Registration Certificate No. 1027700047100).

The primary activity of the Group is the sale of children's clothing and products through retail stores. During the three months and the nine months ended 30 September 2016 and as at 30 September 2016 the Group operated "Detsky Mir" branded stores in Russia and Kazakhstan and Early Learning Centre (hereinafter, the "ELC") branded retail stores in Russia. See below a full listing of the Group entities.

The controlling party of the Company is JSFC Sistema ("Sistema"). The ultimate controlling party of the Company is Mr. Vladimir Yevtushenkov.

As at 30 September 2016 and 31 December 2015 the registered shareholders of the Company and their effective ownership were as follows:

	30 September 2016	**31 December 2015**
JSFC Sistema and its subsidiaries	72.63%	75.82%
Floette Holdings Limited [1]	11.55%	11.55%
Eksapzo Holdings Limited [1]	11.55%	11.55%
Mr. V.S. Chirakhov	1.79%	1.08%
Other individuals	2.48%	-
Total	**100%**	**100%**

[1] Represent the interests of the "Russian-Chinese investment Fund" (Note 16).

The ownership interest of the Group and the proportion of its voting power in its major operating subsidiaries was as follows, as at each period end:

	Ownership interest and proportion of voting power	
Subsidiaries	**30 September 2016**	**31 December 2015**
Detsky Mir Kazakhstan, LLP, Kazakhstan	100%	100%
Kub-Market LLC, RF	100%	100%
Spartema Limited, Cyprus	100%	100%
Detsky Mir GMBH, Germany	100%	100%
Detsky Mir-Orel, JSC (Note 3)	100%	50%

2. BASIS OF PREPARATION AND SIGNIFICANT ACCOUNTING POLICIES

Basis of Preparation

The annual consolidated financial statements of PJSC "Detsky Mir" and its subsidiaries are prepared in accordance with International Financial Reporting Standards ("IFRS"). This interim condensed consolidated financial information for the three months and the nine months ended 30 September 2016 has been prepared in accordance with International Accounting Standard 34 "Interim Financial Reporting" ("IAS 34"). The interim condensed consolidated financial information does not include all the information and disclosures required in the annual consolidated financial statements, and should be read in conjunction with the Group's annual consolidated financial statements for the year ended 31 December 2015.

Functional and presentation currency – The amounts in the interim condensed consolidated financial information are presented in Russian Rubles ("RUB"), which is the functional currency of the Group's entities and the presentation currency.

(in millions of Russian Rubles)

Seasonality of operations – Significant portion of the Group's sales, profit and operating cash flows have historically been realized in the fourth quarter. Thus the results of operations for the three months and the nine months ended 30 September 2016 and cash flows for the nine months ended 30 September 2016 are not necessarily indicative of the results that may be expected for the full year, because of many factors, including seasonal fluctuations in customer demand, product offerings, inventory levels and our promotional activity.

Income tax – Income tax in the interim periods is accrued using the effective tax rate that would be applicable to expected total annual earnings.

Significant accounting policies

Adoption of New Standards and Interpretations

The accounting policies applied by the Group are consistent with those of the financial year ended as at 31 December 2015, except for the adoption of the new standards and interpretations described below.

In 2016 the Group has adopted the following new and amended standards and interpretations issued by the International Accounting Standards Board ("IASB") and the International Financial Reporting Interpretations Committee ("IFRIC") of the IASB:

- *Disclosure Initiative* (Amendments to IAS 1);
- *Clarification of Acceptable Methods of Depreciation and Amortisation* (Amendments to IAS 16 and IAS 38);
- Annual Improvements 2012-2014 Cycle.

The adoption of these standards and interpretations has not had a significant impact on interim condensed consolidated financial information of the Group for the three months and the nine months ended 30 September 2016.

3. ACQUISITION OF CONTROLLING INTEREST IN ASSOCIATE

On 25 August 2016, the Group acquired control over Detsky Mir-Orel JSC ("DM Orel"), formerly an associate of the Group, by increasing of its stake in DM Orel from 50% to 100% for a cash consideration of RUB 28 million.

The acquisition has been accounted for using the purchase method. This interim condensed consolidated financial information includes the results of DM Orel for September 2016.

The fair values of the identifiable assets and liabilities of DM Orel as at the date of acquisition were as follows:

	DM Orel
Property, plant and equipment	2
Trade and other accounts receivable	2
Inventories	61
Cash and cash equivalents	43
Other current assets	1
Accounts payable, provisions and accrued expenses	(9)
Fair value of identifiable net assets	**100**
Less: fair value of investment in associate held at the date of acquisition	(56)
Less: excess of fair value of acquired net assets over consideration paid	(16)
Purchase consideration transferred (paid in cash)	**28**

(in millions of Russian Rubles)

Cash flows arising on acquisition of controlling interest in associate are as follows:

Cash and cash equivalents acquired with the subsidiary	43
Cash consideration paid	(28)
Net inflow of cash and cash equivalents on acquisition	**15**

Gain on acquisition of controlling interest in associate of RUB 16 million, represented by excess of fair value of acquired net assets over consideration paid, has been recognized in condensed consolidated interim statement of profit and loss and other comprehensive income and results from the Group's strong position in negotiations with the previous holder of 50% interest in DM Orel.

From the date of acquisition until 30 September 2016, DM Orel has contributed RUB 18 million to revenue and RUB 1 million as a reduction of the Group's net profit. If the acquisition had taken place on 1 January 2016, net profit of the Group for the nine months ended 30 September 2016 would have been RUB 1,690 million and revenue for the respective period would have been RUB 54,357 million.

4. REVENUE

The Group's revenue for the nine months and three months ended 30 September 2016 and 2015 was as follows:

	For the nine months ended		**For the three months ended**	
	30 September 2016	**30 September 2015**	**30 September 2016**	**30 September 2015**
Retail, excluding luxury and the online store	53,017	39,300	20,046	15,019
Online store	1,158	496	426	184
Luxury	-	108	-	2
Other	51	63	18	17
Total	**54,226**	**39,967**	**20,490**	**15,222**

Revenue for sales of goods ordered via the Internet and picked up at Group's retail shops is included in retail revenue.

Revenue from stores "ELC", reflected in retail sales, for the nine months ended 30 September 2016 and 2015 was RUB 655 million and RUB 597 million, respectively (for the three months ended 30 September 2016 and 2015 – RUB 216 million and RUB 206 million, respectively).

(in millions of Russian Rubles)

5. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

The Group's selling, general and administrative expenses for the nine months and three months ended 30 September 2016 and 2015 were as follows:

	For the nine months ended		For the three months ended	
	30 September 2016	30 September 2015	30 September 2016	30 September 2015
Rent and utility	5,971	5,104	2,008	1,756
Payroll	4,957	3,904	1,832	1,347
Depreciation and amortisation	1,176	638	405	229
Advertising and marketing expenses	671	596	200	227
Banking services	499	299	182	103
Repair and maintenance	247	198	92	71
Software maintenance	234	66	69	19
Security expenses	178	169	63	57
Promotional materials	164	192	62	112
Taxes (other than income tax)	105	39	35	14
Consulting services	83	67	21	7
Communication expenses	79	59	25	20
Travel expenses	58	48	21	20
Stationary and other materials	20	46	6	6
Other	176	109	35	13
Total	**14,618**	**11,534**	**5,056**	**4,001**

6. FINANCE EXPENSE

The Group's finance expense for the nine months and three months ended 30 September 2016 and 2015 was as follows:

	For the nine months ended		For the three months ended	
	30 September 2016	30 September 2015	30 September 2016	30 September 2015
Interest expense on bank loans	1,418	1,212	453	576
Interest expense on bonds	-	39	-	-
Total	**1,418**	**1,251**	**453**	**576**

7. INCOME TAX EXPENSE

Below is a reconciliation of income tax calculated using the income tax rate effective in the Russian Federation where the Group has its main operating entities to the actual income tax expense recorded in the interim condensed consolidated statement of profit or loss and other comprehensive income:

	For the nine months ended		For the three months ended	
	30 September 2016	30 September 2015	30 September 2016	30 September 2015
Profit before tax	2,183	991	1,346	482
Income tax expense calculated at 20%	437	198	269	96
Non-deductible inventory losses	228	111	57	72
Prior period income tax adjustment	(227)	-	(76)	-
Other charges non-deductible for tax purposes	60	25	38	25
Total	**498**	**334**	**288**	**193**

(in millions of Russian Rubles)

8. PROPERTY, PLANT AND EQUIPMENT

During the nine months ended 30 September 2016, the Group incurred capital expenditures in the amount of RUB 729 million (for the nine months ended 30 September 2015: RUB 3,831 million), which mainly comprised leasehold improvements and trade equipment.

During the three months ended 30 September 2016 the Group incurred capital expenditures in the amount of RUB 303 million (for the three months ended 30 September 2015: RUB 1,968 million).

9. LOANS RECEIVABLE

Long-term loans issued on 30 September 2016 and 31 December 2015 were as follows:

	30 September 2016	31 December 2015
A loan granted to CJSC DM-Finance, a related party, on 3 July 2013 denominated in Rubles at MosPrime1M+2% per annum maturing in December 2018	764	4,553
Accrued interest	285	1,254
Total	**1,049**	**5,807**

In January-February 2016, CJSC "DM-Finance" has partially repaid the loan previously issued by the Group in the amount of RUB 4,875 million, including interest.

10. INVENTORIES

Inventories as at 30 September 2016 and 31 December 2015 were as follows:

	30 September 2016	31 December 2015
Goods for resale	20,605	17,275
Materials	139	71
Total	**20,744**	**17,346**

Materials represent spare parts, packaging materials and other materials used in outlets and warehouses.

Write-offs relating to shrinkage and write-down to net realizable value in the amount of RUB 1,102 million and RUB 714 million for the nine months ended 30 September 2016 and 2015, were recorded within cost of sales in profit or loss.

Write-offs relating to shrinkage and write-down to net realizable value in the amount of RUB 318 million and RUB 223 million for the three months ended 30 September 2016 and 2015, were recorded within cost of sales in profit or loss.

(in millions of Russian Rubles)

11. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as at 30 September 2016 and 31 December 2015 consisted of the following:

	30 September 2016	31 December 2015
Cash in current bank accounts	122	317
Cash in transit	143	758
Bank deposits in rubles	38	690
Cash on hand	152	169
Total	**455**	**1,934**

Cash in transit comprises cash collected in the stores of the Group and not yet placed in the bank accounts of the Group as at the reporting date.

12. DIVIDENDS

In accordance with Russian legislation, earnings available for distribution as dividends are limited to retained earnings of the Company, calculated in accordance with Russian statutory rules, and expressed in local currency. On 28 June 2016 at the annual general meeting of shareholders the dividend payment for the year 2015 was approved in an amount of RUB 1,308 million or RUB 1.77 per share. These dividends were fully paid by the Group during July-August 2016.

13. LOANS AND BORROWINGS

Loans and borrowings as at 30 September 2016 and 31 December 2015 comprised:

	30 September 2016	31 December 2015
Bank loans		
Secured bank loans in rubles	2,365	3,200
Unsecured bank loans in rubles	10,637	15,159
	13,002	**18,359**
Less current portion of long-term debt	(8,737)	(12,894)
Loans and borrowings, non-current	**4,265**	**5,465**

Bank loans in rubles

As of September 30, 2016 the loans in rubles were provided to the Group by 5 Russian banks (31 December 2015 – 6 banks).

The fair value of the Group's bank loans, including amounts due within one year, as at 30 September 2016 approximated their carrying amount. The fair value of the Group's bank loans, including amounts due within one year, as at 31 December 2015 amounted to RUB 18,310 million. The carrying amount of this debt as at 30 September 2016 and 31 December 2015 was RUB 13,002 million and RUB 18,359 million, respectively.

Unused credit lines

As at 30 September 2016 and 31 December 2015, the total amount of undrawn credit lines of the Group amounted to RUB 11,913 million and RUB 7,217 million, including RUB 7,011 million and RUB 3,610 million of long-term credit lines.

(in millions of Russian Rubles)

Restrictive covenants

Some of the Group's loan agreements contain certain restrictive covenants, including requirements to comply with specified financial ratios. The Group's loan agreements contain various provisions that come into force in the case of Group's failure to comply with restrictive covenants. In particular, a bank may increase the interest rate on the loan, require additional collateral or immediate repayment of the corresponding amount of debt. Management believes that as at 30 September 2016 and 31 December 2015 the Group is in compliance with all financial covenants stipulated by its loan agreements.

Collateral

The performance of the Group's obligations under a loan agreement with one of its banks as of 30 September 2016 and 31 December 2015 is secured by a mortgage of the building with a net book value of RUB 2,460 million and RUB 2,417 million, respectively.

With the exception of the above mentioned assets as at 30 September 2016 and 31 December 2015 the Group has no other assets or securities pledged as collateral for loans and borrowings granted to the Group.

14. ADVANCES RECEIVED, OTHER PAYABLES AND ACCRUED EXPENSES

Advances received, other payables and accrued expenses as at 30 September 2016 and 31 December 2015 consisted of the following:

	30 September 2016	31 December 2015
Accrued expenses and other current liabilities	2,376	1,851
Accrued salaries	583	631
Taxes payable (other than income tax)	526	416
Forward foreign exchange contracts	127	-
Interest payable	30	54
Total	**3,642**	**2,952**

As at 30 September 2016 the fair value of a liability related to forward foreign exchange contracts amounted to RUB 127 million. As at 31 December 2015 the fair value of foreign exchange contracts was represented by an asset in the amount of RUB 44 million and disclosed within "Advances paid and other receivables" line in the interim condensed consolidated statement of financial position.

15. SHARE-BASED PAYMENTS

Long-term incentive plan adopted in 2014

Under the conditions of an employee long-term incentive plan (the "Incentive Plan 1") effective since 2014, certain employees at senior levels were entitled to share-based compensation, so-called "phantom" shares.

In June 2016, the Group settled part of its obligations under previously granted employee rights to receive a cash equivalent of phantom shares value by paying to them a cash consideration, of which 50% was designated to purchase 0.11% Company's ordinary shares from a JSFC Sistema subsidiary.

As at 30 September 2016, the Group recognized liabilities of RUB 139 million in relation to the Incentive Plan 1, calculated as the fair value of the phantom shares granted to employees as at this date (as at 31 December 2015: RUB 278 million). These liabilities include accrued social contributions of RUB 33 million (as at 31 December 2015: RUB 65 million). Income upon partial settlement of the phantom shares of RUB 32 million was recognized in Selling, General and Administrative expenses in the consolidated statement of profit or loss and other comprehensive income for the nine months ended 30 September 2016 (for the nine months ended 30 September 2015: expense of RUB 28 million).

(in millions of Russian Rubles)

Long-term incentive plan adopted in 2016

In September 2016, the Group's Board of Directors approved a new employee long-term incentive plan (the "Incentive Plan 2"). Under the conditions of the Incentive Plan 2, certain employees at senior levels are entitled to share-based compensation ("phantom" shares), that are to be granted by the Group in annual tranches over 2016-2018. The phantom shares vest on 31 December 2018 contingent on continued employment with the Group and certain established targets relating to the increase in the Group's market value. The phantom shares vest automatically upon a successful initial public offering by the Group or upon the sale by the Group's controlling shareholder of a certain stake in the Group to a third-party investor. Upon redemption of phantom shares, a participant receives either a respective number of shares in the Company or cash consideration computed on the basis of the market value of one ordinary share of the Company. This settlement choice is upon the Group's discretion. Based on the Group's plans and historical experience, management expects that the settlement shall be done in cash. Thus, the Incentive Plan 2 is accounted for as a cash-settled share-based plan.

In September 2016 the Group granted 1,934,238 phantom shares to the participants of the Incentive Plan 2.

As at 30 September 2016, the Group recognized liabilities of RUB 121 million in relation to the Incentive Plan 2, calculated as the fair value of the phantom shares granted to employees as at this date. These liabilities include accrued social contributions of RUB 16 million. The respective expense of RUB 121 million was recognized as Selling, General and Administrative expenses in the condensed consolidated consolidated statement of profit or loss and other comprehensive income for the nine months ended 30 September 2016.

When estimating its liability under the Incentive Plan 2, the Group assumed that the fair value of one phantom share approximates the fair value of one ordinary share of the Company (being RUB 54.21 per share as at 30 September 2016), and that all of the employees participating in the Incentive Plan 2 will stay employed by the Group until their rights vest.

Share-based compensation of the General Director

In June 2016, the Group General Director's previously granted right to receive Company's ordinary shares was extinguished by cash settlement mutually agreed by the Group and the General Director. This cash settlement was designated to be used to purchase 0.71% of Company's ordinary shares from a JSFC Sistema subsidiary. This settlement was recognized as debit movement in equity within the Accumulated deficit line.

16. RELATED PARTIES

Parties are considered related if they are under common control, or one party has the ability to control the other party, exercise significant influence over decisions on matters of economic and financial activity, or can exercise joint control. In considering each possible related party, the management paid special attention to the substance of the relationship and not merely the legal form.

Transactions with related parties may be on terms that are not always accessible to third parties. This table presents the list of transactions and balances in the calculation of the Group with subsidiaries of JSFC Sistema:

	30 September 2016		31 December 2015	
	Assets	**Liabilities**	**Assets**	**Liabilities**
Balances with related parties				
Bank deposits	6	-	11	-
Other receivables/ (payables)	11	(123)	12	(108)
Loans issued/ (received)	1,049	-	5,807	-

Balances with related parties are unsecured and will be settled in cash.

(in millions of Russian Rubles)

The Group's transactions with subsidiaries and associates of Sistema for the three months and the nine months ended 30 September 2016 and 2015 were as follows:

		For the nine months ended		For the three months ended	
Related party	**Type of transaction**	**30 September 2016**	**30 September 2015**	**30 September 2016**	**30 September 2015**
Detsky Mir-Retail assets (i)	Rent and utilities	21	29	3	-
MTS (i)	Communication costs	14	14	7	4
MTS (i)	Advertising and	29	30	5	-
PA-Maxima (ii)	marketing expenses	2	10	1	-
VAO «Intourist» (i)	Costs of organizing events	18	1	1	1
CJSC "NVision group" (i)	Acquisition of fixed assets	22	10	11	-
CJSC "DM-Finance" (i)	Repayment of loans receivable	4,875	-	-	-
	Interest income	118	514	24	203

(i) – subsidiary of JSFC "Sistema";
(ii) – associate of JSFC "Sistema".

The information about dividends declared and paid is disclosed in Note 12.

Remuneration of key management personnel of the Group

During the nine-month period ended 30 September 2016 and 2015, directors of the Group and other members of key management personnel received remuneration in the amount of RUB 413 million (including RUB 292 million of short-term benefits and RUB 121 million of accrued share-based payments) and RUB 234 million (comprising solely short-term benefits), respectively. During the three months ended 30 September 2016 and 2015, directors of the Group and other members of key management personnel received remuneration in the amount of RUB 320 million (including RUB 199 million of short-term benefits and RUB 121 million of accrued share-based payments) and RUB 99 million (comprising solely short-term benefits), respectively.

17. COMMITMENTS AND CONTINGENCIES

Operating leases

The Group leases retail space through lease contracts which expire in various years through 2023. Although the store leases are generally long term, all of the store lease contracts contain provisions that enable the Group to cancel the lease provided the Group either pays a penalty, which typically consists of a payment equal to approximately two to three months rent or sends an advance notice to the lessor. Notwithstanding, the contracts which are more economically beneficial to be continued by the Group rather than to be canceled are classified as non-cancellable under IAS 17.

Future minimum rental payments (net of VAT) under operating leases classified as non-cancellable for IAS 17 purposes, as at 30 September 2016 and 31 December 2015 were as follows:

	30 September 2016	**31 December 2015**
During one year	7,439	6,447
More than one year, but no more than 5 years	36,636	32,806
More than 5 years	11,056	9,490
Total	**55,131**	**48,743**

Option agreements

In December 2015, AFK "Sistema" sold 23.1% of the Company to the Russia-China Investment Fund ("RCIF") for a total consideration of RUB 9.75 billion. The Group has granted the buyer an option to put its stake in the Company at fair value in case of the non-occurrence of prescribed future events. The option is exercisable between 2021 and 2023. The Group concluded that this puttable instrument should be classified as equity instrument rather than a financial liability because the occurrence of these events is considered under the control of the Group and AFK "Sistema".

Legal

In the ordinary course of business, the Group may be a party to various legal and tax proceedings, and be subject to claims. In the opinion of management, the Group's liability, if any, in all pending litigation, other legal proceeding or other matters, will not have a material effect on the financial condition, results of operations or liquidity of the Group.

Taxation

Laws and regulations affecting businesses in the Russian Federation continue to change rapidly. These changes are characterized by different interpretations and arbitrary application by the authorities. Management's interpretation of such legislation as applied to the activity of the Group may be challenged by the relevant regional and federal authorities. The tax authorities in the Russian Federation frequently take an 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 a result, significant additional taxes, penalties and interest may be assessed. Where uncertainty exists, the Group has accrued tax liabilities as management's best estimate of the probable outflow of resources which will be required to settle such liabilities. Management believes that it has adequately provided for tax liabilities based on its interpretations of tax legislation. However, the relevant authorities may have differing interpretations, and the effects could be significant.

Operating environment

Emerging markets such as Russia are subject to different risks than more developed markets, including economic, political and social, and legal and legislative risks. Laws and regulations affecting businesses in Russia continue to change rapidly, tax and regulatory frameworks are subject to varying interpretations. The future economic direction of Russia is heavily influenced by the fiscal and monetary policies adopted by the government, together with developments in the legal, regulatory, and political environment.

Because Russia produces and exports large volumes of oil and gas, its economy is particularly sensitive to the price of oil and gas on the world market. During 2014-2015 and the 1st quarter of 2016 the oil price decreased significantly, which led to substantial decrease of the Russian Ruble exchange rate.

Starting from 2014, sanctions have been imposed in several packages by the U.S. and the E.U. on certain Russian officials, businessmen and companies.

In addition in the first quarter of 2015 two international credit agencies downgraded Russia's long-term foreign currency sovereign rating to the speculative level with the negative outlook.

The above mentioned events have led to reduced access of the Russian businesses to international capital markets, increased inflation, economic recession and other negative economic consequences. The impact of further economic developments on future operations and financial position of the Group is at this stage difficult to determine.

18. EVENTS AFTER THE STATEMENT OF FINANCIAL POSITION DATE

On 3 November 2016 the Company's Board of Directors approved a recommendation to the general meeting of shareholders to distribute dividends in an amount of RUB 4.22 per one ordinary share. The total amount of dividends recommended for the distribution is RUB 3,119 million. The recommendation is subject to approval at the general meeting of shareholders which has not taken place by the date on which the interim condensed consolidated financial information was authorised for issue.

In October-November 2016, the Group opened additional and prolonged existing credit lines in total amount of RUB 10,350 million.

The Group has evaluated subsequent events through 23 November 2016, the date on which the interim condensed consolidated financial information was authorised for issue.

DETSKY MIR GROUP

Consolidated Financial Statements
For the Year Ended 31 December 2015
And Independent Auditor's Report

DETSKY MIR GROUP

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DETSKY MIR GROUP

STATEMENT OF MANAGEMENT'S RESPONSIBILITIES FOR THE PREPARATION AND APPROVAL OF THE CONSOLIDATED FINANCIAL STATEMENTS FOR THE YEAR ENDED 31 DECEMBER 2015

Management is responsible for the preparation of the consolidated financial statements that present fairly the financial position of OJSC Detsky Mir (the "Company") and its subsidiaries (the "Group") as of 31 December 2015, and the results of its operations, cash flows and changes in shareholders' equity for the year then ended, in compliance with International Financial Reporting Standards ("IFRS").

In preparing the consolidated financial statements, management is responsible for:

- Properly selecting and applying accounting policies;
- Presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information;
- Providing additional disclosures when compliance with the specific requirements in IFRSs are insufficient to enable users to understand the impact of particular transactions, other events and conditions on the Group's consolidated financial position and financial performance;
- Making an assessment of the Group's ability to continue as a going concern.

Management is also responsible for:

- Designing, implementing and maintaining an effective and sound system of internal controls, throughout the Group;
- Maintaining adequate accounting records that are sufficient to show and explain the Group's transactions and disclose with reasonable accuracy at any time the consolidated financial position of the Group, and which enable them to ensure that the consolidated financial statements of the Group comply with IFRS;
- Maintaining statutory accounting records in compliance with local legislation and accounting standards in respective jurisdictions in wich the Group operates;
- Taking such steps as are reasonably available to them to safeguard the assets of the Group; and
- Preventing and detecting fraud and other irregularities.

The consolidated financial statements of the Group for the year ended 31 December 2015 were approved by management on 29 February 2016:

On behalf of the Management:

V.S. Chirakhov,	**A.S. Garmanova,**
Chief Executive Officer	Chief Financial Officer
OJSC DETSKY MIR	OJSC DETSKY MIR

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of OJSC Detskiy Mir:

We have audited the accompanying consolidated financial statements of OJSC Detsky Mir and its subsidiaries (collectively the "Group"), which comprise the consolidated statement of financial position as at 31 December 2015 and the related consolidated statements of profit or loss and other comprehensive income, cash flows and changes in shareholders' equity for the year then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with the International Financial Reporting Standards and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2015 and its consolidated financial performance and consolidated cash flows for the years then ended in conformity with the International Financial Reporting Standards.

DELOITTE & TOUCHE

29 February 2016
Moscow, Russia

Andrew Sedov, Partner
(license No. 01-000487 dated 13 February 2012)

ZAO Deloitte & Touche CIS

Audited entity: OJSC Detsky Mir

State Registration Certificate No. 7701233499 issued by Interregional Inspectorate of the Russian Ministry of Taxes and Levies No. 29 for Moscow on 13.09.1999.

Location: 37 Vernadsky Prospekt, bldg 3, Moscow, 117415, Russia

Independent Auditor: ZAO "Deloitte & Touche CIS"

Certificate of state registration № 018.482, issued by the Moscow Registration Chamber on 30.10.1992.

Primary State Registration Number: 1027700425444

Certificate of registration in the Unified State Register № 77 004840299 of 13.11.2002, issued by Moscow Interdistrict Inspectorate of the Russian Ministry of Taxation № 39.

Certificate of membership in "NP "Audit Chamber of Russia" (auditors' SRO) of 20.05.2009 № 3026, ORNZ 10201017407.

DETSKY MIR GROUP

CONSOLIDATED STATEMENT OF PROFIT OR LOSS AND OTHER COMPREHENSIVE INCOME FOR THE YEAR ENDED 31 DECEMBER 2015
(in thousands of Russian Rubles, except per share data)

	Notes	2015	2014
REVENUE	7	60,544,273	45,446,079
COST OF SALES		(38,640,476)	(28,183,281)
GROSS PROFIT		**21,903,797**	**17,262,798**
Selling, general and administrative expenses	8	(17,724,932)	(14,262,267)
Gain on sale of a building, net	11	-	1,163,752
Share of profit of associate, net of income tax		8,829	12,749
Other operating expenses, net		(19,824)	(6,767)
OPERATING PROFIT		**4,167,870**	**4,170,265**
Finance income	9	723,147	55,788
Finance expenses	9	(2,052,721)	(917,725)
Impairment of goodwill	12	(362,581)	-
Foreign exchange loss		(922,112)	(581,784)
PROFIT BEFORE TAX		**1,553,603**	**2,726,544**
Income tax expense	10.1	(577,837)	(683,744)
PROFIT FOR THE YEAR		**975,766**	**2,042,800**
Other comprehensive income/(loss):			
Items that may be reclassified subsequently to profit or loss			
Effect of translation to presentation currency		62,330	(12,945)
TOTAL COMPREHENSIVE INCOME THE YEAR		**1,038,096**	**2,029,855**
Earnings per share			
Weighted average number of shares outstanding, basic and diluted: [1]		739,000,000	564,822,555
Earnings per share, basic and diluted (in Russian Rubles per share)[1]		1.32	3.62

The notes on pages 8 to 47 form an integral part of these consolidated financial statements.

[1] The earnings per share amounts and weighted average number of shares outstanding, basic and diluted, for all periods herein retroactively reflect the Company's 250,000-for-1 stock split, which was effective on 18 February 2014.

DETSKY MIR GROUP

CONSOLIDATED STATEMENT OF FINANCIAL POSITION
AS AT 31 DECEMBER 2015
(in thousands of Russian Rubles)

	Notes	At 31 December 2015	At 31 December 2014	1 January 2014
ASSETS				
NON-CURRENT ASSETS:				
Property, plant and equipment	11	6,791,214	3,098,010	2,240,359
Goodwill	12	-	362,581	362,581
Other intangible assets, net	13	1,299,628	646,271	244,800
Investments in associate		56,232	50,060	53,450
Long-term loans issued	14	5,806,809	5,239,900	-
Deferred tax assets	10.2	1,150,450	706,871	596,223
Other non-current assets	15	247,447	230,919	206,457
Total non-current assets		**15,351,780**	**10,334,612**	**3,703,870**
CURRENT ASSETS:				
Inventories	16	17,346,114	11,124,205	8,635,730
Trade receivables	17	2,709,894	1,330,875	1,456,915
Advances paid and other receivables	18	1,850,379	1,163,748	764,015
Short-term loans issued	14	-	1,220,000	-
Prepaid income tax		1,939	-	4,038
Cash and cash equivalents	19	1,933,782	1,670,035	859,902
Total current assets		**23,842,108**	**16,508,863**	**11,720,600**
TOTAL ASSETS		**39,193,888**	**26,843,475**	**15,424,470**
EQUITY AND LIABILITIES				
SHAREHOLDERS' EQUITY/(DIFICIT):				
Share capital	20	392	392	392
Additional paid-in capital		5,793,195	6,536,844	6,509,136
Treasury shares	20	-	-	(4,542,514)
Accumulated deficit		(5,448,440)	(3,877,979)	(4,064,967)
Foreign currency translation reserve		49,385	(12,945)	-
Total equity/(deficit)		**394,532**	**2,646,312**	**(2,097,953)**
NON-CURRENT LIABILITIES				
Long-term loans and borrowings	21	5,465,125	3,487,670	4,350,000
Deferred tax liabilities	10.2	63,093	34,994	88,644
Total non-current liabilities		**5,528,218**	**3,522,664**	**4,438,644**
CURRENT LIABILITIES				
Trade payables		16,717,972	10,993,231	9,167,930
Short-term loans and borrowings and current portion of long-term loans and borrowings	21	12,893,789	6,228,309	1,572,321
Advances received, other payables and accrued expenses	23	2,952,626	2,452,490	1,605,259
Deferred revenue	24	277,734	347,013	353,770
Current income tax liability		429,017	653,456	384,499
Total current liabilities		**33,271,138**	**20,674,499**	**13,083,779**
Total liabilities		**38,799,356**	**24,197,163**	**17,522,423**
TOTAL EQUITY AND LIABILITIES		**39,193,888**	**26,843,475**	**15,424,470**

The notes on pages 8 to 47 form an integral part of these consolidated financial statements.

DETSKY MIR GROUP

CONSOLIDATED STATEMENT OF CHANGES IN SHAREHOLDERS' EQUITY
FOR THE YEAR ENDED 31 DECEMBER 2015
(in thousands of Russian Rubles)

	Share capital	Additional paid-in capital	Treasury shares	Accumulated deficit	Foreign currency translation reserve	Total
Balance at 1 January 2014	**392**	**6,509,136**	**(4,542,514)**	**(4,064,967)**	**-**	**(2,097,953)**
Profit for the year	-	-	-	2,042,800	-	2,042,800
Effect of translation to presentational currency	-	-	-	-	(12,945)	(12,945)
TOTAL COMPREHENSIVE INCOME/(LOSS) FOR THE YEAR	**-**	**-**	**-**	**2,042,800**	**(12,945)**	**2,029,855**
Sale of treasury shares	-	177,091	196,052	-	-	373,143
Reorganisation (Note 1)		(149,383)	4,346,462	-	-	4,197,079
Dividends (Note 20)	-	-	-	(1,855,812)	-	(1,855,812)
Balance at 31 December 2014	**392**	**6,536,844**	**-**	**(3,877,979)**	**(12,945)**	**2,646,312**
Profit for the year	-	-	-	975,766	-	975,766
Effect of translation to presentational currency	-	-	-	-	62,330	62,330
TOTAL COMPREHENSIVE INCOME FOR THE YEAR	**-**	**-**	**-**	**975,766**	**62,330**	**1,038,096**
Share-based compensation (Note 22)	-	-	-	426,400	-	426,400
Disposal of a subsidiary to the shareholder (Note 1)	-	(743,649)	-	-	-	(743,649)
Dividends (Note 20)	-	-	-	(2,972,627)	-	(2,972,627)
Balance at 31 December 2015	**392**	**5,793,195**	**-**	**(5,448,440)**	**49,385**	**394,532**

The notes on pages 8 to 47 form an integral part of these consolidated financial statements.

DETSKY MIR GROUP

CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED 31 DECEMBER 2015
(in thousands of Russian Rubles)

	Notes	2015	2014
Operating activities:			
Profit for the year		975,766	2,042,800
Adjustments for:			
Income tax expense recognised in profit or loss		577,837	683,744
Share based compensation		684,130	373,134
Impairment of goodwill		362,581	-
Finance income		(723,147)	(55,788)
Finance expense		2,052,721	917,725
Gain/(loss) on disposal of property, plant and equipment and intangible assets		30,570	(1,192,695)
Bad debts written-off and change in allowance for doubtful debts		(26,291)	50,953
Shrinkage and inventory obsolesence expenses		888,153	455,444
Depreciation and amortization expense		954,055	739,693
Foreign exchange loss, net		922,112	581,784
Share of profit of associates, net of income tax		(8,829)	(12,749)
Movements in working capital:			
(Increase)/decrease in trade receivables		(1,364,590)	126,674
Increase in advances paid and other receivables		(788,883)	(414,123)
Increase in inventories		(7,110,062)	(2,943,211)
Increase in trade payables		4,865,996	1,371,583
Increase in advances received, other payables and accrued expenses		166,639	226,088
Decrease in deferred revenue		(69,279)	(6,739)
Cash generated by operations		**2,389,479**	**2,944,317**
Interest paid		(2,044,169)	(794,856)
Interest received		165,438	-
Income tax paid		(1,189,852)	(657,292)
Net cash (used in)/generated by operating activities		**(679,104)**	**1,492,169**
Investing activities:			
Dividends received from associate		2,657	17,324
Payments for property, plant and equipment		(4,588,662)	(1,576,836)
Proceeds from disposal of property, plant and equipment		20,378	1,440,520
Payments for intangible assets		(719,192)	(368,584)
Proceeds from loans repayment		98,212	-
Loans issued to related parties		(30,900)	(2,158,000)
Net cash used in investing activities		**(5,217,507)**	**(2,645,576)**
Financing activities:			
Cash transferred to shareholders in course of reorganization		-	(276)
Cash consideration received in the course of disposal of a subsidiary (Note 1)		169,740	-
Proceeds from borrowings		36,746,425	19,210,907
Repayment of borrowings		(27,783,180)	(15,391,279)
Dividends paid		(2,972,627)	(1,855,812)
Net cash generated by financing activities		**6,160,358**	**1,963,540**
NET INCREASE IN CASH AND CASH EQUIVALENTS		**263,747**	**810,133**
CASH AND CASH EQUIVALENTS, beginning of the year		**1,670,035**	**859,902**
CASH AND CASH EQUIVALENTS, end of the year		**1,933,782**	**1,670,035**

The notes on pages 8 to 47 form an integral part of these consolidated financial statements.

(in million of Russian Rubles)

1. GENERAL INFORMATION

OJSC Detsky Mir (the “Company”) together with its subsidiaries (the “Group”) is the largest retail chain in the children’s products market in the Russian Federation (“RF”). The Company is registered in the Unified State Register of Legal Entities under the laws of the Russian Federation (State Registration Certificate No. 1027700047100). In March 2014, the Company changed its legal name from OJSC Detsky Mir-Center to OJSC Detsky Mir.

The primary activity of the Group is the sale of children’s products through retail stores. In 2015 and as at 31 December 2015 the Group operated “Detsky Mir” branded stores in Russia and Kazakhstan and Early Learning Centre (hereinafter, the “ELC”) branded retail stores in Russia.

The controlling shareholder of the Company is JSFC Sistema (“Sistema”).

The registered shareholders of the Company and their effective ownership were as follows, as at the specified dates:

	31 December 2015	31 December 2014	1 January 2014
JSFC Sistema and subsidiaries	75.82%	98.92%	100%
Floette Holdings Limited	11.55%	-	-
Exarzo Holdings Limited	11.55%	-	-
Mr. Chirakhov V.S.	1.08%	1.08%	-
Total	100%	100%	100%

As at 31 December 2015, 2014 and 1 January 2014 the Group’s ultimate controlling party was Mr. Vladimir Evtushenkov.

The ownership interest of the Group and the proportion of its voting rights in its major operating subsidiaries was as follows, as at each period end:

	Ownership interest and proportion of voting rights		
Subsidiaries	**31 December 2015**	**31 December 2014**	**1 January 2014**
Detskaya Galereya “Yakimanka” LLC, RF*	-	-	100%
Detsky Mir Kazakhstan, LLP, Kazakhstan	100%	100%	100%
Kub-Market LLC, RF	100%	100%	100%
DM-Finance LLC, RF	-	-	100%
Spartema Limited, Cyprus	100%	100%	100%
Detsky Mir GMBH, Germany	100%	100%	100%

* – as noted below, as at 31 December 2014 the Group retained control over Detskaya Galereya "Yakimanka" LLC through an option arrangement, which was subsequently calnceled in November 2015.

As at 31 December 2015, 2014 and 1 January 2014 the Group does not have non-wholly owned subsidiaries that have material non-controlling interests to the Group.

Group reorganisation

On 12 August 2014 an extraordinary shareholders meeting approved the reorganisation of the Group through spin-off of a new subsidiary, CJSC DMF-Invest, and merging this subsidiary with CJSC DM-Finance, holder of treasury shares. The reorganisation was completed in December 2014 and control over these entities was transferred to the Company’s shareholders – JSFC Sistema and its subsidiaries. JSFC Sistema and its subsidiaries have retained control over the Group after the reorganisation.

(in million of Russian Rubles)

In the course of the reorganisation the Group also transferred its 100% interest in LLC Detskaya Galereya "Yakimanka" to CJSC DMF-Invest and, ultimately, to JSFC Sistema and its subsidiaries. However, the Group has retained control over the luxury retail business by entering into an option arrangement, which gives the Group a right to purchase 100% of LLC Detskaya Galereya "Yakimanka" for 100 Russian Rubles at any point in time until 1 January 2016.

The carrying amounts of assets and liabilities disposed by the Group through the reorganisation, and the impact of the reorganisation on the Group's equity are presented below:

	31 December 2014
Disposed assets and liabilities	
Current assets	
Cash and cash equivalents	276
Other current assets	1,560
Non-current assets	
Long-term loans receivable	938,000
Deferred tax assets	103,750
Current liabilities	
Other current liabilities (interest payable on loans and borrowings)	(696,754)
Non-current liabilities	
Long-term loans and borrowings	(4,543,911)
Total net assets disposed of	**(4,197,079)**
Treasury shares disposed of	**4,346,462**
Effect of reorganisation on the Group's additional paid-in capital	**149,383**

In November 2015, the above option arrangement was canceled by mutual agreement of the parties. Therefore, the Group lost control over LLC Detskaya Galereya "Yakimanka". At the same time, JSFC Sistema retained control over LLC Detskaya Galereya "Yakimanka". After the disposal date, LLC Detskaya Galereya "Yakimanka" repaid a loan previously received from the Company in the amount of RUB 169,740 thousand, which is presented within the line "Cash consideration received in the course of disposal of a subsidiary" of the consolidated statement of cash flows. The carrying amounts of assets and liabilities effectively transferred by the Group to its shareholders are presented below:

	5 November 2015
Disposed assets and liabilities	
Current assets	
Cash and cash equivalents	3,192
Short-term loans granted	1,143,688
Other current assets	115,060
Current liabilities	
Short-term borrowings	(320,178)
Trade payables	(1,035)
Other current liabilities (interest payable on loans and borrowings)	(27,338)
Total net assets disposed of	**(913,389)**
Consideration received	169,740
Effect on the Group's additional paid-in capital	**(743,649)**

2. BASIS OF PREPARATION

Previously, the Group has been preparing its consolidated financial statements in accordance with the accounting principles generally accepted in the United States of America ("US GAAP"). The previous financial statements issued in accordance with US GAAP was prepared for the six months ended 30 June 2015.

The current financial statements represent the first set of the Group's consolidated financial statements prepared under the International Financial Reporting Standards ("IFRS") which include standards and interpretations approved by the International Accounting Standards Board, including International Accounting Standards ("IAS") and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") which replaced the Standing Interpretations Committee. The Group applied IFRS 1 "*First time adoption of International Financial Reporting Standards*".

Note 6 discusses the impact of IFRS adoption on the Group's financial postion, results of operations and cash flows.

3. ADOPTION OF NEW AND REVISED STANDARDS AND INTERPRETATIONS

New and revised IFRSs in issue but not yet effective

The Group has not applied the following new and revised IFRSs that have been issued but are not yet effective:

- IFRS 9 *Financial Instruments* [2];
- IFRS 15 *Revenue from Contracts with Customers* [2];
- IFRS 16 *Leases* [3];
- Amendments to IFRS 11 – *Accounting for Acquisition of Interests in Joint Operations* [1];
- Amendments to IAS 1 – *Disclosure Initiative* [1];
- Amendments to IAS 16 and IAS 38 – *Clarification of Acceptable Methods of Depreciation and Amortisation* [1];
- Amendments to IAS 16 and IAS 41 – *Agriculture: Bearer Plants* [1];
- Amendments to IFRS 10 and IAS 28 – *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture* [1];
- Amendments to IFRS 10, IFRS 12 and IAS 28 – *Investment Entities: Applying the Consolidation Exception* [1];
- IFRS 14 *Regulatory Deferral Accounts* [1];
- Amendments to IAS 27 – *Equity Method in Separate Financial Statements* [1];
- Annual Improvements to IFRSs 2012-2014 Cycle [1];

[1] Effective for annual periods beginning on or after 1 January 2016, with early application permitted.
[2] Effective for annual periods beginning on or after 1 January 2018, with early application permitted.
[3] Effective for annual periods beginning on or after 1 January 2019, with early application permitted.

IFRS 9 *Financial Instruments*

IFRS 9 issued in November 2009 introduced new requirements for the classification and measurement of financial assets. IFRS 9 was subsequently amended in October 2010 to include requirements for the classification and measurement of financial liabilities and for derecognition, and in November 2013 to include the new requirements for general hedge accounting. Another revised version of IFRS 9 was issued in July 2014 mainly to include a) impairment requirements for financial assets and b) limited amendments to the classification and measurement requirements by introducing a 'fair value through other comprehensive income' (FVTOCI) measurement category for certain simple debt instruments.

The key requirements of IFRS 9 are:

- **Classification and measurement of financial assets**. All recognised financial assets that are within the scope of IAS 39 *Financial Instruments: Recognition and Measurement* are required to be subsequently measured at amortised cost or fair value. Specifically, debt investments that are held within a business model whose objective is to collect the contractual cash flows, and that have contractual cash flows that are solely payments of principal and interest on the principal outstanding are generally measured at amortised cost at the end of subsequent accounting periods. Debt instruments that are held within a business model whose objective is achieved both by collecting contractual cash flows and selling financial assets, and that have contractual terms that give rise on specified dates to cash flows that are solely payments of principal and interest on the principal amount outstanding, are generally measured at FVTOCI. All other debt investments and equity investments are measured at their fair value at the end of subsequent accounting periods. In addition, under IFRS 9, entities may make an irrevocable election to present subsequent changes in the fair value of an equity investment (that is not held for trading) in other comprehensive income, with only dividend income generally recognised in profit or loss.
- **Classification and measurement of financial liabilities.** With regard to the measurement of financial liabilities designated as at fair value through profit or loss, IFRS 9 requires that the amount of change in the fair value of the financial liability that is attributable to changes in the credit risk of that liability is presented in other comprehensive income, unless the recognition of the effects of changes in the liability's credit risk in other comprehensive income would create or enlarge an accounting mismatch in profit or loss. Changes in fair value attributable to a financial liability's credit risk are not subsequently reclassified to profit or loss. Under IAS 39, the entire amount of the change in the fair value of the financial liability designated as fair value through profit or loss is presented in profit or loss.
- **Impairment.** In relation to the impairment of financial assets, IFRS 9 requires an expected credit loss model, as opposed to an incurred credit loss model under IAS 39. The expected credit loss model requires an entity to account for expected credit losses and changes in those expected credit losses at each reporting date to reflect changes in credit risk since initial recognition. In other words, it is no longer necessary for a credit event to have occurred before credit losses are recognised.
- **Hedge accounting.** The new general hedge accounting requirements retain the three types of hedge accounting mechanisms currently available in IAS 39. Under IFRS 9, greater flexibility has been introduced to the types of transactions eligible for hedge accounting, specifically broadening the types of instruments that qualify for hedging instruments and the types of risk components of non-financial items that are eligible for hedge accounting. In addition, the effectiveness test has been overhauled and replaced with the principle of an 'economic relationship'. Retrospective assessment of hedge effectiveness is also no longer required. Enhanced disclosure requirements about an entity's risk management activities have also been introduced.

The standard is effective from 1 January 2018 with early application permitted. Depending on the chosen approach to applying IFRS 9, the transition can involve one or more than one date of initial application for different requirements.

The management of the Group anticipates that the application of IFRS 9 in the future may have a significant impact on amounts reported in respect of the Group's financial assets and financial liabilities. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 9 until a detailed review has been completed.

IFRS 15 *Revenue from Contracts with Customers*

IFRS 15 establishes a single comprehensive model for entities to use in accounting for revenue arising from contracts with customers. IFRS 15 will supersede the current revenue recognition guidance including IAS 18 *Revenue*, IAS 11 *Construction Contracts* and the related interpretations when it becomes effective.

The core principle of IFRS 15 is that an entity should recognise revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods and services. Specifically, the standard provides a single, principles based five-step model to be applied to all contracts with customers.

The five steps in the model are as follows:

- Identify the contract with the customer;
- Identify the performance obligations in the contract;
- Determine the transaction price;
- Allocate the transaction price to the performance obligations in the contracts;
- Recognise revenue when (or as) the entity satisfies a performance obligation.

Under IFRS 15, an entity recognises revenue when or as a performance obligation is satisfied, i.e. when 'control' of the goods or services underlying the particular performance obligation is transferred to the customer. Far more prescriptive guidance has been added in IFRS 15 to deal with specific scenarios. Furthermore, extensive disclosures are required by IFRS 15.

The management of the Group anticipates that the application of IFRS 15 in the future may have a significant impact on amount and timing of revenue recognition. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 15 until a detailed review has been completed.

IFRS 16 *Leases*

IFRS 16 *Leases* brings most leases on-balance sheet for lessees under a single model, eliminating the distinction between operating and finance leases. Lessor accounting however remains largely unchanged and the distinction between operating and finance leases is retained.

Under IFRS 16 a lessee recognises a right-of-use asset and the lease liability. The right-of-use asset is treated similarly to other non-financial assets and depreciated accordingly and the liability accrues interest. The lease liability is initially measured at the present value of the lease payments payable over the lease term, discounted at the rate implicit in the lease, or if that cannot be readily determined, the lessee shall use their incremental borrowing rate.

As with IAS 17, lessors classify leases as operating of finance in nature. A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership of an underlying asset. Otherwise, a lease is classified as an operating lease. For finance leases a lessor recognises finance income over the lease term, based on a pattern reflecting a constant periodic rate of return on the net investment. A lessor recognises operating lease payments as income on a straight-line basis or, if more representative of the pattern in which benefit from use of the underlying asset is diminished, another systematic basis.

The management of the Group anticipates that the application of IFRS 16 in the future may have a significant impact on the amount of assets and liabilities due to recognition of all leases for contracts where the Group is a lessee. However, it is not practicable to provide a reasonable estimate of the effect of IFRS 16 until a detailed review has been completed.

Amendments to IAS 1 *Disclosure Initiative*

The amendments to IAS 1 provide guidance on how to apply the concept of materiality in practice. The amendments are effective for annual periods beginning on or after 1 January 2016. The management of the Group does not anticipate that the application of these amendments will have a significant impact on the Group's consolidated financial statements.

Amendments to IAS 16 and IAS 38 – *Clarification of Acceptable Methods of Depreciation and Amortisation*

The amendments to IAS 16 prohibit entities from using a revenue-based depreciation method for items of property, plant and equipment. The amendments to IAS 38 introduce a rebuttable presumption that revenue is not an appropriate basis for amortization of an intangible asset. This presumption can only be rebutted when the intangible asset is expressed as a measure of revenue, or when it can be demonstrated that revenue and consumption of the economic benefits of the intangible asset are highly correlated.

The amendments apply prospectively for annual periods beginning on or after 1 January 2016. Currently, the Group uses straight-line method for depreciation and amortization of its property, plant and equipment and intangible assets, respectively. The management of the Group believes that the straight-line method is the most appropriate method to reflect the consumption of economic benefits inherent in the respective assets and accordingly does not anticipate that the application of these amendments will have a material impact on the Group's consolidated financial statements.

Amendments to IFRS 10 and IAS 28 – *Sale or Contribution of Assets between an Investor and its Associate or Joint Venture*

The amendments to IFRS 10 and IAS 28 deal with situations where there is a sale or contribution of assets between an investor and its associate or joint venture. Specifically, the amendments state that gains or losses resulting from the loss of control of a subsidiary that does not contain a business in a transaction with an associate or a joint venture that is accounted for using the equity method, are recognised in the parent's profit or loss only to the extent of the unrelated investors' interests in that associate or joint venture. Similarly, gains and losses resulting from the remeasurement of investments retained in any former subsidiary (that has become an associate or a joint venture that is accounted for using the equity method) to fair value are recognised in the former parent's profit or loss only to the extent of the unrelated investors' interests in the new associate or joint venture.

The amendments apply prospectively to transactions occurring in annual periods beginning on or after 1 January 2016. The management of the Group anticipate that the application of these amendments to IFRS 10 and IAS 28 may have an impact on the Group's consolidated financial statements in future periods should such transactions arise.

Amendments to IFRS 10, IFRS 12 and IAS 28 *Investment Entities: Applying the Consolidation Exception*

The amendments to IFRS 10, IFRS 12 and IAS 28 clarify that the exemption from preparing consolidated financial statements is available to a parent entity that is a subsidiary of an investment entity, even if the investment entity measures all its subsidiaries at fair value in accordance with IFRS 10. The amendments also clarify that the requirement for an investment entity to consolidate a subsidiary providing services related to the former's investment activities applies only to subsidiaries that are not investment entities themselves.

The management of the Group does not anticipate that the application of these amendments to IFRS 10, IFRS 12 and IAS 28 will have a material impact on the Group's consolidated financial statements as the Group is not an investment entity and does not have any holding company, subsidiary, associate or joint venture that qualifies as an investment entity.

Amendments to IAS 27 – *Equity Method in Separate Financial Statements*

The amendments to IAS 27 allows entities to apply the equity method as one of the option for accounting for its investments in subsidiaries, joint ventures and associates in its separate financial statements. The amendments are effective from 1 January 2016 with earlier application permitted. The management of the Group does not anticipate that the application of these amendments will have a significant impact on the Group's consolidated financial statements.

Annual Improvements to IFRSs 2012-2014 Cycle

The Annual Improvements to IFRSs 2012-2014 Cycle include the following amendments to various IFRSs.

The amendments to IFRS 5 introduce specific guidance in IFRS 5 for when an entity reclassifies an asset (or disposal group) from held for sale to held for distribution to owners (or vice versa). The amendments clarify that such a change should be considered as a continuation of the original plan of disposal and hence requirements set out in IFRS 5 regarding the change of sale plan do not apply. The amendments also clarifies the guidance for when held-for-distribution accounting is discontinued.

The amendments to IFRS 7 provide additional guidance to clarify whether a servicing contract is continuing involvement in a transferred asset for the purpose of the disclosures required in relation to transferred assets.

The amendments to IAS 19 clarify that the rate used to discount post-employment benefit obligations should be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. The assessment of the depth of a market for high qualify corporate bonds should be at the currency level (i.e. the same currency as the benefits are to be paid). For currencies for which there is no deep market in such high quality corporate bonds, the market yields at the end of the reporting period on government bonds denominated in that currency should be used instead.

The amendments to IAS 34 clarify that information required by IAS 34 that is provided elsewhere within the interim financial report but outside the interim financial statements should be incorporated by way of a cross-reference from the interim financial statements to the other part of the interim financial report that is available to users on the same terms and at the same time as the interim financial statements.

The management of the Group does not anticipate that the application of these amendments will have a significant impact on the Group's consolidated financial statements.

4. SIGNIFICANT ACCOUNTING POLICIES

The Group's entities maintain their accounting records in compliance with the local legislation on accounting and reporting adopted in jurisdictions of the countries in which they were founded and registered. The accounting principles and reporting procedures in these jurisdictions may differ from generally accepted IFRS principles. Accordingly, financial statements of individual entities of the Group have been adjusted to ensure that the consolidated financial statements are presented in accordance with IFRS.

These consolidated financial statements of the Group have been prepared on the historical cost basis except for certain assets and financial instruments that are measured at fair values or revalued amounts, as explained in the accounting policies below. Historical cost is usually based on the fair value of the consideration paid for purchased assets.

The accounting principles set out below have been applied in the preparation of these consolidated financial statements for the year ended 31 December 2015 as well as comparative information presented in these financial statements.

Going concern principle

These consolidated financial statements have been prepared on the management's assumption that the Group will continue as a going concern in the foreseeable future, which implies the realization of assets and settlement of liabilities in the normal course of business.

Presentation currency and functional currency

Management has determined that the functional currency of the Company and its Russian subsidiaries is the Russian Ruble ("RUB"). The functional currencies of the Company's German and Kazakhstan subsidiaries are the Euro and Tenge, respectively.

These consolidated financial statements are presented in thousands of Russian Rubles. The management believes that the Russian Ruble is the most convenient presentation currency for users of these consolidated financial statements.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and entities controlled by the Company. Control is achieved when the Company:

- Has power over an entity;
- Is exposed, or has rights, to variable returns of the investee; and
- Has the ability to use its power to affect variable returns.

The Company reassesses whether or not it controls an investee if facts and circumstances indicate that there are changes to one or more of the three elements of control listed above.

The Company controls an entity without the majority of voting rights if existing voting rights give the possibility to direct the relevant activities of the entity unilaterally. The Company considers all relevant facts and circumstances in assessing whether or not the Company's voting rights are sufficient for control, including:

- The size of the Company's holding of voting rights relative to the size and dispersion of holdings of the other vote holders;
- Potential voting rights held by the Company, other vote holders or other parties;
- Rights under the agreements; any additional facts and circumstances that indicate whether the Company has the ability to direct the significant activities at the time that decisions need to be made, including voting patterns at previous shareholder's meetings.

Consolidation of subsidiaries begins since the acquisition and ends with the loss of the control.

The financial results of subsidiaries acquired or disposed of during the year are included in the consolidated statement of profit or loss and other comprehensive income from the effective date of acquisition and up to the effective date of disposal, as appropriate. Total comprehensive income of subsidiaries is attributed to the shareholders of the Company and to the non-controlling interests even if this results in the non-controlling interests having a deficit balance.

When necessary, adjustments are made to the financial statements of subsidiaries to bring their accounting policies into line with those used by other members of the Group. All intra-group transactions, income and expenses are eliminated on consolidation.

Changes in the Group's ownership interests in subsidiaries that do not result in the Group losing control over the subsidiaries are accounted for as equity transactions. The carrying amounts of the Group's interests and the non-controlling interests are adjusted to reflect the changes in their relative interests in the subsidiaries. Any difference between the amount by which the non-controlling interests are adjusted and the fair value of the consideration paid or received is recognized directly in equity and attributed to shareholders of the Group.

When the Group loses control of a subsidiary, the profit or loss on disposal is calculated as the difference between (i) the aggregate of the fair value of the consideration received and the fair value of any retained interest and (ii) the previous carrying amount of the assets, and liabilities of the subsidiary and any non-controlling interests.

Segment information

Reportable segments are determined based on the financial information which is available and utilized on a regular basis by the Company's chief operating decision maker to assess financial performance and to allocate resources. The Group has two operating segments pursuant to the IFRS 8 Segment Reporting, being retail and online sales; however online sales are below the quantitative thresholds, for being separately reportable segments and as such are aggregated with the retail segment. The disclosures presented herein therefore, constitute the Group's entity wide disclosures.

The Group mainly operates in the Russian Federation, with insignificant sales in Kazakhstan that are not disaggregated to separate reportable segment. The Group believes that disaggregating its geographic operating segments would not provide material or meaningful additional information.

Customer base of the Group is diversified; therefore transactions with a single external customer do not exceed 10% of the Group's revenue.

Business combinations

Acquisitions of businesses are accounted for using the acquisition method. The consideration transferred in a business combination is measured at fair value which is calculated as the sum of the acquisition-date fair values of the assets transferred by the Group, liabilities incurred by the Group to the former owners of the acquiree and the equity interests issued by the Group in exchange for control of the acquiree. Acquisition-related costs are recognised in profit or loss as incurred.

At the acquisition date, the identifiable assets acquired and the liabilities assumed are recognised at their fair value, except that:

- Deferred tax assets and liabilities are recognized and measured in accordance with IAS 12 "Income Taxes";
- Assets (or disposal groups) that are classified as held for sale in accordance with IFRS 5 "Non-current Assets Held for Sale and Discontinued Operations" are measured in accordance with that Standard.

Non-controlling interests that present ownership interests and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation may be initially measured either at fair value or at proportionate share of the recognized amounts of the acquiree's identifiable net assets. The choice of measurement basis is made on a transaction-by-transaction basis.

Additional interests in subsidiaries acquired from non-controlling interests are accounted for as transactions between shareholders. Differences in the Group's interests in the net fair value of the identifiable assets, liabilities and contingent liabilities acquired from the Group's non-controlling interests and the amount of consideration are recognized directly in retained earnings. Profit and losses, arising from the disposal of non-controlling interests in the subsidiaries of the Group are recognized in the consolidated statement of profit or loss and other comprehensive income.

When the consideration transferred by the Group in a business combination includes assets or liabilities resulting from a contingent consideration arrangement, the contingent consideration is measured at its acquisition-date fair value and included as part of the consideration transferred in a business combination. Subsequent changes in the fair value of the contingent consideration are adjusted against the cost of the acquisition when they qualify as measurement period adjustments with corresponding adjustments against goodwill. Measurement period adjustments are adjustments that arise from additional information obtained during the "measurement period" (which cannot exceed one year from the acquisition date) about facts and circumstances that existed at the acquisition date. Contingent consideration that is classified as equity is not remeasured at subsequent reporting dates and its subsequent settlement is accounted for within equity. Contingent consideration that is classified as an asset or a liability is remeasured at subsequent reporting dates in accordance with IAS 39 "Financial Instruments: Recognition and Measurement", or IAS 37 "Provisions, Contingent Liabilities and Contingent Assets", as appropriate, with the corresponding gain or loss being recognized in profit or loss.

When a business combination is achieved in stages, the Group's previously held equity interest in the acquiree is remeasured to fair value at the acquisition date (i.e. the date when the Group obtains control) and the resulting gain or loss, if any, is recognized in profit or loss. Amounts arising from interests in the acquiree prior to the acquisition date that have previously been recognized in other comprehensive income are reclassified to profit or loss where such treatment would be appropriate if that interest was disposed of.

If the initial accounting for a business combination is incomplete by the end of the reporting period in which the combination occurs, the Group reports provisional amounts for the items for which the accounting is incomplete. Those provisional amounts are adjusted during the measurement period, or additional assets or liabilities are recognized, to reflect new information obtained about facts and circumstances that existed at the acquisition date that, if known, would have affected the amounts recognized at that date.

Goodwill

Goodwill arising on an acquisition of a business is carried at cost as established at the date of acquisition of the business less accumulated impairment losses, if any.

For the purposes of impairment testing, goodwill is allocated to each of the Group's cash-generating units (or groups of cash-generating units) that is expected to benefit from the synergies of the combination.

A cash-generating unit to which goodwill has been allocated is tested for impairment annually, or more frequently when there is an indication that the unit may be impaired. If the recoverable amount of the cash-generating unit is less than its carrying amount, the impairment loss is allocated first to reduce the carrying amount of any goodwill allocated to the unit and then to the other assets of the unit pro rata based on the carrying amount of each asset in the unit. Any impairment loss for goodwill is recognized directly in profit or loss. An impairment loss recognized for goodwill is not reversed in subsequent periods.

On disposal of the relevant cash-generating unit, the attributable amount of goodwill is included in the determination of the profit or loss on disposal.

Investments in associates and joint ventures

An associate is an entity over which the Group has significant influence. Significant influence is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

A joint venture is a joint arrangement whereby the parties that have joint control of the arrangement have rights to the net assets of the joint arrangement. Joint control is the contractually agreed sharing of control of an arrangement, which exists only when decisions about the relevant activities require unanimous consent of the parties sharing control.

The results and assets and liabilities of associates or joint ventures are incorporated in these consolidated financial statements using the equity method of accounting, except when the investment, or a portion thereof, is classified as held for sale, in which case it is accounted for in accordance with IFRS 5. Under the equity method, an investment in an associate or a joint venture is initially recognised in the consolidated statement of financial position at cost and adjusted thereafter to recognise the Group's share of the profit or loss and other comprehensive income of the associate or joint venture. When the Group's share of losses of an associate or a joint venture exceeds the Group's interest in that associate or joint venture (which includes any long-term interests that, in substance, form part of the Group's net investment in the associate or joint venture), the Group discontinues recognising its share of further losses. Additional losses are recognised only to the extent that the Group has incurred legal or constructive obligations or made payments on behalf of the associate or joint venture.

An investment in an associate or a joint venture is accounted for using the equity method from the date on which the investee becomes an associate or a joint venture. On acquisition of the investment in an associate or a joint venture, any excess of the cost of the investment over the Group's share of the net fair value of the identifiable assets and liabilities of the investee is recognised as goodwill, which is included within the carrying amount of the investment. Any excess of the Group's share of the net fair value of the identifiable assets and liabilities over the cost of the investment, after reassessment, is recognised immediately in profit or loss in the period in which the investment is acquired.

When a group entity transacts with an associate or a joint venture of the Group, profits and losses resulting from the transactions with the associate or joint venture are recognised in the Group's consolidated financial statements only to the extent of interests in the associate or joint venture that are not related to the Group.

Group's investment in associate OJSC Detsky Mir – Orel is included within the "Investments in associate" line of the consolidated statement of financial position.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable. Revenue is reduced for estimated customer returns, rebates and other similar allowances.

Revenue from the sale of goods is recognized when the goods are delivered and titles have passed, at which time all the following conditions are satisfied:

- The Group has transferred to the buyer the significant risks and rewards of ownership of the goods;
- The Group retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;
- The amount of revenue can be measured reliably;
- It is probable that the economic benefits associated with the transaction will flow to the Group; and
- The costs incurred or to be incurred in respect of the transaction can be measured reliably.

The Group reconizes retail revenues when goods are sold in retail stores.

For online sales the Group recognizes revenue upon delivery of the products to customers.

The Group sells gift cards to its customers in its retail stores. The gift cards have an expiration date and are required to be used during specified periods of time. The Group recognizes income from gift cards either when the gift card is redeemed by the customer or when the gift card expires.

Bonuses and allowances received from suppliers

The Group receives bonuses and allowances that are related to formal agreements negotiated with its suppliers. These bonuses and allowances are predominantly for cooperative advertising, promotions, and volume related discounts. The Group accounts for supplier bonuses and allowances as a reduction in cost of inventories unless these represent a reimbursement of specific, incremental, identifiable costs incurred by the Group in selling the suppliers' products. Supplier allowances provided as a reimbursement of specific incremental and identifiable costs incurred to promote a supplier's product are included as a reduction in the respective expenses when the cost is incurred.

Customer Loyalty Program

The Group has a customer loyalty program «Yo-Yo» which allows customers to earn points for each purchase made in any of the Group's retail stores. Points earned enable customers to receive a cash discount on future purchases, provided the purchase is made within one year of earning the points. Proceeds from sales to members of the loyalty programs are allocated between the loyalty points and the other components of the sale. The consideration allocated to the loyalty points is measured by reference to their fair value, i.e. the amount for which the loyalty points could be sold separately. This amount is deferred and recognized as revenue when the points are redeemed. Expected breakage is recognized as revenue at the time of initial sale as it is excluded from the amount allocated to loyalty points. Other administrative costs of the Customer Loyalty Program are recorded in Selling, general and administrative expenses as incurred.

Finance income

Interest income from a financial asset is recognized when it is probable that the economic benefits will flow to the Group and the amount of income can be measured reliably. Interest income is accrued on a time basis, by reference to the principal outstanding and at the effective interest rate applicable, which is the rate that exactly discounts estimated future cash receipts through the expected life of the financial asset to that asset's net carrying amount on initial recognition.

Foreign currency transactions

In preparing the financial statements of each individual group entity, transactions in currencies other than the entity's functional currency (foreign currencies) are recognized at the rates of exchange prevailing at the dates of the transactions. At the end of each reporting period, monetary items denominated in foreign currencies are retranslated at the rates prevailing at that date. Non-monetary items carried at fair value that are denominated in foreign currencies are retranslated at the rates prevailing at the date when the fair value was determined. Non-monetary items that are measured in terms of historical cost in a foreign currency are not retranslated.

Exchange differences on monetary items are recognized in profit or loss in the period in which they arise except for:

- Exchange differences on monetary items receivable from or payable to a foreign operation for which settlement is neither planned nor likely to occur (therefore forming part of the net investment in the foreign operation), which are recognized initially in other comprehensive income and reclassified from equity to profit or loss on repayment of the monetary items.

For the purposes of presenting these consolidated financial statements, the assets and liabilities of the Group's foreign operations are translated into RUB using exchange rates prevailing at the end of each reporting period. Income and expense items are translated at the average exchange rates for the period, unless exchange rates fluctuate significantly during that period, in which case the exchange rates at the dates of the transactions are used. Exchange differences arising, if any, are recognized in other comprehensive income and accumulated in equity (and attributed to non-controlling interests as appropriate).

On the disposal of a foreign operation (i.e. a disposal of the Group's entire interest in a foreign operation, or a disposal involving loss of control over a subsidiary that includes a foreign operation or a disposal involving loss of significant influence over an associate that includes a foreign operation), all of the exchange differences accumulated in equity in respect of that operation attributable to the Company's shareholders are reclassified to profit or loss.

Goodwill and fair value adjustments to identifiable assets acquired and liabilities assumed through acquisition of a foreign operation are treated as assets and liabilities of the foreign operation and translated at the rate of exchange prevailing at the end of each reporting period. Exchange differences arising are recognized in equity.

(in million of Russian Rubles)

Exchange rates for the currencies in which the Group transacts are presented below:

	At 31 December 2015	At 31 December 2014	At 1 January 2014
Closing exchange rates at the year end – RUB			
1 EUR	79.6972	68.3427	44.9699
1 Tenge	0.2152	0.3083	0.2131
1 USD	72.8827	56.2584	32.7292

	2015	2014
Average exchange rates for the year ended – RUB		
1 EUR	67.7767	50.8150
1 Tenge	0.2833	0.2146
1 USD	60.9579	38.4217

Borrowing costs

Borrowing costs directly attributable to the acquisition, construction of qualifying assets, which are assets that necessarily take a substantial period of time to get ready for their intended use or sale, are added to the cost of those assets, until such time as the assets are substantially ready for their intended use or sale.

Investment income earned on the temporary investment of specific borrowings pending their expenditure on qualifying assets is deducted from the borrowing costs eligible for capitalisation.

All other borrowing costs are recognized in profit or loss in the period in which they are incurred.

Income tax

Income tax expense represents the sum of the tax currently payable and deferred tax.

Current income tax

The tax currently payable is based on taxable profit for the year. Taxable profit differs from 'profit before tax' as reported in the consolidated statement of profit or loss and other comprehensive income because of items of income or expense that are taxable or deductible in other years and items that are never taxable or deductible. The Group's current tax is calculated using tax rates that have been enacted or substantively enacted by the end of the reporting period.

Deferred tax

Deferred tax is recognized on temporary differences between the carrying amounts of assets and liabilities in the consolidated financial statements and the corresponding tax bases used in the computation of taxable profit. Deferred tax liabilities are generally recognized for all taxable temporary differences. Deferred tax assets are generally recognized for all deductible temporary differences to the extent that it is probable that taxable profits will be available against which those deductible temporary differences can be utilised. Such deferred tax assets and liabilities are not recognized if the temporary difference arises from the initial recognition (other than in a business combination) of assets and liabilities in a transaction that affects neither the taxable profit nor the accounting profit. In addition, deferred tax liabilities are not recognized if the temporary difference arises from the initial recognition of goodwill.

Deferred tax liabilities are recognized for taxable temporary differences associated with investments in subsidiaries and associates, and interests in joint ventures, except where the Group is able to control the reversal of the temporary difference and it is probable that the temporary difference will not reverse in the foreseeable future. Deferred tax assets arising from deductible temporary differences associated with such investments and interests are only recognized to the extent that it is probable that there will be sufficient taxable profits against which to utilise the benefits of the temporary differences and they are expected to reverse in the foreseeable future.

The carrying amount of deferred tax assets is reviewed at the end of each reporting period and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax liabilities and assets are measured at the tax rates that are expected to apply in the period in which the liability is settled or the asset realised, based on tax rates (and tax laws) that have been enacted or substantively enacted by the end of the reporting period. The measurement of deferred tax liabilities and assets reflects the tax consequences that would follow from the manner in which the Group expects, at the end of the reporting period, to recover or settle the carrying amount of its assets and liabilities.

Current and deferred tax for the year

Current and deferred tax are recognized in profit or loss, except when they relate to items that are recognized in other comprehensive income or directly in equity, in which case, the current and deferred tax are also recognized in other comprehensive income or directly in equity respectively. Where current tax or deferred tax arises from the initial accounting for a business combination, the tax effect is included in the accounting for the business combination.

Property, plant and equipment

Buildings, leasehold improvements and equipment are stated in the consolidated statement of financial position at their cost that includes all costs directly attributable to bringing the asset to working condition for its intended use. Major expenditures for improvements and replacements which extend the useful lives of the assets or increase their values or revenue generating capacity are capitalized. Repairs and maintenance are charged to the consolidated statements of proft or loss and other comprehensive oncome as incurred.

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

Buildings	20-40 years
Leasehold improvements	5-10 years
Trade equipment	5-7 years
Office equipment and other property, plant and equipment	3-5 years

Leasehold improvements are depreciated on a straight-line basis over the shorter of their useful life or lease term. The lease term includes renewals when the Group has a right to renew and it is highly probable that the Group will exercise its right.

Construction in-progress and equipment for installation are not depreciated until the asset is placed into service. Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the consolidated balance sheet along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is recognized within profits and losses for the period.

Leases

The Group has not entered in any finance leases, although enters into operating leases in the normal course of business, particularly relating to rental of retail store premises.

Operating lease payments are recognized as an expense on a straight line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are activated.

Intangible assets acquired separately

Intangible assets with finite useful lives that are acquired separately are carried at cost less accumulated amortisation and accumulated impairment losses. Amortisation is recognized on a straight-line basis over their estimated useful lives. The estimated useful life and amortisation method are reviewed at the end of each reporting period, with the effect of any changes in estimate being accounted for on a prospective basis. Intangible assets with indefinite usefulives that are acquired separately are carried at cost less accumulated impairment losses.

Amortization is recognized on a straight-line basis over their estimated useful lives, presented below.

Purchased software	2-10 years
Other	2-10 years

Intangible assets acquired in a business combination and recognized separately from goodwill are initially recognized at their fair value at the acquisition date (which is regarded as their cost).

Subsequent to initial recognition, intangible assets acquired in a business combination are reported at cost less accumulated amortization and accumulated impairment losses, on the same basis as intangible assets that are acquired separately.

Derecognition of intangible assets

An intangible asset is derecognized on disposal, or when no future economic benefits are expected from use or disposal. Gains or losses arising from derecognition of an intangible asset, measured as the difference between the net disposal proceeds and the carrying amount of the asset, are recognized in profit or loss when the asset is derecognized.

Impairment of tangible and intangible assets other than goodwill

At the end of each reporting period, the Group reviews the carrying amounts of its tangible and intangible assets to determine whether there is any indication that those assets have suffered an impairment loss. If any such indication exists, the recoverable amount of the asset is estimated in order to determine the extent of the impairment loss (if any). When it is not possible to estimate the recoverable amount of an individual asset, the Group estimates the recoverable amount of the cash-generating unit to which the asset belongs. When a reasonable and consistent basis of allocation can be identified, corporate assets are also allocated to individual cash-generating units, or otherwise they are allocated to the smallest group of cash-generating units for which a reasonable and consistent allocation basis can be identified.

Intangible assets with indefinite useful lives and intangible assets not yet available for use are tested for impairment at least annually, and whenever there is an indication that the asset may be impaired.

Recoverable amount is the higher of fair value less costs to sell and value in use. In assessing value in use, the estimated future cash flows are discounted to their present value using a pre-tax discount rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the estimates of future cash flows have not been adjusted.

If the recoverable amount of an asset (or cash-generating unit) is estimated to be less than its carrying amount, the carrying amount of the asset (or cash-generating unit) is reduced to its recoverable amount. Impairment losses are recognized in profit or loss.

When an impairment loss subsequently reverses, the carrying amount of the asset (or a cash-generating unit) is increased to the revised estimate of its recoverable amount, but so that the increased carrying amount does not exceed the carrying amount that would have been determined had no impairment loss been recognized for the asset (or cash-generating unit) in prior years. Recovery of impairment losses is immediately recognized in profit or loss.

Inventories

Inventories are stated at the lower of cost and net realizable value. The cost of inventories is determined on the average cost basis and includes expenditure incurred in acquiring the inventories, conversion costs and other costs incurred in bringing them to their existing location (retail shops and distribution warehouses) and condition. Supplier allowances that do not represent reimbursement of specific, incremental and identifiable costs incurred to promote a supplier's products are also included in cost of inventories (as a reduction of it). Net realizable value is the estimated selling price in the ordinary course of business, less the cost of completion and selling expenses.

At the end of each reporting period, the Group provides for estimated shrinkage, obsolete and slow-moving inventory.

Financial instruments

Financial assets and financial liabilities are recognized when a Group entity becomes a party to the contractual provisions of the instrument.

Financial assets and financial liabilities are initially measured at fair value. Transaction costs that are directly attributable to the acquisition or issue of financial assets and financial liabilities (other than financial assets and financial liabilities at fair value through profit or loss) are added to or deducted from the fair value of the financial assets or financial liabilities, as appropriate, on initial recognition. Transaction costs directly attributable to the acquisition of financial assets or financial liabilities at fair value through profit or loss are recognized immediately in profit or loss.

Effective interest method

The effective interest method is a method of calculating the amortized cost of a financial instrument and of allocating interest income or expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash receipts or payments (including all fees and amounts paid or received that form an integral part of the effective interest rate, transaction costs and other premiums or discounts) through the expected life of the financial instrument, or, where appropriate, a shorter period, to the net carrying amount on initial recognition.

Fair value of financial instruments

Fair value of financial instruments which are traded in the active market is estimated at each reporting date on the basis of market quotations or dealer quotes without any deduction for transaction costs. For financial instruments which are not traded in the active market, fair value of the instrument is estimated using valuation techniques that include use of data on market transactions; data on current fair value of other similar instruments; discounted cash flow analyses or other valuation techniques.

The Group uses the following hierarchy to determine and disclose methods of fair value measurement of financial instruments:

- Level 1: prices on similar assets and liabilities determined in active markets (unadjusted);
- Level 2: techniques where all used inputs that significantly affect the fair value are observable directly or indirectly;
- Level 3: techniques where used inputs that significantly affect the fair value are not based on obesrvable market data.

Financial assets

Financial assets are classified into the following specified categories: financial assets at fair value through profit or loss, held to maturity investments, available for sale financial assets and loans and receivables.

The classification depends on the nature and purpose of the financial assets and is determined at the time of initial recognition. All regular routine purchases or sales of financial assets are recognized on a trade date basis. Regular routine purchases or sales are purchases or sales of financial assets that require delivery of assets within the time frame established by regulation or convention in the marketplace.

Investments held-to-maturity

Investments held-to-maturity are non-derivative financial assets with fixed or determinable payments and fixed maturity dates that the Group has the positive intent and ability to hold to maturity. Subsequent to initial recognition, held-to-maturity investments are measured at amortized cost using the effective interest method less any impairment.

Loans and receivables

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market. Loans and receivables (including trade and other receivables) are measured at amortized cost using the effective interest method, less any impairment.

Interest income is recognized by applying the effective interest rate, except for short-term receivables when the recognition of interest would be immaterial.

Cash and cash equivalents

Cash and cash equivalents comprise cash balances, cash deposits and highly liquid investments with original maturities of three months or less, that are readily convertible to known amounts of cash and are subject to an insignificant risk of changes in value.

Impairment of financial assets

Financial assets are assessed for indicators of impairment at the end of each reporting period. Financial assets are considered to be impaired when there is objective evidence that, as a result of one or more events that occurred after the initial recognition of the financial asset, the estimated future cash flows of the investment have been affected.

Objective evidence that financial assets are impaired can include:

- Significant financial difficulty of the issuer or counterparty; or
- Breach of contract, such as default or delinquency in interest or principal payments; or
- It becoming probable that the borrower will enter bankruptcy or financial re-organization; or
- Disappearance of an active market for that financial asset because of financial difficulties.

For certain categories of financial assets, such as trade receivables, assets that are assessed not to be impaired individually are, in addition, assessed for impairment on a collective basis. Objective evidence of impairment for a portfolio of receivables could include the Group’s past experience of collecting payments, an increase in the number of delayed payments as well as observable changes in economic conditions that correlate with defaults on receivables.

For financial assets carried at amortized cost, the amount of the impairment is the difference between the asset’s carrying amount and the present value of estimated future cash flows, discounted at the original effective interest rate.

For financial assets carried at cost, the amount of the impairment loss is measured as the difference between the asset's carrying amount and the present value of the estimated future cash flows discounted at the current market rate of return for a similar financial asset. Such impairment loss will not be reversed in subsequent periods.

The carrying value of the financial asset is reduced by the impairment loss directly for all financial assets with the exception of trade receivables, where the carrying amount is reduced through the use of a provision account. When a trade receivable is considered uncollectible, it is written off against the provision account. Subsequent recoveries of amounts previously written off are credited against the provision account. Changes in the carrying amount of the provision account are recognized in profit or loss.

<u>Derecognition of financial assets</u>

The Group derecognizes a financial asset only when the contractual rights to the cash flows from the asset expire; or it transfers the financial asset and substantially all the risks and rewards of ownership of the asset to another entity. If the Group neither transfers nor retains substantially all the risk and rewards of ownership and continues to control the transferred asset, the Group recognizes its retained interest in the asset and an associated liability for amounts it may have to pay. If the Group retains substantially all the risks and rewards of ownership of a transferred financial asset, the Group continues to recognize the financial asset and also recognizes a collateralized borrowing for the proceeds received.

On derecognition of a financial asset in its entirety, the difference between the asset's carrying amount and the sum of the consideration received and receivable and the cumulative gain or loss that had been recognized in other comprehensive income and accumulated in equity is recognized in profit or loss.

On derecognition of a financial asset other than in its entirety (e.g. when an entity retains an option to repurchase part of a transferred asset or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the control is retained), the Group allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognizes on the basis of the relative fair values of those parts on the date of the transfer. The difference between the carrying amount allocated to the part that is no longer recognized and the sum of the consideration received for the part no longer recognized and any cumulative gain or loss allocated to it that had been recognized in other comprehensive income is recognized in profit or loss. A cumulative gain or loss that had been recognized in other comprehensive income is allocated between the part that continues to be recognized and the part that is no longer recognized on the basis of the relative fair values of those parts.

Financial liabilities

<u>Classification as debt or equity</u>

Debt and equity instruments issued by Group entities are classified as either financial liabilities or as equity in accordance with the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument.

<u>Equity instrument</u>

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities. Equity instruments issued by the Group are recognized at the proceeds received, net of direct issue costs.

Repurchase of the Group's own equity instruments is recognized and deducted directly in equity. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments.

Financial liabilities

Financial liabilities (including borrowings) are subsequently measured at amortized cost using the effective interest method.

Derecognition of financial liabilities

The Group derecognizes financial liabilities when, and only when, the Group's obligations are discharged, canceled or they expire. The difference between the carrying amount of the financial liability derecognized and the consideration paid and payable is recognized in profit and loss.

Derivative financial instruments

In course of its business the Group from time to time enters into derivative financial instruments to manage its exposure to foreign exchange rate risk mostly through foreign exchange forward contracts. The Group does not use hedge accounting for these derivatives. As a result, such derivative financial instruments are treated as other financial assets and liabilities at FVTPL. Gains and losses recognized for the changes in fair value of forward contracts are presented as part of finance costs or other operating expenses of the Group depending on whether its use is related to a financial item or an operating item.

The fair value of forward exchange contracts is calculated by reference to current forward exchange rates for contracts with similar maturity profiles.

Provisions

Provisions are recognized when the Group has a present obligation (legal or constructive) as a result of a past event, it is probable that the Group will be required to settle the obligation, and a reliable estimate can be made of the amount of the obligation.

The amount recognized as a provision is the best estimate of the consideration required to settle the present obligation at the end of the reporting period, taking into account the risks and uncertainties surrounding the obligation. When a provision is measured using the cash flows estimated to settle the present obligation, its carrying amount is the present value of those cash flows (when the effect of the time value of money is material).

When some or all of the economic benefits required to settle a provision are expected to be recovered from a third party, a receivable is recognized as an asset if it is virtually certain that reimbursement will be received and the amount of the receivable can be measured reliably.

Cash-settled share-based payments

In 2014-2015, certain Company's employees of managerial positions were entitled to share-based payments ("phantom" shares). The Group's liabilities related to such payments are recognized as "cash-settled share-based payments" and initially measured at the fair value of such liabilities. At the end of each reporting period until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured, with any changes in fair value recognized in profit or loss for the period.

Equity-settled share-based payments

Equity-settled share-based payments are accounted for at fair value determined on the grant date. The fair value determined at the grant date is expensed on a straight-line basis over the vesting period.

Dividends

Dividends and the related taxes are recognized as a liability in the period in which they have been declared and become legally payable. Dividends can be paid out in accordance with laws of the jurisdictions in which the Group's entities are incorporated and registered.

Treasury shares

If the Group reacquires its own equity instruments, those instruments ("treasury shares") are recognised as a deduction to equity at cost, being the consideration paid to reacquire the shares. No gain or loss is recognised in profit or loss on the purchase, sale, issue or cancellation of the Group's own equity instruments. Such treasury shares may be acquired and held by the Company or by other subsidiaries of the Group.

5. CRITICAL ACCOUNTING JUDGMENTS AND KEY SOURCES OF ESTIMATION UNCERTAINTY

In the application of the Group's accounting policies, which are described in Note 4 "Significant Accounting Policies", management is required to make judgments, estimates and assumptions about the carrying amounts of assets and liabilities that are not readily apparent from other sources. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates.

The estimates and underlying assumptions are reviewed on an ongoing basis. Revisions to accounting estimates are recognized in the period in which the estimate is revised if the revision affects only that period, or in the period of the revision and future periods if the revision affects both current and future periods.

The key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

Useful economic life and residual value of property, plant and equipment

The Group's property, plant and equipment are depreciated using the straight-line method over their estimated useful lives which are based on management's business plans and operational estimates.

Estimated useful lives of leasehold improvements is based on leases retail space contracts, as it is the intent, and experience, that these leases will be kept until the expiration of the agreed term.

Management annually reviews the appropriateness of asset's useful economic lives. The review is based on the current condition of the assets and plans to fully renovate the stores in the near future.

Recoverability of loans issued

Loans granted to related parties (Note 14) are measured at amortized cost. On each reporting date, the management of the Group reviews them to identify indicators of chances for not being repaid to the Group in cash. If such indicators are identified, an amount of impairment is determined and charged directly to equity as a distribution to Company's shareholders. The Group's management believes that the loans granted to related parties included in the consolidated statement of financial position in the amount of RUB 5,806,809 thousand are fully recoverable, which is supported by repayment of a significant part of this amount after the reporting date (Note 29).

Taxation

The Group is subject to income taxes and other taxes. Significant judgment is required in determining the provision for income tax and other taxes as there are a number of transactions and calculations for which the ultimate tax determination is uncertain. The Group recognizes liabilities for anticipated tax audit issues based on estimates of whether additional taxes will be due. Where the final tax outcome of various matters is different from the amounts that were recorded, such difference will impact the amounts of current and deferred income tax in the period in which such determination is made.

Supplier bonuses

The Group receives various types of bonuses from suppliers in the form of cash payments or allowances for various programs, primarily volume incentives and reimbursements for specific programs such as markdowns, margin protection and advertising. Management has concluded that substantially all payments from suppliers are accounted for as a reduction of inventory purchases and recognized in the consolidated statement of profit or loss and other comprehensive income when the related inventory is sold.

Measuring inventories

Management reviews the inventory balances to determine if inventories can be sold at amounts greater than or equal to their carrying amounts plus costs to sell. This review includes identification of slow moving inventories, obsolete inventories and partially or fully damaged inventories. The identification process includes historical performance of the inventory, current operational plans for the inventory as well as industry and customer specific trends. Damaged stock is either provided for or written off depending on the extent of damage. Management makes an allowance for any items considered to be obsolete. The allowance represents the difference between the cost of inventory and its estimated net realizable value.

If actual results differ from management's expectations with respect to the selling of inventories at amounts equal to or less than their carrying amounts, management would be required to adjust the carrying amount of inventories.

During the period between inventory counts or cycle counts in stores, the Group estimates losses related to shrinkage that may have been identified in each store if a stock count was carried out on the reporting date, on a store-by-store basis. The estimation as of reporting date is based on the average historical actual shrinkage results, net of surpluses, in stores of the Group.

Revenue attributed to loyalty program "YO-YO"

The Group accounts for customer loyalty points as a separate component of the sale transaction in which they are granted. A portion of a fair value of the consideration received from customers is allocated to the award points and deferred, and is recognized then as a revenue over the period that the award credits are redeemed. Therefore, management has to make assumptions about expected redemption rates, which may be based on prior periods' statistics. These assumptions are connected with significant uncertainty at each reporting date, as far as issued points are expired through the passage of time in the future.

6. FIRST TIME ADOPTION OF IFRS

The consolidated financial statements of the Group have been prepared in accordance with *IFRS 1 First time adoption of International Financial Reporting Standards ("IFRS 1")*, as a part of the Group's conversion to IFRS. The term "International Financial Reporting Standards" includes standards and interpretations approved by the International Accounting Standards Board, including International Accounting Standards ("IAS") and interpretations issued by the International Financial Reporting Interpretations Committee ("IFRIC") which replaced the Standing Interpretations Committee.

Until 2014 (inclusively) the Group prepared its annual consolidated financial statements in compliance with accounting principles generally accepted in the United States of America ("US GAAP"), which may differ from IFRS. Hence, adjustments necessary for preparing the consolidated financial statements in compliance with IFRS have been made to the financial statements of the Group.

(in million of Russian Rubles)

The Group applied IFRS 1 in the preparation of its consolidated statement of financial position as at 1 January 2014, the Group's transition date to IFRS with the following exemption to its opening balance sheet:

- IFRS 1 indicates that a first-time adopter may elect not to apply IFRS 3 (2008), Business Combinations, retrospectively to business combinations that occurred before the date of transition to IFRS. The Group has applied this exemption as part of the transition to IFRS and as a result has not restated business combinations that occurred prior to the date of transition thereby retaining the amounts recognised under U.S. GAAP.
- In accordance with IFRS 1, if a company elects to apply IFRS 3 (2008), Business Combinations, retrospectively, IAS 27, Consolidated and Separate Financial Statements, must also be applied retrospectively. As the Company elected to apply IFRS 3 (2008) effective 1 January 2014 prospectively through the use of the Business Combinations exemption under IFRS 1, the Group has also applied IAS 27 for the same period. This exemption also applies to past acquisitions of investments in associate.

IFRS 1 requires the Group to disclose reconciliations of its equity reported in accordance with US GAAP to its equity in accordance with IFRS at the date of transition to IFRS and at the end of the latest period presented in the entity's most recent annual financial statements in accordance with US GAAP as well as reconciliation of its total comprehensive income in accordance with IFRS for the latest period in the Group's most recent annual financial statements with total comprehensive income in accordance with US GAAP for the same period. The Group has decided not to present these reconciliations in these consolidated financial statements because transition to IFRS has impacted neither equity at the respective dates nor total comprehensive income for the respective period.

7. REVENUE

	2015	**2014**
Retail, excluding luxury and the online store	59,446,805	44,405,304
Online store	968,807	442,569
Luxury retail	107,794	587,787
Other	20,867	10,419
Total	**60,544,273**	**45,446,079**

Revenue for sales of goods ordered via the Internet and picked up at Group's retail shops is included in retail revenue.

Revenue from ELC-branded stores, shown within retail revenue, for the years ended 31 December 2015 and 2014 amounted to RUB 934,306 thousand and RUB 812,815 thousand, respectively.

(in million of Russian Rubles)

8. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

	2015	2014
Rent and utility	7,073,117	5,798,620
Payroll	6,808,576	5,216,991
Advertising and marketing expenses	1,090,709	781,861
Depreciation and amortisation	954,055	739,693
Banking services	457,316	303,133
Repair and maintenance	287,336	256,589
Promotional materials	228,585	180,393
Security expenses	227,914	226,362
Support of software	121,600	90,138
Communication expense	89,399	73,512
Taxes (other than income tax)	83,157	47,317
Travel expenses	72,889	57,682
Stationary and other materials	53,081	16,600
Consulting services	45,922	66,038
Bad debts written off and change in allowance for doubtful debts	(26,291)	50,953
(Income)/losses from fines for cancellation of orders from luxury goods suppliers*	(92,579)	119,594
Other	250,146	236,791
Total	**17,724,932**	**14,262,267**

* Income included in this line is connected with partial release of provisions for fines booked in 2014.

9. FINANCE INCOME AND EXPENSES

Finance income

	2015	2014
Interest income on bank deposits	94,220	54,491
Interest income on loans issued to related parties	628,927	1,297
Total	**723,147**	**55,788**

Finance expenses

	2015	2014
Interest expense on bonds	39,099	97,750
Interest expense on bank loans	2,013,622	819,975
Total	**2,052,721**	**917,725**

10. INCOME TAXES

10.1. Income tax recognized in profit or loss

	31 December 2015	31 December 2014
Current tax		
In respect of the current year	(1,044,279)	(967,321)
In respect of prior years	53,182	15,529
Others	(2,220)	-
	(993,317)	(951,792)
Deferred tax		
In respect of the current year	415,480	268,048
	415,480	268,048
Total income tax expense recognized in profit or loss	**(577,837)**	**(683,744)**

(in million of Russian Rubles)

Below is a reconciliation of income tax calculated using the income tax rate effective in the Russian Federation where the Group has its main operating entities to the actual income tax expense recorded in the consolidated statement of profit or loss and other comprehensive income:

	2015	**2014**
Profit before tax	1,553,603	2,726,544
Income tax expense calculated at 20% (2014: 20%)	310,721	545,309
Non-deductible inventory losses	172,568	128,666
Loss from goodwill impairment not deductible for tax purposes	72,516	-
Other non-deductible expenses, net	33,022	31,190
Deferred tax assets not recognized in respect of current period tax losses	42,629	-
Other charges not deductible for tax purposes	2,220	-
Prior period income tax adjustment	(53,182)	(15,529)
Effect of rates different from Russian statutory rate	(2,657)	(5,892)
Income tax expense recognized in profit or loss	**577,837**	**683,744**

10.2. Deferred tax balances

Deferred tax assets and liabilities of the Group comprise differences resulting from differences between the tax and accounting bases for the following assets and liabilities:

2015	**Opening balance**	**Recognized in profit or loss**	**Closing balance**
Deferred tax /assets in relation to:			
Inventories	1,814,180	1,451,969	3,266,149
Accrued expenses and other deductible temporary differences	1,220,020	761,842	1,981,862
Deferred revenue	347,015	(69,279)	277,736
Losses carried forward	162,505	63,996	226,501
Less: valuation allowance	(9,365)	9,365	-
Total temporary differences	**3,534,355**	**2,217,893**	**5,752,248**
Deferred tax assets	**706,871**	**443,579**	**1,150,450**
Deferred tax liabilities:			
Property, plant and equipment	(52,850)	(262,617)	(315,467)
Other taxable temporary differences	(122,120)	122,120	-
Total temporary differences	**(174,970)**	**(140,497)**	**(315,467)**
Deferred tax liabilities	**(34,994)**	**(28,099)**	**(63,093)**
Net deferred tax assets	**671,877**	**415,480**	**1,087,357**

(in million of Russian Rubles)

2014	Opening balance	Recognized in profit or loss	Disposals resulting from reorganization (Note 1)	Closing balance
Deferred tax /assets in relation to:				
Inventories	964,365	849,815	-	1,814,180
Accrued expenses and other deductible temporary differences	1,181,715	38,305	-	1,220,020
Deferred revenue	353,805	(6,790)	-	347,015
Losses carried forward	514,500	166,757	(518,752)	162,505
Less: valuation allowance	(33,270)	23,905	-	(9,365)
Total temporary differences	**2,981,115**	**1,071,992**	**(518,752)**	**3,534,355**
Deferred tax assets	**596,223**	**214,398**	**(103,750)**	**706,871**
Deferred tax liabilities:				
Property, plant and equipment	(129,445)	76,595	-	(52,850)
Accrued supplier bonuses and marketing compensations	(263,305)	263,305	-	-
Other taxable temporary differences	(50,470)	(71,650)	-	(122,120)
Total temporary differences	**(443,220)**	**268,250**	**-**	**(174,970)**
Deferred tax liabilities	**(88,644)**	**53,650**	**-**	**(34,994)**
Net deferred tax assets	**507,579**	**268,048**	**(103,750)**	**671,877**

As at 31 December 2015 there were no taxable temporary differences related to investments in subsidiaries for which deferred tax liabilities might have been recognized if the Group had not been in a position to control the timing of the reversal of these temporary differences (31 December 2014 and 1 January 2014: nil).

11. PROPERTY, PLANT AND EQUIPMENT

	Buildings and leashold improvements	Trade equipment	Office and warehouse equipment and other fixed assets	Construction in-progress	Total
Historical cost					
At 1 January 2014	2,573,901	1,597,109	707,289	106,043	4,984,342
Additions	97,764	2,178	6,686	1,642,434	1,749,062
Transfers	667,479	598,463	(2,514)	(1,263,428)	-
Disposals	(368,976)	(173,719)	(50,854)	(4)	(593,553)
At 31 December 2014	**2,970,168**	**2,024,031**	**660,607**	**485,045**	**6,139,851**
Additions	22,554	4,466	8,274	4,558,641	4,593,935
Transfers	3,373,371	175,422	1,277,106	(4,825,899)	-
Disposals	(40,743)	(28,261)	(27,744)	(43,186)	(139,934)
At 31 December 2015	**6,325,350**	**2,175,658**	**1,918,243**	**174,601**	**10,593,852**

(in million of Russian Rubles)

	Buildings and leashold improvements	Trade equipment	Office and warehouse equipment and other fixed assets	Construction in-progress	Total
Accumulated depreciation and impairment					
At 1 January 2014	1,143,216	1,366,358	234,409	-	2,743,983
Depreciation expense	294,751	274,115	75,906	-	644,772
Disposals	(127,460)	(172,140)	(47,314)	-	(346,914)
At 31 December 2014	**1,310,507**	**1,468,333**	**263,001**	**-**	**3,041,841**
Depreciation expense	431,208	106,620	312,202	-	850,030
Disposals	(36,871)	(27,123)	(25,239)	-	(89,233)
At 31 December 2015	**1,704,844**	**1,547,830**	**549,964**	**-**	**3,802,638**
Carrying amount / net book value					
Balance at 1 January 2014	**1,430,685**	**230,751**	**472,880**	**106,043**	**2,240,359**
Balance at 31 December 2014	**1,659,661**	**555,698**	**397,606**	**485,045**	**3,098,010**
Balance at 31 December 2015	**4,620,506**	**627,828**	**1,368,279**	**174,601**	**6,791,214**

In December 2014 the Group sold the building occupied by its luxury retail store, which on the date of disposal had a carrying amount of RUB 229,007 thousand, to a third party for cash consideration of RUB 1,440,520 thousand. In addition, the Group incurred transaction costs for the disposal of the building totalling RUB 47,761 thousand. Gain on disposal of the building of RUB 1,163,752 thousand was presented as a separate line item in the consolidated statement of operations and comprehensive income.

In 2015, the Group completed construction of a distribution center in Bekasovo, Moscow Region. The carrying value at the date of putting into operation amounted to RUB 2,648,311 thousand and was included within the “Buildings and leashold improvements” group. Also, in 2015, the Group purchased warehouse equipment with the carrying value of RUB 524,106 thousand, which were included within the “Office and warehouse equipment and other fixed assets” group.

Loss on disposal of other property, plant and equipment of RUB 30,570 thousand and RUB 28,943 thousand was recognized in other operating income and expense, net in the consolidated statements of profit or loss and other comprehensive income for the years ended 31 December 2015 and 2014, respectively.

12. GOODWILL

	31 December 2015	31 December 2014	1 January 2014
Goodwill relating to acquisition of Kub-Market LLC – cost	362,581	362,581	362,581
Accumulated impairment losses	(362,581)	-	-
Balance at end of year	**-**	**362,581**	**362,581**

As at 31 December 2015, the Group performed an impairment testing of goodwill, which resulted in recognition of impairment loss of RUB 362,581 thousand (as of 31 December 2014 no impairment was identified). Goodwill impairment as of 31 December 2015 was primarily caused by the impact of the existing economic instability and Russian Ruble exchange rate dynamics on the cash flows generated by Kub-Market LLC, and also high sensitivity of the forecast model to changes of key parameters.

(in million of Russian Rubles)

13. OTHER INTANGIBLE ASSETS

	Software	Trademarks	Total
Cost			
At 1 January 2014	638,612	4,484	643,096
Additions	497,549	29	497,578
Disposals	-	(1,200)	(1,200)
At 31 December 2014	**1,136,161**	**3,313**	**1,139,474**
Additions	757,303	326	757,629
Disposals	(2,044)		(2,044)
At 31 December 2015	**1,891,420**	**3,639**	**1,895,059**
Accumulated amortisation			
At 1 January 2014	398,296	-	398,296
Amortisation expense	94,921	-	94,921
Disposals	(14)	-	(14)
At 31 December 2014	**493,203**	**-**	**493,203**
Amortisation expense	104,025	-	104,025
Disposals	(1,797)	-	(1,797)
Balance at 31 December 2015	**595,431**	**-**	**595,431**
Currying amount			
Balance at 1 January 2014	**240,316**	**4,484**	**244,800**
Balance at 31 December 2014	**642,958**	**3,313**	**646,271**
Balance at 31 December 2015	**1,295,989**	**3,639**	**1,299,628**

The increase of the carrying amount of software in 2014 and 2015 relates primarily to licenses acquired for an ERP system (SAP) and capitalised implementation costs. The Group launched SAP in 2015.

14. LOANS ISSUED

Long-term loans receivable as at 31 December 2015 and 2014 comprised the following:

	2015	2014
A loan granted to CJSC DM-Finance, a related party, on 3 July 2013 denominated in Rubles at 10.55% per annum maturing in September 2020 (Note 1)	4,553,112	4,543,911
Accrued interest	1,253,697	695,989
Total	**5,806,809**	**5,239,900**

Short-term loans receivable as at 31 December 2015 and 2014 comprised the following:

	2015	2014
A loan granted to CJSC Sistema-Telecom-Aktivy, a related party, denominated in Rubles at 12% per annum maturing in December 2015 *	-	1,220,000
Accrued interest	-	-
Total	**-**	**1,220,000**

* Disposed of as part of the Detskaya Galereya “Yakimanka” LLC disposal (Note 1).

Long-term and short-term loans granted to subsidiaries of Sistema, related parties, are unsecured.

(in million of Russian Rubles)

The fair value of long-term loans receivable from related parties as at 31 December 2015 was RUB 4,486,617 (2014: RUB 3,264,320 thousand). The fair value of short-term loans granted to related parties as at 31 December 2015 and 2014 approximated their carrying amount.

15. OTHER NON-CURRENT ASSETS

	31 December 2015	31 December 2014	1 January 2014
Long-term advances paid under operating lease agreements for warehouses and stores	243,919	230,848	189,175
Other	3,528	71	17,282
Total	**247,447**	**230,919**	**206,457**

16. INVENTORIES

	31 December 2015	31 December 2014	1 January 2014
Merchandise inventories	17,274,622	11,086,896	8,550,845
Materials	71,492	37,309	84,885
Total	**17,346,114**	**11,124,205**	**8,635,730**

Materials are represented by spare parts, packaging materials and other materials used in outlets and warehouses.

Write-offs of merchandise inventories relating to shrinkage and write-down to market in the amount of RUB 888,153 thousand and RUB 455,444 thousand for the years ended 31 December 2015 and 2014, respectively, were recorded within cost of sales in the consolidated statements of operations and comprehensive income.

As at 31 December 2015 and 2014 and 1 January 2014 no inventories were pledged.

17. TRADE RECEIVABLES

	31 December 2015	31 December 2014	1 January 2014
Trade receivables	2,710,138	1,331,119	1,457,794
Allowance for doubtful debts	(244)	(244)	(879)
Total	**2,709,894**	**1,330,875**	**1,456,915**

Trade receivables are generally represented by amounts receivable from suppliers in relation to volume and other bonuses and for goods returned to suppliers.

(in million of Russian Rubles)

18. ADVANCES PAID AND OTHER RECEIVABLES

	31 December 2015	31 December 2014	1 January 2014
Advances paid to suppliers	295,899	252,434	112,968
Value added tax receivable	1,162,169	439,896	231,428
Other advances paid	196,038	169,482	109,316
Other taxes receivable	1,152	5,101	11,934
Prepaid expenses	23,705	19,661	12,462
Loyalty program receivables from OJSC Sberbank of Russia	-	1,673	154,446
Other receivables	203,613	309,785	159,620
Less: allowance for doubtfull accounts	(32,197)	(34,284)	(28,159)
	1,850,379	**1,163,748**	**764,015**

Other advances paid include prepayments on leases and customs duties. Other receivables include amounts due from Detsky Mir – Rosnichnye Aktivy, a subsidiary of JSFC Sistema, of RUB 12,010 thousand (31 December 2014: RUB 16,687 thousand; 1 January 2014: RUB 31,944 thousand).

The following is the movement in the allowance for other doubtful receivables and advances paid:

	2015	2014
Balance at beginning of the year	(34,284)	(28,159)
Impairment loss recognized on other receivables	(7,651)	(7,694)
Write-offs against allowance for doubtful receivables on advances paid and other receivables	9,588	1,177
Reversal of impairment loss on other receivables and advances paid	150	392
Balance at the end of the year	**(32,197)**	**(34,284)**

In determining the recoverability and quality of advances paid and other receivables, the Group considers any change in the solvency of debtors from the date of receivables origination up to the reporting date. The details about concentration of credit risk and related risk management activities are described in Note 28

19. CASH AND CASH EQUIVALENTS

	31 December 2015	31 December 2014	1 January 2014
Cash on bank accounts	316,657	716,789	392,456
Cash in transit	757,992	590,799	376,713
Bank deposits in USD	-	175,808	-
Bank deposits in RUB	690,000	56,000	-
Cash on hand	169,133	130,639	90,733
Total	**1,933,782**	**1,670,035**	**859,902**

Cash and cash equivalents as at 31 December 2015 include RUB-denominated term deposits of RUB 690,000 thousand with interest rate of 4.4% and maturity on 11 January 2016.

Cash and cash equivalents as at 31 December 2014 include a RUB-denominated term deposit of RUB 56,000 thousand with interest rate 23% and USD-denominated term deposits of 175,808 thousand with interest rates from 0.3% to 1.5% with maturity date 12 January 2015.

There were no term deposits as 1 January 2014.

Cash in transit represents cash collected from the Group’s stores and not yet deposited into the Group’s bank accounts at the year-end.

(in million of Russian Rubles)

20. SHAREHOLDERS' EQUITY / (DIFICIT)

All share and per share information for all periods herein retroactively reflect the Company's 250,000-for-1 stock split, which was effective on 18 February 2014.

Ordinary shares

As at 31 December 2015, 2014 and 1 January 2014 the ordinary share capital of the Company was as follows:

	Outstanding ordinary shares	Issued ordinary shares	Authorised ordinary shares
At 1 January 2014	**554,000,000**	**739,000,00**	**739,000,000**
Sale of treasury shares to the General Director	7,984,499	-	-
Transfer of treasury shares to shareholders in course of reorganization	177,015,501	-	-
At 31 December 2014	**739,000,000**	**739,000,000**	**739,000,000**
At 31 December 2015	**739,000,000**	**739,000,000**	**739,000,000**

All ordinary shares have a par value of RUB 0.0004 per share.

Treasury shares

In September 2013 following the approval by the Board of Directors, the Group purchased 185,000,000 issued ordinary shares of the Company from OJSC Sberbank of Russia for total cash consideration of RUB 4,542,514 thousand.

In December 2014, the Group sold 7,984,499 treasury shares to the General Director (Note 22), and the remaining treasury shares were transferred to the Group's shareholders – Sistema and subsidiaries – as part of reorganisation (Note 1).

Dividends

In accordance with the Russian legislation, earnings available for dividends are limited to retained earnings of the Company, calculated in accordance with statutory rules in local currency. On 30 June 2014, the Annual General Meeting approved dividends of RUB 846,776 thousand for 2013. On 17 November 2014, an Extraordinary General Meeting approved dividends for 2011, 2013 and 9 months of 2014 of RUB 1,628,757 thousand. Dividends attributable to treasury shares of RUB 619,721 thousand were fully eliminated when preparing these consolidated financial statements.

On 2 July 2015, the Annual General Meeting approved dividends of RUB 839,060 thousand for 2014. On 4 December 2015, an Extraordinary General Meeting approved dividends for 9 months of 2015 of RUB 2,133,567 thousand.

(in million of Russian Rubles)

21. LOANS AND BORROWINGS

Loans and borrowings as at 31 December 2015, 2014 and 1 January 2014 comprise:

	31 December 2015	31 December 2014	1 January 2014
RUB-denominated corporate bonds	-	1,150,000	1,150,000
Bank loans			
RUB-denominated secured bank loans	3,200,000	3,200,000	3,200,000
RUB-denominated unsecured bank loans	15,158,914	5,365,979	1,572,321
	18,358,914	**9,715,979**	**5,922,321**
Less current portion of long-term debt	(12,893,789)	(6,228,309)	(1,572,321)
Loans and borrowings, net of current portion	**5,465,125**	**3,487,670**	**4,350,000**

Corporate bonds

In May 2015, the Group fully repaid corporate bonds issued in December 2005 with a total par value of RUB 1,150,000 thousand.

RUB-denominated bank loans

At 31 December 2015 the Group's RUB denominated bank loans were obtained from 6 Russian banks (31 December 2014–6 banks).

The fair value of the Group's bank loans, including amounts due within one year, as at 31 December 2015, 2014 and 1 January 2014 was RUB 18,309,735 thousand, RUB 8,441,284 thousand and RUB 5,025,478 thousand, respectively. The carrying amount of this debt was RUB 18,358,914 thousand, RUB 8,565,979 thousand and RUB 4,772,321 thousand, respectively.

Unused credit line facilities

As of 31 December 2015 and 2014 the Group had total available unused credit line facilities of RUB 7,217,600 thousand and RUB 4,032,230 thousand, including RUB 3,610,000 thousand and RUB 983,152 thousand available under long-term credit lines.

Covenants

Certain of the Group's loan agreements contain covenants requiring the Group to meet certain financial ratios. The loan agreements contain various provisions that are triggered in the case of non-compliance with the specific covenants and these provisions differ in each agreement. Specifically, the banks may either increase interest rates on the loans, request the Group to contribute additional collateral, or request immediate repayment of the respective debt. Management believes that the Group was in compliance with all restrictive financial covenants as at 31 December 2015, 31 December 2014 and 1 January 2014.

Pledges

Loan agreement with one of the Group's banks effective as at 31 December 2015 obliges the Group to secure its liabilities with a mortgage of a building with the carrying value of RUB 2,416,944 thousand as at 31 December 2015. As at 31 December and 1 January 2014, 100% stake in LLC Detskaya Galereya "Yakimanka" was pledged as security under one of the Group's loan agreements.

Except for the assets mentioned above, as at 31 December 2015, 31 December 2014 and 1 January 2014 the Group had no other assets or securities pledged to secure loans and borrowings granted to the Group.

(in million of Russian Rubles)

Maturity analysis of loans and borrowings

The following table presents the aggregated scheduled maturities of the bonds and bank loans principal outstanding as at 31 December 2015, 2014 and 2014:

As at 31 December 2015	
Within the first month	2,385,495
From one to three months	3,807,666
From three months to one year	6,700,628
From one year to two years	1,600,045
From two year to five year	3,865,080
More than five years	-
Total	**18,358,914**

As at 31 December 2014	
Within the first month	6,228,309
From one to three months	290,045
From three months to one year	930,045
From one year to two years	930,045
From two year to five year	910,867
More than five years	426,668
Total	**9,715,979**

22. SHARE BASED PAYMENTS

Long-term incentive plan

In August 2014, the Group's Board of Directors approved an employee long-term incentive plan (the "Incentive Plan"). Under the conditions of the Incentive Plan, certain employees at senior levels are entitled to share-based compensation, so-called "phantom" shares, that are to be granted by the Group in annual tranches over 2014-2016. The phantom shares vest on 31 December 2016 contingent on continued employment with the Group and certain established targets relating to the increase in the Group's market value. The phantom shares vest automatically upon a successful initial public offering by the Group or upon the sale by the Group's controlling shareholder of a certain stake in the Group to a third-party investor. Upon redemption of phantom shares, a participant receives either a respective number of shares in the Company or cash consideration computed on the basis of the market value of one ordinary share of the Company.

Phantom shares granted by the Group to the participants of the Incentive Plan as well as other changes in phantom shares outstanding are summarized below:

	Number of phantom shares	**Weighted average exercise price**
Outstanding at 1 January 2014	**-**	**-**
Granted during the period	2,648,588	-
Forfeited / canceled during the period	-	-
Outstanding at 31 December 2014	**2,648,588**	**-**
Granted during the period	1,331,479	-
Forfeited / canceled during the period	(711,940)	-
Outstanding at 31 December 2015	**3,268,127**	-
Exercisable at 31 December 2014	-	-

(in million of Russian Rubles)

According to the terms of the Incentive Plan, the right to receive Company's ordinary shares or cash compensation in exchange for the phantom shares granted to the employees as at 31 December 2015 arises during 2016-2018 provided they continue to be employed by the Company.

As at 31 December 2015, the Group recognized liabilities of RUB 278,077 thousand in relation to the Incentive Plan, calculated as the fair value of the phantom shares granted to employees as at this date (as at 31 December 2014: RUB 20,347 thousand). These liabilities include accrued social contributions of RUB 65,483 (as at 31 December 2014: RUB 4,695 thousand). The respective expense of RUB 257,730 thoussand was recognized as Selling, General and Administrative expenses in the consolidated statement of profit or loss and other comprehensive income for the year ended 31 December 2015 (for the year ended 31 December 2014: RUB 20,347 thousand).

When estimating its liability under the Incentive Plan the Group assumed that the fair value of one phantom share approximates the fair value of one ordinary share of the Company (being RUB 65.1 per share as at 31 December 2015 and RUB 32.9 per share as at 31 December 2014), and that all of the employees participating in the Incentive Plan will stay employed by the Group until their rights vest.

Share-based compensation of the General Director

In December 2014, the Board of Directors approved payment of one-off stock based compensation to the Group's General Director. Compensation of RUB 373,134 thousand was paid in cash and used by the General Director to acquire 7,984,499 shares in the Company which were taken from treasury shares carried on the Group's balance sheet. Gain on sale of treasury shares to the General Director of RUB 177,091 thousand was recognised in equity as additional paid-in capital as at 31 December 2014.

In December 2015, in connection with the sale of a certain share in the Group by the controlling shareholder to an investor, the Group's Board of Directors approved payment of compensation to the Groups' General Director consisting of two parts:

- compensation of RUB 378,408 thousand was paid in cash in December 2015;
- compensation of RUB 426,400 thousand will be settled by granting the General Director a right to receive Company's ordinary shares. The shares may be received by the General Director in August 2016 subject to his continued employement by the Company and Group's shares reaching certain level of market value established by the Board of Directors. The Group classified this compensation as an equity-settled share-based payment and recognized an expense of RUB 426,400 thousand within the consolidated statement of profit or loss and other comprehensive income, with an identical amount charged directly to equity within the Accumulated losses line. The amount was calculated as the fair value of the ordinary shares to which the General Director is entitled, based on an assessment of one share's market value of RUB 65.1. The above amount includes accrued social contributions of RUB 98,400 thousand.

23. ADVANCES RECEIVED, OTHER PAYABLES AND ACCRUED EXPENSES

	31 December 2015	31 December 2014	1 January 2014
Taxes payable other than income tax	415,859	500,314	272,984
Salaries payable	631,138	389,358	353,475
Interest payable	53,988	37,400	16,954
Accrued expenses and other current liabilities	1,851,641	1,525,418	961,846
	2,952,626	**2,452,490**	**1,605,259**

(in million of Russian Rubles)

24. DEFERRED REVENUE

Deferred revenue relating to the Group's customer loyalty program as at 31 December 2015, 2014 and 1 January 2014 was as follows:

	2015	2014
As at 1 January	347,013	353,770
Revenue deferred during the period	2,027,107	1,268,275
Revenue released to the consolidated statement of profir or loss and other comprehensive income	(2,096,386)	(1,275,032)
As at 31 December	**277,734**	**347,013**

25. RELATED PARTIES

For the purposes of these consolidated financial statements, related parties are generally considered to be related if one party has the ability to control the other party, is under common control, or can exercise significant influence or joint control over the other party in making financial and operational decisions. Management has used reasonable judgments in considering each possible related party relationship with attention directed to the substance of the relationship, not merely the legal form.

Transactions with related parties may be performed on terms that would not necessarily be available to third parties. The Group had the following transactions and balances with subsidiaries of Sistema:

	31 December 2015		31 December 2014		1 January 2014	
	Assets	Liabilities	Assets	Liabilities	Assets	Liabilities
Balances outstanding with related parties						
Bank deposits	11,207	-	68,631	-	22,354	-
Other receivables /(payables)	12,010	(107,943)	16,687	(76,065)	31,944	(7,364)
Loans issued/(received)	5,806,809	-	6,459,900	-	-	-

Outstanding balances with related parties are unsecured by any collateral and will be settled in cash.

During the years ended 31 December 2015 and 2014 the Group entered into transactions with fellow subsidiaries of Sistema as follows:

- Rent and utility expenses – During the years ended 31 December 2015 and 2014, the Group incurred costs payable under contracts with Detsky Mir – Roznichnye Aktivy, a subsidiary of Sistema, of RUB 40,500 thousand and RUB 43,986 thousand, respectively.
- Communication expenses – During the years ended 31 December 2015 and 2014, the Group incurred costs payable to MTS, a subsidiary of Sistema, of RUB 19,568 thousand and RUB 39,523 thousand, respectively.
- Advertising and marketing expenses – During the years ended 31 December 2015 and 2014 the Group incurred Advertising and marketing expenses payable to PA Maxima, an affiliate of Sistema, in the amount of RUB 10,431 thousand and RUB 19,458 thousand, respectively. The Group also incurred advertising and marketing expenses payable to MTS, a subsidiary of Sistema, of RUB 44,099 thousand and RUB 269,457 thousand, respectively.
- Security expenses – During the years ended 31 December 2015 and 2014 the Group incurred security expenses payable to LLC PSE AB-Safety, a subsidiary of Sistema, in the amount of RUB 88 thousand and RUB 13,390 thousand, respectively.
- Acquisition of property, plant and equipment – During the years ended 31 December 2015 and 2014 the Group purchased property, plant and equipment from CJSC NVision Group, a subsidiary of Sistema, in the amount of RUB 8,824 thousand and RUB 17,395 thousand, respectively.

(in million of Russian Rubles)

- Medical services – During the years ended 31 December 2015 and 2014 the Group incurred expenses under an agreement with CJSC Medsi Group, a subsidiary of Sistema, in the amount of RUB 4,000 thousand and RUB 403 thousand, respectively.
- Event organization expenses – During the years ended 31 December 2015 and 2014 the Group incurred expenses under an agreement with VAO Intourist, a subsidiary of Sistema, in the amount of RUB 1,150 thousand and nil, respectively.
- Interest income – During the years ended 31 December 2015 and 2014 the Group earned interest income from subsidiaried of Sistema in the amount of RUB 628,927 thousand and RUB 1,297 thousand, respectively.

Compensation of key management personnel of the Group

During 2015 and 2014 the Group's directors and other members of key management received as remuneration RUB 1,187 million and RUB 817 million, respectively.

26. CAPITAL MANAGEMENT

The Group manages its capital to ensure that entities in the Group will be able to continue as going concerns while maximising the return to stakeholders through the optimisation of the debt and equity balance.

The capital structure of the Group consists of net debt (borrowings offset by cash and bank balances) and equity of the Group.

The Group's management periodically reviews the capital structure of the Group. As part of this review, management considers the cost of capital, risks associated with each class of capital and the level of debt-to-equity ratio.

Debt to equity ratio at the end of the reporting period was as follows:

	31 December 2015	31 December 2014	1 January 2014
Loans and borrowings	18,358,914	9,715,979	5,922,321
Cash and cash equivalents	(1,933,782)	(1,670,035)	(859,902)
Net borrowings	16,425,132	8,045,944	5,062,419
Equity/(deficit)	394,532	2,646,312	(2,097,951)
Net debt to equity/(deficit) ratio	41.63	3,04	Not applicable

Categories of financial instruments as at 31 December 2015, 2014 and 1 January 2014 are presented as follows:

	31 December 2015	31 December 2014	1 January 2014
Financial assets			
Loans issued	5,806,809	6,459,900	-
Cash and cash equivalents	1,933,782	1,670,035	859,902
Trade accounts receivable	2,709,894	1,330,875	1,456,915
Other receivables	203,613	309,785	159,620
	10,654,098	**9,770,595**	**2,476,437**
Financial liabilities at amortized cost			
Loans and borrowings	(18,358,914)	(9,715,979)	(5,922,321)
Trade payables	(16,717,972)	(10,993,231)	(9,167,930)
Other payables	(2,536,767)	(1,952,176)	(1,332,275)
	(37,613,653)	**(22,661,386)**	**(16,422,526)**
Net financial liabilities	**(26,959,555)**	**(12,890,791)**	**(13,946,089)**

(in million of Russian Rubles)

27. RISK MANAGEMENT ACTIVITIES

The main risks inherent to the Group's operations are those related to liquidity risk, credit risk, fluctuations in foreign exchange rates and market movements in interest rates. A description of the Group's risks and management policies in relation to these risks follows.

Liquidity risk

Liquidity risk is the risk that the Group will not be able to settle all liabilities as they fall due. The Group thoroughly controls and manages liquidity risk by maintaining adequate cash reserves, by continuously monitoring forecasted and actual cash flows and matching the maturity profiles of financial assets and liabilities. The average credit period on purchases of goods for sale is 3 to 5 months. No interest is charged on the trade payables. The Group has financial risk management policies in place to ensure that all payables are paid within the pre-agreed credit terms.

The Group's objective is to maintain a continuity of funding and flexibility through the use of bank overdrafts and credit lines. Each year the Group analyses its funding needs and anticipated cash flows, so that it can determine its funding obligations. The seasonality of the business, the store expansion plan, capitalized projects and the anticipated working capital requirements form the basis of the evaluation. When necessary the Group uses long-term instruments (loans and borrowings) to cover its base liquidity needs. The Group uses short-term loans and bank overdrafts to cover seasonality needs. Every quarter the Group updates its liquidity needs and secures facilities with several banks to ensure that the Group has a sufficient amount of approved undrawn borrowing facilities.

Presented below is the maturity profile of the Group's financial obligations based on contractual undiscounted payments, including interest:

	Total	Less than 3 months	3 months to 1 year	1-5 years
At 31 December 2015				
Fixed rate borrowings				
Loan principal	15,452,401	6,112,638	6,353,096	2,986,667
Interest	49,850	49,850	-	-
	15,502,251	**6,162,488**	**6,353,096**	**2,986,667**
Floating rate borrowings				
Loan principal	2,906,513	80,521	347,534	2,478,458
Interest	4,138	4,138	-	-
	2,910,651	**84,659**	**347,534**	**2,478,458**
Other financial liabilities				
Trade payables	16,717,972	-	16,717,972	-
Other non-interest bearing liabilities	2,482,779	2,482,779	-	-
	19,200,751	**2,482,779**	**16,717,972**	**-**
Total	**37,613,653**	**8,729,926**	**23,418,602**	**5,465,125**

(in million of Russian Rubles)

At 31 December 2014	Total	Less than 1 year	1-5 years
Fixed rate borrowings			
Loan principal	8,512,290	5,312,290	3,200,000
Interest	30,608	30,608	-
	8,542,898	**5,342,898**	**3,200,000**
Floating rate borrowings			
Loan principal	1,203,689	916,019	287,670
Interest	6,792	6,792	-
	1,210,481	**922,811**	**287,670**
Other financial liabilities			
Trade payables	10,993,231	10,993,231	-
Other non-interest bearing liabilities	1,914,776	1,914,776	-
	12,908,007	**12,908,007**	**-**
	22,661,386	**19,173,716**	**3,487,670**

At 1 January 2014	Total	Less than 1 year	1-5 years
Fixed rate borrowings			
Loan principal	5,415,372	1,065,372	4,350,000
Interest	16,815	16,815	-
	5,432,187	**1,082,187**	**4,350,000**
Floating rate borrowings			
Loan principal	506,949	506,949	-
Interest	139	139	-
	507,088	**507,088**	**-**
Other financial liabilities			
Trade payables	9,167,930	9,167,930	-
Other non-interest bearing liabilities	1,315,321	1,315,321	-
	10,483,251	**10,483,251**	**-**
	16,422,526	**12,072,526**	**4,350,000**

Weithed average effective interest rate as at 31 December 2015 was 13.9% (31 December 2014: 12.3%; 1 January 2014: 9.6%).

Credit risk management

Credit risk refers to the risk that counterparty may default on its contractual obligations resulting in financial loss to the Group. Financial assets which are potentially subject the Group to credit risk consist primarily of loans issued, bonuses receivable from suppliers, other receivables as well as cash on current and deposit accounts with banks and other financial institutions.

Bonuses receivable from suppliers are either offset against respective accounts payable or paid in cash. At 31 December 2015 bonuses receivable from three major suppliers comprised 52% of the Group’s consolidated trade accounts receivable (31 December 2014: 31%). The Group believes no significant credit risk is associated with these receivables since all of the debtors are represented by the Group’s major suppliers.

The credit risk on liquid funds (see the table below) is managed by the Group’s treasury. The management believes that credit risk on investments of surplus funds is limited as the counterparties are financial institutions with high credit ratings assigned by international credit rating agencies.

(in million of Russian Rubles)

The table below shows the balances that the Group has with 5 of its major counterparties as at the balance sheet date:

Counterparty	**Rating (Moody's)**	**Carrying amount as at 31 December 2015**
Sberbank	Ba2	714,937
Raiffeisenbank	Ba2	121,723
ING Bank	Ba1	41,098
VTB 24	Ba2	16,299
MTS bank	B3	11,207
Total		**905,264**

At of 31 December 2015 all loans issued in amount of 5,806,809 are granted to subsidiaries of Sistema which has a credit rating of Ba3 (Moody's). The Group's management believes that such rating is indicative of a high probability of repayment of these loans.

The carrying amount of financial assets recorded in the consolidated financial statements, which is net of impairment losses, represents the Group's maximum exposure to credit risk. There were no other concentrations of credit risk as at 31 December 2015 and 2014.

Foreign currency risk management

The Group undertakes transactions denominated in foreign currencies; consequently, exposures to exchange rate fluctuations arise. Exchange rate exposures are managed within approved policy parameters utilising forward foreign exchange contracts.

The carrying amounts of the Group's monetary assets and liabilities denominated in foreign currencies other than its functional currency were as follows:

	31 December 2015		**31 December 2014**	
	EUR	**USD**	**EUR**	**USD**
Assets				
Cash and and cash equivalents	3,071	79,494	565	455,541
Trade and other receivables	190,608	145,718	7,124	233,161
Total assets	**193,679**	**225,212**	**7,689**	**688,702**
Liabilities				
Trade and other payables	(167,212)	(2,898,131)	(283,797)	(1,944,692)
Total liabilities	**(167,212)**	**(2,898,131)**	**(283,797)**	**(1,944,692)**
Total net position	**26,467**	**(2,672,919)**	**(276,108)**	**(1,255,990)**

Foreign currency sensitivity analysis

The table below details the Group's sensitivity to a depreciation of the RUB against the primary foreign currencies of the Group by 20%, which management believes is an appropriate measure in the current market conditions and which would impact its operations.

	31 December 2015		**31 December 2014**	
	EUR	**USD**	**EUR**	**USD**
Profit/(loss)	5,293	(534,584)	(55,222)	(251,198)

(in million of Russian Rubles)

Interest rate risk

Interest rate risk arises from the possibility that changes in interest rates will affect the value of financial instruments.

The Group manages this risk through analysis of current interest rates, performed by treasury function on the Group entities level. To mitigate the risk exposure the Group receives loans at both fixed and floating rates. In case of changes in market interest rates management may consider refinancing of a particular financial instrument on more favorable terms.

The table below details the Group's sensitivity to change of floating rates by 3%, which management believes is an appropriate measure in the current market conditions and which would impact its operations. The analysis was applied to borrowings based on the assumptions that amount of liability outstanding at the reporting date was outstanding for the entire annual period.

	2015	2014
Profit or loss	87,195	36,111

28. COMMITMENTS AND CONTINGENCIES

Operating Leases

The Group leases retail space through operating lease contracts which expire in various years through 2023, all of which are classified as operating leases. Although the store leases are generally long term, all of the store lease contracts contain provisions that enable the Group to cancel the lease provided the Group either pays a penalty, which typically consists of a payment equal to approximately two to three months rent or sends an advance notice to the lessor.

Future minimum rental payments (without VAT) under non-cancellable operating leases in effect as at 31 December 2015, 31 December 2014 and 1 January 2014 are as follows:

	31 December 2015	31 December 2014	1 January 2014
Within one year	6,447,600	6,962,552	5,203,059
After one year but not more than five years	32,805,763	31,197,923	23,395,389
More than five years	9,490,268	8,746,352	6,507,678
Total	**48,743,631**	**46,906,827**	**35,106,126**

Legal

In the ordinary course of business, the Group may become a party to various legal and tax proceedings, and may be subject to claims. In the opinion of management, the Group's liability, if any, in all pending litigation, other legal proceeding or other matters, will not have a material effect on the financial condition, results of operations or liquidity of the Group.

Taxation

Laws and regulations affecting businesses in the Russian Federation continue to change rapidly. These changes are characterized by different interpretations and arbitrary application by the authorities. Management's interpretation of such legislation as applied to the activity of the Group may be challenged by the relevant regional and federal authorities. The tax authorities in the Russian Federation frequently take an assertive position in their interpretation of the legislation and assessments and as a result, it is possible that transactions and activities may be challenged. It is therefore possible that significant additional taxes, penalties and interest may be assessed. Under certain circumstances reviews may cover longer periods. Where uncertainty exists, the Group has accrued tax liabilities as management's best estimate of the probable outflow of resources which will be required to settle such liabilities. Management believes that it has provided adequately for tax liabilities based on its interpretations of tax legislation. However, the relevant authorities may have differing interpretations, and the effects could be significant.

Operating environment

Emerging markets, including Russia, are subject to economic, political, social, legal, and legislative risks which differ from the risks affecting more developed markets. Laws and regulations affecting businesses in the RF may change rapidly and may be subject to arbitrary interpretations. The future economic direction of the RF is largely dependent upon fiscal and monetary measures undertaken by the government, together with legal, regulatory, and political developments.

Because the RF produces and exports large volumes of oil and gas, the Russian economy is particularly sensitive to the price of oil and gas on the world market. During 2014, the oil price decreased significantly, which led to substantial decrease of the Russian Ruble exchange rate.

Starting from 2014, sanctions have been imposed in several packages by the U.S. and the E.U. on certain Russian officials, businessmen and companies.

In December 2014, the Central Bank of of the RF raised the key interest rate sharply, which caused a significant growth of credit interest rates on the domestic market. In the first quarter of 2015 two international credit agencies downgraded Russia’s long-term foreign currency sovereign rating to the speculative level with the negative outlook.

The above mentioned events have led to reduced access of the Russian businesses to international capital markets, increased inflation, economic recession and other negative economic consequences. The impact of further economic developments on future operations and financial position of the Group is at this stage difficult to determine.

29. SUBSEQUENT EVENTS

The Group has evaluated subsequent events through 29 February 2016, the date on which the consolidated financial statements are available to be issued.

On 29 January 2016 and 5 February 2016, CJSC LM-Finance partially repaid the loan previously issued by the Group in the amount of RUB 4,694,994 thousand and RUB 180,242 thousand, respectively.

DETSKY MIR GROUP

Consolidated Financial Statements
As at 31 December 2014 and 2013
and for the Years then Ended

DETSKY MIR GROUP

CONTENTS

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors and Shareholders of OJSC Detskiy Mir:

We have audited the accompanying consolidated financial statements of OJSC Detsky Mir and its subsidiaries (collectively the "Group"), which comprise the consolidated balance sheets as at 31 December 2014 and 2013 and the related consolidated statements of operations and comprehensive income, cash flows and changes in shareholders' equity/(deficit) for the years then ended, and a summary of significant accounting policies and other explanatory notes.

Management's responsibility for the consolidated financial statements

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with the accounting principles generally accepted in the United States of America and for such internal control as management determines is necessary to enable the preparation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

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

Opinion

In our opinion, the consolidated financial statements present fairly, in all material respects, the consolidated financial position of the Group as at 31 December 2014 and 2013 and its consolidated financial performance and consolidated cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

DELOITTE & TOUCHE

27 February 2015
Moscow, Russia

Andrew Sedov, Partner
(license No. 01-000487)

ZAO Deloitte & Touche CIS

Audited entity: OJSC Detsky Mir

State Registration Certificate No. 7701233499 issued by Interregional Inspectorate of the Russian Ministry of Taxes and Levies No. 29 for Moscow on 13.09.1999.

Location: 37 Vernadsky Prospekt, bldg 3, Moscow, 117415, Russia

Independent auditor: ZAO Deloitte & Touche CIS

State Registration Certificate No. 018.482 issued by the Moscow Registration Chamber on 30 October 1992.

Certificate of registration in the Unified State Register of Legal Entities No. 1027700425444 issued by Interregional Inspectorate of the RF Ministry of Taxes and Levies No.39 for Moscow on 13 November 2002.

Certificate of membership in "NP "Audit Chamber of Russia" (auditors' SRO) of 20 May 2009 No. 3026, ORNZ 10201017407.

DETSKY MIR GROUP

CONSOLIDATED BALANCE SHEETS AS AT 31 DECEMBER 2014 AND 2013
(in thousands of Russian Rubles)

	Notes	2014	2013
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	3	1,670,035	859,902
Loans receivable	4	1,220,000	-
Trade receivables, net	5	459,885	415,828
Inventories	6	11,124,205	8,635,730
Other current assets	7	1,135,722	768,053
Deferred tax assets	13	700,136	510,090
Total current assets		16,309,983	11,189,603
NON-CURRENT ASSETS:			
Property, plant and equipment, net	8	3,098,010	2,240,359
Goodwill	9	362,581	362,581
Other intangible assets, net	9	646,271	244,800
Investment in associate		50,060	53,450
Loans receivable	4	5,239,900	-
Other non-current assets	10	230,919	206,457
Deferred tax assets	13	6,735	86,133
Total non-current assets		9,634,476	3,193,780
TOTAL ASSETS		**25,944,459**	**14,383,383**
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Trade payables		10,094,215	8,126,843
Short-term loans and borrowings and current portion of long-term loans and borrowings	11	6,228,309	1,572,321
Other current liabilities	12	3,452,959	2,343,528
Total current liabilities		19,775,483	12,042,692
NON-CURRENT LIABILITIES:			
Long-term loans and borrowings	11	3,487,670	4,350,000
Deferred tax liabilities	13	34,994	88,644
Total non-current liabilities		3,522,664	4,438,644
TOTAL LIABILITIES		23,298,147	16,481,336
SHAREHOLDERS' EQUITY/(DEFICIT):			
Share capital		392	392
Additional paid-in capital		6,536,844	6,509,136
Treasury shares	18	-	(4,542,514)
Accumulated deficit		(3,877,979)	(4,064,967)
Accumulated other comprehensive loss		(12,945)	-
TOTAL SHAREHOLDERS' EQUITY/(DEFICIT)		2,646,312	(2,097,953)
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY/(DEFICIT)		**25,944,459**	**14,383,383**

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

V.S. Chirakhov
Chief Executive Officer
OJSC DETSKY MIR

A.V. Mrinskaya
Chief Financial Officer
OJSC DETSKY MIR

27 February 2015

DETSKY MIR GROUP

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME FOR THE YEARS ENDED 31 DECEMBER 2014 AND 2013

(in thousands of Russian Rubles, except per share data)

	Notes	2014	2013
Revenue	15	45,446,079	36,000,928
Cost of sales		(28,183,281)	(22,092,798)
Gross profit		17,262,798	13,908,130
Selling, general and administrative expenses	16	(13,522,574)	(11,155,133)
Gain on disposal of a building, net	8	1,163,752	-
Depreciation and amortization		(739,693)	(634,140)
Interest in earnings of associates, net of tax		12,749	19,265
Other operating income and (expenses), net		(6,767)	(1,020)
OPERATING PROFIT		4,170,265	2,137,102
Interest income		55,788	11,034
Interest expense		(917,725)	(517,818)
Foreign exchange loss		(581,784)	(58,410)
Income before income tax expense		2,726,544	1,571,908
Income tax expense	13	(683,744)	(419,165)
NET PROFIT		2,042,800	1,152,743
Other comprehensive loss:			
Effect of translation to presentation currency		(12,945)	-
Total comprehensive income		**2,029,855**	**1,152,743**
Weighted average number of shares outstanding, basic and diluted: [1]		564,822,555	657,000,000
Earnings per share, basic and diluted (in Russian Rubles per share) [1]		3.62	1.75

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

V.S. Chirakhov
Chief Executive Officer
OJSC DETSKY MIR

A.V. Mrinskaya
Chief Financial Officer
OJSC DETSKY MIR

27 February 2015

[1] The earnings per share amounts and weighted average number of shares outstanding, basic and diluted, for all periods herein retroactively reflect the Company's 250,000-for-1 stock split, which was effective on 18 February 2014.

DETSKY MIR GROUP

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED 31 DECEMBER 2014 AND 2013
(in thousands of Russian Rubles)

	2014	2013
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net profit	2,042,800	1,152,743
Adjustments to reconcile net profit to net cash from operations:		
Depreciation and amortization	739,693	634,140
Shrinkage and merchandise inventories obsolescence expenses	455,444	302,073
Foreign exchange loss	581,784	58,410
Deferred income tax benefit	(268,050)	(57,716)
(Gain)/loss on disposal of property, plant and equipment	(1,162,304)	39,525
Share based compensation (Note 14)	373,134	-
Bad debts written off and change in allowance for doubtful accounts	50,953	8,042
Interest in earnings of associates, net of tax	(12,749)	(19,265)
Changes in operating assets and liabilities:		
Trade receivables	(43,423)	(73,282)
Inventories	(2,943,211)	(2,097,606)
Other assets	(416,488)	(85,768)
Trade payables	1,513,654	1,422,062
Other current liabilities	580,932	741,933
Net cash provided by operating activities	1,492,169	2,025,291
CASH FLOW FROM INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	(1,576,836)	(640,081)
Proceeds from sale of property, plant and equipment	1,440,520	-
Purchase of intangible assets	(368,584)	(132,233)
Loans granted to related parties	(2,158,000)	-
Dividends received from associates	17,324	22,771
Net cash used in investing activities	(2,645,576)	(749,543)

DETSKY MIR GROUP

CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED 31 DECEMBER 2014 AND 2013 (CONTINUED)
(in thousands of Russian Rubles)

	2014	2013
CASH FLOW FROM FINANCING ACTIVITIES:		
Dividends paid	(1,855,812)	(420,462)
Repurchase of own shares	-	(4,542,514)
Proceeds from borrowings	19,210,907	13,791,071
Principal repayments on borrowings	(15,391,279)	(10,875,232)
Cash transferred to shareholders in course of reorganization	(276)	-
Net cash generated by / (used in) financing activities	1,963,540	(2,047,137)
INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	810,133	(771,389)
CASH AND CASH EQUIVALENTS, beginning of year	**859,902**	**1,631,291**
CASH AND CASH EQUIVALENTS, end of year	**1,670,035**	**859,902**
CASH PAID DURING THE YEAR FOR:		
Interest	794,856	460,777
Income taxes	657,292	162,138

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

V.S. Chirakhov
Chief Executive Officer
OJSC DETSKY MIR

A.V. Mrinskaya
Chief Financial Officer
OJSC DETSKY MIR

27 February 2015

DETSKY MIR GROUP

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY/(DEFICIT) FOR THE YEARS ENDED 31 DECEMBER 2014 AND 2013
(in thousands of Russian Rubles)

	Share capital		Treasury shares				Accumulated other	
	RUB '000	**Number of shares, 000**	**RUB '000**	**Number of shares, 000**	**Additional paid-in capital**	**Accumulated deficit**	**comprehensive loss**	**Total**
Balance at 1 January 2013	**392**	**739,000**	**-**	**-**	**6,509,136**	**(4,797,248)**	**-**	**1,712,280**
Dividends declared	-	-	-	-	-	(420,462)	-	(420,462)
Repurchase of own shares	-	-	(4,542,514)	185,000	-	-		(4,542,514)
Comprehensive loss								
Net loss	-	-	-	-	-	1,152,743	-	1,152,743
Effect of translation to presentation currency	-	-	-	-	-	-	-	-
Balance at 31 December 2013	**392**	**739,000**	**(4,542,514)**	**185,000**	**6,509,136**	**(4,064,967)**	**-**	**(2,097,953)**
Dividends declared (Note 14)	-	-		-		(1,855,812)	-	(1,855,812)
Sale of treasury shares (Note 14)	-	-	196,052	(7,985)	177,091	-	-	373,143
Reorganisation (Note 1)	-	-	4,346,462	(177,015)	(149,383)	-	-	4,197,079
Comprehensive income:		-						
Net profit	-	-	-	-	-	2,042,800	-	2,042,800
Effect of translation to presentation currency	-	-	-	-	-	-	(12,945)	(12,945)
Balance at 31 December 2014	**392**	**739,000**	**-**	**-**	**6,536,844**	**(3,877,979)**	**(12,945)**	**2,646,312**

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

V.S. Chirakhov
Chief Executive Officer
OJSC DETSKY MIR

A.V. Minskaya
Chief Financial Officer
OJSC DETSKY MIR

27 February 2015

(in thousands of Russian Rubles, unless otherwise stated)

1. DESCRIPTION OF BUSINESS

Nature of the business

OJSC Detsky Mir (the "Company") together with its subsidiaries (the "Group") is the largest retail chain in the children's products market in the Russian Federation ("RF"). The Company is registered in the Unified State Register of Legal Entities under the laws of the Russian Federation, No. 1027700047100. In March 2014, the Company changed its legal name from OJSC Detsky Mir-Center to OJSC Detsky Mir.

The primary activity of the Group is the sale of children's products through retail stores. In 2014 and as at 31 December 2014 the Group operated Detsky Mir branded stores in Russia and Kazakhstan and Early Learning Centre (hereinafter, the "ELC") branded retail stores in Russia.

The controlling shareholder of the Company is JSFC Sistema ("Sistema"). The Detsky Mir Group represents the "Consumer Assets" business unit of Sistema.

As at 31 December 2014 and 2013, the registered shareholders of the Company and their respective ownership were as follows:

	31 December 2014	31 December 2013
JSFC Sistema and its subsidiaries	98.9%	100%
Mr. V.S. Chirakhov	1.1%	-
Total	**100%**	**100%**

The ownership interest of the Group and the proportion of its voting power in its major operating subsidiaries were as follows, as at each period end:

	Ownership interest and proportion of voting power	
Subsidiaries	**31 December 2014**	**31 December 2013**
Detskaya Galereya "Yakimanka" LLC, RF	-*	100%
Detsky Mir Kazakhstan, LLP, Kazakhstan	100%	100%
Kub-Market LLC, RF	100%	100%
DM-Finance LLC, RF	-	100%
Spartema Limited, Cyprus	100%	100%
Detsky Mir GMBH, Germany	100%	100%

* - as noted below, as at 31 December 2014 the Group retained control over Detskaya Galereya "Yakimanka" LLC through an option arrangement.

(in thousands of Russian Rubles, unless otherwise stated)

Group reorganisation

On 12 August 2014 an extraordinary shareholders meeting approved the reorganisation of the Group through spin-off of a new subsidiary, CJSC DMF-Invest, and merging this subsidiary with CJSC DM-Finance, holder of treasury shares. The reorganisation was completed in December 2014 and control over these entities was transferred to the Company's shareholders – JSFC Sistema and its subsidiaries. JSFC Sistema and its subsidiaries have retained control over the Group after the reorganisation.

In the course of the reorganisation the Group also transferred its 100% interest in LLC Detskaya Galereya "Yakimanka" to CJSC DMF-Invest and, ultimately, to JSFC Sistema and its subsidiaries. However, the Group has retained control over the luxury retail business by entering into an option arrangement, which gives the Group a right to purchase 100% of LLC Detskaya Galereya "Yakimanka" for 100 Russian Rubles at any point in time until 1 January 2016. In 2014, the Group also embarked on a plan to transfer the retail luxury business to the Company.

The carrying amounts of assets and liabilities disposed by the Group through the reorganisation, and the impact of the reorganisation on the Group's equity are presented below:

	31 December 2014
Disposed assets and liabilities	
Current assets	
Cash and cash equivalents	276
Other current assets	1,415
Non-current assets	
Long-term loans receivable	938,000
Deferred tax assets	103,750
Current liabilities	
Other current liabilities (interest payable on loans and borrowings)	(696,754)
Non-current liabilities	
Long-term loans and borrowings	(4,543,911)
Total net assets disposed of	**(4,197,224)**
Treasury shares disposed of	**4,346,462**
Effect of reorganisation on the Group's additional paid-in capital	**149,238**

Operating environment

Emerging markets, including Russia, are subject to economic, political, social, legal, and legislative risks which differ from the risks affecting more developed markets. Laws and regulations affecting businesses in the RF may change rapidly and may be subject to arbitrary interpretations. The future economic direction of RF is largely dependent upon fiscal and monetary measures undertaken by the government, together with legal, regulatory, and political developments.

Because RF produces and exports large volumes of oil and gas, the Russian economy is particularly sensitive to the price of oil and gas on the world market. During 2014 energy prices dropped significantly. Management is unable to estimate reliably further price movements and the impact that they may have on the Company's financial position.

Starting from March 2014, the USA and the EU imposed sanctions on a number of Russian officials, businessmen, and organizations. International rating agencies downgraded the RF's long-term foreign currency sovereign rating. In December 2014, the Russian Central Bank raised its key policy rate significantly, which caused a considerable growth of lending rates in the domestic market. The ruble devaluated significantly against other currencies, whereas the Group pays for a large proportion of merchandise purchases in Euros and US dollars. These developments may restrict access to international capital and export markets for Russian businesses, which might provoke capital flight, weakening of the Ruble, and other negative economic consequences.

The Group's management believes that it has taken appropriate measures to support sustainability of the business in the current conditions.

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of presentation – The accompanying consolidated financial statements have been prepared in conformity with the accounting principles generally accepted in the United States of America ("U.S. GAAP").

The Group's Russian entities maintain accounting records in Russian Rubles in accordance with the requirements of Russian accounting and tax legislation. Other Group entities maintain accounting records in the local currencies of their domicile in accordance with the requirements of the respective accounting and tax legislation. The accompanying consolidated financial statements differ from the financial statements prepared for statutory purposes in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP.

Principles of consolidation – The consolidated financial statements include the financial position and results of the Company, controlled subsidiaries and entities where the Group has operating and financial control through direct or indirect ownership of a majority voting interest or through a shareholders' agreement.

All significant intercompany transactions, balances and unrealized gains and losses on transactions have been eliminated.

Investments are accounted for using the equity method of accounting if the Group has the ability to exercise significant influence, but not control, over the investee. Significant influence is generally deemed to exist if the Group has an equity ownership in the voting stock of the investee between 20 and 50 percent, although other factors, such as representation on the Board of Directors and the impact of commercial arrangements, are considered in determining whether the equity method of accounting is appropriate. Under the equity method of accounting the investment is carried at cost of acquisition, plus the Group's equity in undistributed net income since acquisition, less any dividends received since acquisition. The Group's share in the net income of associates is included within operating income, provided that the Group has day-to-day involvement in the business activities and they are considered to be integral to the Group's business.

The Group periodically reviews its investments in associates for which fair value is less than cost to determine if the decline in value is other than temporary. If the decline in value is judged to be other than temporary, the cost basis of the investment is written down to fair value. The amount of any write-down is included in the statements of operations as a realized loss.

All other equity investments in which the Group does not have the ability to exercise significant influence are accounted for by the cost method.

Segment reporting – Reportable segments are determined based on the financial information which is available and utilized on a regular basis by the Company's chief operating decision maker to assess financial performance and to allocate resources. The Group has three operating segments pursuant to the Financial Accounting Standards Board ("FASB") Accounting Standards Codification

("ASC") 280 Segment Reporting, being retail, luxury retail, and online sales. However, luxury retail and online sales are below the quantitative thresholds stipulated by ASC 280, Segment Reporting, for being separately reportable segments and as such are aggregated with the retail segment. The disclosures presented herein therefore, constitute the Group's entity wide disclosures.

The Group mainly operates in the Russian Federation, with insignificant sales in Kazakhstan that are not disaggregated to separate reportable segment. The Group believes that disaggregating its geographic operating segments would not provide material or meaningful additional information.

Customer base of the Group is diversified; therefore, transactions with a single external customer do not exceed 10% of the Group's revenue.

Use of estimates – The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as at the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. The estimates and associated assumptions are based on historical experience and other factors that are considered to be relevant. Actual results may differ from these estimates. The estimates and underlying assumptions are reviewed on an ongoing basis.

In particular, significant estimates and assumptions used in preparing the consolidated financial statements include the useful lives and recoverability of long-lived tangible and intangible assets including goodwill, judgment as to whether bonuses received from suppliers are in substance volume based or represent a reimbursement of specific, incremental, identifiable costs incurred by the Group in selling the suppliers' products, the allocation of a portion of bonuses received from suppliers during the period to merchandise inventories held in the Group's stores and warehouses at period-end, shrinkage and merchandise inventories obsolescence expenses and valuation allowance for deferred tax assets.

Financial instruments – The Group's financial instruments include cash and cash equivalents, trade receivables, trade payables, borrowings, loans receivable and derivative financial instruments. The particular recognition methods adopted are disclosed in the individual policy statements associated with each item.

Cash and cash equivalents – Cash includes cash on hand and amounts in bank accounts. Cash equivalents include cash invested temporarily in highly liquid instruments with maturities of three months or less at the time of purchase.

Trade receivables – Trade receivables are stated at their net realizable value after deducting the allowance for doubtful debts. Such allowance reflects either specific cases of delinquencies or defaults or estimates based on evidence of collectability.

Borrowings – Borrowings are initially recognized at their fair value, net of transaction costs, and are subsequently stated at amortized cost; any difference between the proceeds (net of transaction costs) and the redemption value is recognized in the consolidated income statement over the period of the borrowings using the effective interest method. Debt issuance costs are capitalized and amortized over the term of the respective borrowings using the effective interest method. Borrowings are classified as current liabilities, except when the Group has unconditional right to defer the settlement of the liability for at least 12 months after the balance sheet date. Borrowing costs directly attributable to the acquisition, construction or production of assets that necessarily take a substantial time to get ready for intended use or sale (qualifying assets) are capitalised as part of the costs of those assets. Capitalisation of borrowing costs continues up to the date when the assets are substantially ready for their use or sale.

Concentration of credit risk – Financial instruments that potentially expose the Group to concentration of credit risk consist primarily of cash and cash equivalents. RUB 561,905 thousand of the Group's cash and cash equivalents balance as at 31 December 2014 were held with three banks (as at 31 December 2013: RUB 627,124 thousand with three banks).

Moreover, the Group has a concentration of risk with respect to loans receivable from related parties. As at 31 December 2014, all the loans of RUB 6,459,900 thousand were owed to the Group by JSFC Sistema and its subsidiaries.

The Group is not exposed to significant concentration of credit risk on its sales and trade receivables since the Group is engaged in retail sale of its products where sales to each individual customer represent a minor percentage of total sales and all transactions are paid for in the stores.

Fair value measurements – The Group records and discloses certain financial and non-financial assets and liabilities at their fair value. The fair value of an asset is the price at which the asset could be sold in an orderly transaction between unrelated, knowledgeable and willing parties able to engage in the transaction. A liability's fair value is defined as the amount that would be paid to transfer the liability to a new debtor in a transaction between such parties, not the amount that would be paid to settle the liability with the creditor.

Assets and liabilities recorded at fair value are measured using a three-tier fair value hierarchy, which prioritizes the inputs used in measuring fair value. These tiers include:

- Level 1 – Valuations based on quoted prices in active markets that the Company has the ability to access for identical assets or liabilities;
- Level 2 – Valuations based on quoted prices in markets that are not active or for which all significant inputs are observable, either directly or indirectly; and
- Level 3 – Valuations based on inputs that are unobservable and significant to overall fair value measurement.

The disclosure of fair value of certain financial assets and liabilities recorded at cost or amortised cost is as follows:

- Cash and cash equivalents: The carrying value approximates fair value due to the short maturity of these instruments;
- Trade and other receivables, short-term loans receivable, trade and other payables, short-term borrowings: The carrying value approximates fair value due to the short maturity of these instruments;
- Long-term loans receivable: The fair value is based on the current interest rate for similar types of loan arrangements or, where applicable, quoted market prices.
- Long-term borrowings: The fair value is based on the Group's current incremental borrowing rate for similar types of borrowing arrangements or, where applicable, quoted market prices.

Derivative financial instruments – In 2014 the Group entered into foreign exchange forward contracts to manage its exposure to foreign exchange rate risks. The Group accounts for derivative financial instruments in accordance with Accounting Standards Codification ("ASC") Topic 815 Derivatives and Hedging ("ASC 815") and records all derivatives as either assets or liabilities on the consolidated balance sheet measured at fair value and recognizes the changes in fair value as unrealized gains and losses in the consolidated statement of operations and comprehensive income within foreign exchange gains and losses. The Group does not designate its foreign exchange forward contracts as hedges.

The fair value of the Group's foreign currency derivatives is determined in accordance with ASC 820, using Level 2 inputs. The inputs used include quoted prices for similar contracts in an active market.

Foreign currency translation – The Group follows a translation policy in accordance with ASC 830, Foreign Currency Matters. Management has determined that the functional currency of the Company and its Russian subsidiaries is the Russian Ruble ("RUB"). The functional currencies of the Company's German and Kazakhstan subsidiaries are the Euro and Tenge, respectively.

The Group has selected the Russian ruble as the presentation currency starting with its consolidated financial statements for the year ended 31 December 2014. The management believes that the Russian Ruble is the most convenient presentation currency for users of these consolidated financial statements. The change of the presentation currency from the US dollars to the Russian Ruble is a change of accounting policy and was applied retrospectively, i.e. comparative information is also presented in Russian Rubles.

Business combinations – The Group accounts for acquisition of businesses from third parties using the acquisition method and recognizes identifiable assets and liabilities acquired and non-controlling interests in the entity acquired at fair value as at the acquisition date. The results of operations of the acquired subsidiaries are included in the Group's results from the acquisition date.

Revenue recognition – The Group generates and recognizes sales to retail customers at the point of sale in its stores, net of value added tax. For online sales, the Group recognizes revenue at the time the products are delivered to customers. Discounts earned by customers are recorded by the Group as a reduction of the sales price at the time of sale. Revenue from services is recognized in the period in which services are rendered.

The Group sells gift cards to its customers in its retail stores. The gift cards have an expiration date and are required to be used during specified periods of time. The Group recognizes revenue from gift cards either when the gift card is redeemed by the customer or when the gift card expires.

Customer loyalty program – The Group has a customer loyalty program which allows customers to earn points for each purchase made in any of its retail stores. Points earned enable customers to receive a cash discount on future purchases, provided the purchase is made within one year of earning the points. The value of points issued under the Group's loyalty program is included as a liability on the Group's balance sheet and is recorded as a reduction in revenue at the time the points are earned, based on the value of points that are projected to be redeemed. Other administrative costs of the Customer Loyalty Program are recorded in Selling, general and administrative expenses.

During 2014 and 2013 the Group participated in a partnership program run by OJSC Sberbank of Russia. Pursuant to this program, buyers can collect bonus points when paying for their purchases of goods or services using an OJSC Sberbank of Russia payment card; such bonus points can be redeemed against future purchases of goods or services from any of the program's participants. Participants in the program pay OJSC Sberbank of Russia a contracted sum for each bonus point issued, and receive compensation from OJSC Sberbank of Russia for points received by customers against their goods or services.

The Group recognizes amounts payable to and receivable from OJSC Sberbank of Russia under the program as a reduction of and increase to revenue, respectively, at the point the bonus points are earned or redeemed by the customer.

On 14 November 2014 the Group left the loyalty program run by OJSC Sberbank of Russia with an agreement that any amounts due to/from the Group under this program at this date should be settled in full.

Cost of sales – Cost of sales includes the cost of merchandise acquired from vendors, freight in, costs related to transporting merchandise from distribution centers to stores, write-off of excess and obsolete inventory, provision for inventory shrinkage and credits and allowances from merchandise vendors.

Leases – The Group has not entered in any finance leases, although enters into operating leases in the normal course of business, particularly relating to rental of retail store premises.

Operating lease payments are recognized as an expense on a straight-line basis over the lease term, except where another systematic basis is more representative of the time pattern in which economic benefits from the leased asset are consumed. Contingent rentals arising under operating leases are recognized as an expense in the period in which they are incurred.

Merchandise inventories – Merchandise inventories are stated at the lower of: cost (using the first-in, first out or "FIFO" method) or market. The cost of merchandise inventories includes the purchase price, and associated customs duties, transportation costs, and other costs related in bringing the inventory to a point where it is ready for sale.

At the end of each reporting period, the Group makes a write-off for estimated inventory shrinkage and estimated losses from obsolete and slow-moving stock.

Volume rebates from suppliers are included as a reduction to the cost of inventory. Costs associated with storing and transporting merchandise inventories from the central distribution warehouse to the stores are expensed as incurred and included within cost of sales.

Bonuses and allowances received from suppliers – The Group receives bonuses and allowances that are related to formal agreements negotiated with its suppliers. These bonuses and allowances are predominantly for cooperative advertising, promotions, and volume related discounts. The Group accounts for supplier bonuses and allowances as a reduction of product cost unless these represent a reimbursement of specific, incremental, identifiable costs incurred by the Group in selling the suppliers' products. Supplier allowances provided as a reimbursement of specific incremental and identifiable costs incurred to promote a supplier's product are included as a reduction in the respective expenses when the cost is incurred.

Value-added taxes – Value-added taxes ("VAT") related to sales are payable to the tax authorities on the earliest of (a) cash received from customers or (b) goods are transferred or services are rendered to customers. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. Recoverable input VAT related to purchase transactions for which there is no legal right of offset with output VAT are recorded as VAT receivable in the accompanying consolidated financial statements.

Property, plant and equipment – Cost includes all costs directly attributable to bringing the asset to working condition for its intended use. Major expenditures for improvements and replacements that extend the useful lives of the assets or increase their values or revenue generating capacity are capitalized. Repairs and maintenance are charged to the consolidated statements of operations and comprehensive income as incurred.

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

Buildings	20-40 years
Leasehold improvements	5-10 years
Trade equipment	5-7 years
Office equipment and other property, plant and equipment	3-5 years

Leasehold improvements are depreciated on a straight-line basis over the shorter of their useful life or lease term. The lease term includes renewals when such renewals are reasonably assured.

Construction in-progress and equipment for installation are not depreciated until the asset is placed into service. Items of property, plant and equipment that are retired or otherwise disposed of are eliminated from the consolidated balance sheet along with the corresponding accumulated depreciation. Any gain or loss resulting from such retirement or disposal is included in the determination of consolidated net income.

Impairment of long-lived assets – The Group evaluates long-lived assets such as store property and equipment and other corporate assets for impairment whenever events or changes in circumstances indicate that the carrying amount of those assets may not be recoverable. Factors considered important that could trigger an impairment review include, but are not limited to, significant underperformance relative to historical or projected future operating results and significant changes in the manner of use of the assets or our overall business strategies. Potential impairment exists if the estimated undiscounted cash flows expected to result from the use of the asset plus any net proceeds expected from disposition of the asset are less than the carrying value of the asset. The amount of the impairment loss represents the excess of the carrying value of the asset over its fair value and is included in real estate and other, net on the consolidated statement of operations and other comprehensive income. We estimate fair value based on either a projected discounted cash flow method using a discount rate that is considered commensurate with the risk inherent in our current business model or appraised value, as appropriate. We also take other factors into consideration in estimating the fair value of our stores, such as local market conditions, operating environment, mall performance and other trends.

Goodwill and other intangible assets – Goodwill represents the excess of the cost of businesses acquired over the fair value of the identifiable assets, liabilities and contingent liabilities at the dates of acquisition.

The Group reviews goodwill for impairment annually and whenever facts or circumstances indicate that the carrying amounts may not be recoverable. In testing for impairment, the fair value of each reporting unit is compared with its carrying value, including goodwill. If the carrying amount of a reporting unit exceeds its fair value, the amount of an impairment loss, if any, is calculated by comparing the implied fair value of reporting unit goodwill with the carrying amount of that goodwill.

No impairment of long-lived assets, goodwill and other intangible assets has been recognized in any of the reporting periods covered by these consolidated financial statements.

Intangible assets with finite useful lives are amortized on a straight-line basis. The Group's other intangible assets represent Detsky Mir trademarks and various purchased software. Trademarks which have an insignificant carrying value are not amortized. Other intangible assets are amortized over three to ten years.

Income taxes – Income taxes have been computed in accordance with the laws of the country of incorporation of the respective companies of the Group. The income tax rate in the Russian Federation in all reported periods was 20%. The foreign subsidiaries of the Group pay income taxes in their respective jurisdictions.

Deferred tax assets and liabilities are recognized for the expected future tax consequences of existing differences between the financial and tax reporting bases of assets and liabilities, as well as loss carry forwards, using enacted tax rates expected to be in effect at the time these differences are realized. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in the consolidated statement of operations and comprehensive income in the period in which the change is substantively enacted. Deferred tax assets are reduced through the establishment of a valuation allowance at such time as, based on available evidence, it is more likely than not that the deferred tax assets will not be realized. The Group adjusts valuation allowances to measure deferred tax assets at the amount considered realizable in future periods if the Group's facts and assumptions change. In making such determination, the Group considers all available positive and negative evidence, including future reversals of existing taxable temporary differences, projected future taxable income, tax planning strategies and recent financial operations.

Positions taken in the tax returns of the subsidiaries forming part of the Group may be subject to challenge by the taxing authorities upon examination. The Group recognizes income on uncertain tax positions in the consolidated financial statements for positions which are considered more likely than not of being sustained based on the technical merits of the position on audit by the tax authorities. The measurement of the tax benefit recognized in the consolidated financial statements is based upon the largest amount of tax benefit that, in management's judgment, is greater than 50% likely of being realized based on a cumulative probability assessment of the possible outcomes. The Group classifies uncertain tax positions as well as penalties and fines as tax related liabilities. The Group recognizes interest and penalties accrued related to unrecognized tax positions as part of the provision for income taxes.

Retirement and post-retirement benefits – The Group makes payments for employees into the Pension fund of the Russian Federation. The rate is 22%, and from 2013 the maximum amount subject to contributions was RUB 568 thousand for each employee per annum. From 1 January 2014 the limit was increased to RUB 624 thousand. The rate of contribution to the pension fund in cases where the threshold has been exceeded is 10%. The Group has no additional pension obligations. Contributions to medical and social funds, which are expensed as incurred, are calculated at a rate of 6%. Contributions to the Russian Pension Fund and to medical and social funds are expensed as incurred.

Share-based payments – In August to September 2014 a number of the Company's employees were entitled to share-based payments (“phantom” shares). The Group's liabilities related to such payments are recognized as “awards classified as liabilities” and measured at the fair value of such liabilities. At the end of each reporting period until the liability is settled, and at the date of settlement, the fair value of the liability is remeasured, with any changes in fair value recognized in profit or loss for the period.

Distributions to shareholders – Distributable retained earnings of the Group are based on amounts extracted from the statutory accounts of individual entities and may significantly differ from amounts calculated on the basis of U.S. GAAP. Distributions are recognized as a liability in the period in which they have been declared by the shareholders at a general meeting and become legally payable.

Comprehensive income – Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources.

Treasury stock – If the Group reacquires its own equity instruments, those instruments (“treasury shares”) are recognized as a deduction of equity at cost, being the consideration paid to reacquire the shares. No gain or loss is recognized in profit or loss on the purchase, sale, issue or cancellation of the Group’s own equity instruments. Such treasury shares may be acquired and held by the Company or by other subsidiaries of the Group.

Effect of recent accounting pronouncements – Accounting Standards Update (“ASU”) No. 2013-11 Presentation of Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists amending ASC 740 provides that a liability related to an unrecognized tax benefit should be offset against a deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward if such settlement is required or expected in the event the uncertain tax position is disallowed. In that case, the liability associated with the unrecognized tax benefit is presented in the financial statements as a reduction to the related deferred tax asset for a net operating loss carryforward, a similar tax loss or a tax credit carryforward. In situations in which a net operating loss carryforward, a similar tax loss or a tax credit carryforward is not available at the reporting date under the tax law of the jurisdiction or the tax law of the jurisdiction does not require, and the entity does not intend to use, the deferred tax asset for such purpose, the unrecognized tax benefit should be presented in the financial statements as a liability and should not be combined with deferred tax assets. This amendment is effective prospectively for fiscal years, and interim periods within those years, beginning after 15 December 2013. The Group adopted ASU No. 2013-11 starting from 1 January 2014. The adoption did not have a material effect on the Group’s financial position, results of operations or cash flows.

New accounting pronouncements – In April 2014, the Financial Accounting Standards Board (“FASB”) issued ASU 2014-08, Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity, an amendment to ASC Topic 205, Presentation of Financial Statements, and ASC Topic 360, Property, Plant and Equipment. The update revises the definition of discontinued operations by limiting discontinued operations reporting to disposals of components of an entity that represent strategic shifts that have (or will have) a major effect on an entity's operations and financial results, removing the lack of continuing involvement criteria and requiring discontinued operations reporting for the disposal of an equity method investment that meets the definition of discontinued operations. The update also requires expanded disclosures for discontinued operations, including disclosure of pretax profit or loss of an individually significant component of an entity that does not qualify for discontinued operations reporting. This ASU is effective for the Group prospectively beginning in fiscal 2015, with early adoption permitted. The adoption of this guidance should not have a material impact on the Group's results of operations, financial position or cash flows.

(in thousands of Russian Rubles, unless otherwise stated)

In May 2014, FASB issued ASU 2014-09, Revenue from Contracts with Customers, issued as a new Topic, ASC Topic 606. The new revenue recognition standard provides a five-step analysis of transactions to determine when and how revenue is recognized. The core principle of the guidance is that a Company should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. For public companies these amendments become effective for fiscal years, and interim periods within those years, beginning after 15 December 2016. Early adoption is prohibited. The Group has not determined a procedure for adoption and is currently evaluating the effect of the ASU on its consolidated financial statements.

3. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of 31 December 2014 and 2013 comprised:

	2014	**2013**
Cash on hand	130,640	90,733
Cash on bank accounts	948,287	392,456
Cash in transit	591,108	376,713
Total	**1,670,035**	**859,902**

Cash in transit represents cash collected from the Group's stores and not yet deposited into the Group's bank accounts at the year-end.

Cash and cash equivalents as at 31 December 2014 and 2013 include cash and term deposits held in MTS Bank, a subsidiary of Sistema, in the amount of RUB 68,631 thousand and RUB 22,354 thousand, respectively.

4. LOANS RECEIVABLE

Long-term loans receivable as at 31 December 2014 and 2013 comprised the following:

	2014	**2013**
A loan granted to CJSC DM-Finance, a related party, on 3 July 2013 denominated in Rubles at 10.55% per annum maturing in September 2020 (Note 1)	4,543,911	-
Accrued interest	695,989	-
Total	**5,239,900**	**-**

(in thousands of Russian Rubles, unless otherwise stated)

Short-term loans receivable as at 31 December 2014 and 2013 comprised the following:

	2014	**2013**
A loan granted to CJSC Sistema-Telecom-Aktivy, a related party, denominated in Rubles at 12% per annum maturing in December 2015	1,220,000	-
Accrued interest	-	-
Total	**1,220,000**	**-**

Long-term and short-term loans granted to subsidiaries of Sistema, related parties, are unsecured.

The fair value of long-term loans receivable from related parties as at 31 December 2014 was RUB 3,264,320 thousand. The fair value of short-term loans granted to related parties as at 31 December 2014 approximated their carrying amount.

5. TRADE RECEIVABLES, NET

Trade receivables as at 31 December 2014 and 2013 consisted of the following:

	2014	**2013**
Trade receivables	460,129	416,712
Less: allowance for doubtful accounts	(244)	(884)
Total	**459,885**	**415,828**

Trade receivables are generally represented by amounts receivable from suppliers related to volume and other bonuses and for goods returned to suppliers.

6. INVENTORIES

Inventories as at 31 December 2014 and 2013 consisted of the following:

	2014	**2013**
Merchandise inventories	11,086,896	8,550,830
Materials	37,309	84,900
Total	**11,124,205**	**8,635,730**

Materials are represented by spare parts, packaging materials and other materials used in outlets and warehouses.

Write-offs of merchandise inventories relating to shrinkage and write-down to market in the amount of RUB 455,444 thousand and RUB 302,073 thousand for the years ended 31 December 2014 and 2013, respectively, were recorded within cost of sales in the consolidated statements of operations and comprehensive income.

(in thousands of Russian Rubles, unless otherwise stated)

7. OTHER CURRENT ASSETS

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

	2014	2013
Advances to suppliers	252,434	112,981
Value added tax receivable	439,896	231,428
Other advances	169,482	109,316
Other taxes receivable	5,101	15,972
Prepaid expenses	19,662	12,437
Loyalty program receivables from OJSC Sberbank of Russia	1,673	154,446
Other	281,758	159,620
Less: allowance for doubtful accounts	(34,284)	(28,147)
Total	**1,135,722**	**768,053**

Other advances consist of lease prepayments and customs duties. Other current assets include receivables due from Detsky Mir – Roznichnye Aktivy, a subsidiary of Sistema, in the amount of RUB 16,687 thousand. (2013: RUB 31,944 thousand).

8. PROPERTY, PLANT AND EQUIPMENT, NET

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

	2014	2013
Buildings and leasehold improvements	2,970,168	2,573,901
Trade equipment	2,684,638	2,304,398
Construction in-progress (fixtures and fittings for installation)	485,045	106,043
	6,139,851	**4,984,342**
Less: accumulated depreciation	(3,041,841)	(2,743,983)
Total	**3,098,010**	**2,240,359**

Depreciation expense for the years ended 31 December 2014 and 2013 amounted to RUB 644,772 thousand and RUB 564,315 thousand, respectively.

In December 2014 the Group sold the building occupied by its luxury retail store, which on the date of disposal had a carrying amount of RUB 229,007 thousand, to a third party for cash consideration of RUB 1,440,520 thousand. In addition, the Group incurred transaction costs for the disposal of the building totalling RUB 47,761 thousand. Gain on disposal of the building of RUB 1,163,752 thousand was presented as a separate line item in the consolidated statement of operations and comprehensive income.

Loss on disposal of other property, plant and equipment of RUB 1,448 thousand and RUB 38,441 thousand was recognized in other operating income and expense, net in the consolidated statements of operations and comprehensive income for the years ended 31 December 2014 and 2013, respectively.

(in thousands of Russian Rubles, unless otherwise stated)

9. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

Goodwill and other Intangible assets, net of accumulated amortization, as at 31 December 2014 and 2013 consisted of the following:

	2014	2013
Goodwill	362,581	362,581
Other intangible assets	646,271	244,800
Total	**1,008,852**	**607,381**

As at 31 December 2014 and 2013, management performed an impairment test of goodwill, which had arisen on acquisition of Kub-Market LLC, and concluded that the goodwill was not impaired.

Other intangible assets as at 31 December 2014 and 2013 consisted of the following:

	2014	2013
Software	1,136,161	638,612
Trademarks	3,313	4,484
	1,139,474	**643,096**
Less: accumulated amortization	(493,203)	(398,296)
Total	**646,271**	**244,800**

The increase of the carrying amount of software in 2014 relates primarily to licenses acquired for an ERP system (SAP) and capitalised implementation costs. The Group is planning to start launching SAP in 2015.

Amortization expense on other intangible assets for the years ended 31 December 2014 and 2013 amounted to RUB 94,921 thousand and RUB 69,810 thousand, respectively. The estimated amortization expense on other intangible assets for each of the five succeeding years and thereafter is as follows:

Year ended 31 December	
2015	124,871
2016	73,668
2017	55,314
2018	45,281
2019	39,747
Thereafter	304,077
Total	**642,958**

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

(in thousands of Russian Rubles, unless otherwise stated)

10. OTHER NON-CURRENT ASSETS

Other non-current assets as at 31 December 2014 and 2013 consisted of the following:

	2014	2013
Long-term advances paid under operating lease agreements for warehouses and stores	230,848	189,175
Other	71	17,282
Total	**230,919**	**206,457**

11. LOANS AND BORROWINGS

Loans and borrowings as at 31 December 2014 and 2013 comprise:

	Annual interest rate (as at 31 December 2014)	2014	2013
Corporate bonds	8.5%	1,150,000	1,150,000
Bank loans			
RUB-denominated bank loans	from 6.7% to 16.5% per annum Mosprime+3% per annum	8,565,979	4,772,321
		9,715,979	**5,922,321**
Less current portion of long-term debt		(6,228,309)	(1,572,321)
Loans and borrowings, net of current portion		**3,487,670**	**4,350,000**

Corporate bonds

In December 2005, the Company issued corporate RUB-denominated bonds in the amount of RUB 1,150 million maturing in May 2015. The bonds are traded on the MICEX stock exchange, with the interest payable semi-annually. The market value of the bonds, determined based on MICEX stock exchange quotations, as at 31 December 2014 and 2013 was RUB 1,137,356 thousand and RUB 1,194,417 thousand, respectively. The principal of corporate bonds is fully and unconditionally guaranteed by the Moscow City Government. The Company has pledged to the Moscow City Government real estate with an approximate carrying value of RUB 120,160 thousand (as at 31 December 2013: RUB 129,215 thousand).

RUB-denominated bank loans

During 2013, the Group took a long-term loan from OJSC Sberbank of Russia to fund the repurchase of its own shares from OJSC Sberbank of Russia (Note 18). The Group pledged repurchased treasury shares and 100% shares of the Group's subsidiary – LLC Detskaya Galereya "Yakimanka" – as security for the loan. During the reorganisation (Note 1) the pledge of the assets was terminated by agreement with OJSC Sberbank of Russia; however, the share in LLC Detskaya Galereya "Yakimanka" controlled by the Group through the option arrangement (Note 1) continues to be pledged by its sole participant CJSC DM-Finance. As at 31 December 2014 and 2013, the amount due to OJSC Sberbank of Russia under this loan agreement was RUB 3,200,000 thousand.

In 2014 the Group increased the amount of its short-term debt received under a credit facility from OJSC Sberbank of Russia from RUB 1,000,000 thousand as at 31 December 2013 to RUB 2,500,000 thousand as at 31 December 2014, and raised new short-term loans from CJSC Unicredit Bank of RUB 1,200,620 thousand. Also, as at 31 December 2014 the Group had debt under short-term credit facilities from CJSC Raiffeisenbank and OJSC VTB Bank totalling RUB 1,049,592 thousand.

(in thousands of Russian Rubles, unless otherwise stated)

In 2014, the Group also entered into a long-term credit facility with OJSC VTB Bank with a maximum limit of RUB 1,290,000 thousand. As at 31 December 2014, the Group drew 306,848 thousand under this facility, maturing in 2019. Interest rates under the credit facility range from 11.45% to 11.85% per annum.

The fair value of the Group's bank loans, including amounts due within one year, as at 31 December 2014 and 2013 was RUB 8,441,284 thousand and RUB 5,025,478 thousand, respectively. The carrying amount of this debt was RUB 8,565,979 thousand and RUB 4,772,315 thousand, respectively.

Unused credit line facilities

As of 31 December 2014 the Group had total available unused credit line facilities of RUB 4,032,230 thousand, including RUB 983,152 thousand available under long-term credit lines.

Covenants

Certain of the Group's loan agreements contain covenants requiring the Group to meet certain financial ratios. The loan agreements contain various provisions that are triggered in the case of non-compliance with the specific covenants and these provisions differ in each agreement. Specifically, the banks may either increase interest rates on the loans, request the Group to contribute additional collateral, or request immediate repayment of the respective debt. Management believes that the Group was in compliance with all restrictive financial covenants as at 31 December 2014 and 2013.

In particular, the loan agreement entered into by the Group with OJSC Sberbank of Russia in 2013 with the purpose of financing repurchase of treasury shares from OJSC Sberbank of Russia contains a condition that that should the Group sell out LLC Detskaya Galereya "Yakimanka", a subsidiary, then the repayment schedule of the borrowing will be accelerated. In 2014, the Group received a waiver letter from OJSC Sberbank of Russia which confirms that OJSC Sberbank of Russia will not request immediate repayment of the loan as a result of reorganisation (Note 1).

Pledges

Except for the above real estate and 100% in LLC Detskaya Galereya "Yakimanka" pledged as security under a loan agreement with OJSC Sberbank of Russia, as at 31 December 2014 and 31 December 2013 the Group has no other assets or securities pledged to secure loans and borrowings granted to the Group.

Maturity analysis of loans and borrowings

The following table presents the aggregated scheduled maturities of the bonds and bank loans principal outstanding as at 31 December 2014:

Year ending 31 December	
2015	6,228,309
2016	290,045
2017	930,045
2018	930,045
2019	910,867
2020	426,668
Total	**9,715,979**

(in thousands of Russian Rubles, unless otherwise stated)

12. OTHER CURRENT LIABILITIES

Other current liabilities as at 31 December 2014 and 2013 consisted of the following:

	2014	2013
Taxes payable	1,153,769	657,464
Accrued salaries	389,358	353,475
Accrued liabilities under the loyalty program	347,013	353,770
Interest payable	37,400	16,954
Accrued expenses and other current liabilities	1,525,419	961,865
Total	**3,452,959**	**2,343,528**

Included in other current liabilities are liabilities to subsidiaries of Sistema as at 31 December 2014 and 2013 in the amount of RUB 76,065 thousand and RUB 7,364 thousand, respectively.

13. INCOME TAX

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

	2014	2013
Current income tax expense	(951,793)	(476,874)
Deferred income tax benefit	268,050	57,709
Total income tax expense	**(683,744)**	**(419,165)**

Income tax expense is different from that which would be obtained by applying the statutory income tax rate of 20% effective in the Russian Federation to profit before income tax. The items causing this difference are as follows:

	2014	2013
Income tax expense computed on profit before income taxes at statutory rate of 20%	(545,309)	(314,382)
Adjustments for:		
Non-deductible inventory losses	(128,666)	(121,436)
Other non-deductible expenses, net	(31,190)	(10,733)
Prior period income tax adjustment	15,529	25,001
Effect of rates different from Russian statutory rate	5,892	287
Change in valuation allowance for deferred tax assets	-	2,098
Income tax expense	**(683,744)**	**(419,165)**

(in thousands of Russian Rubles, unless otherwise stated)

Tax effects of the temporary differences as at 31 December 2014 and 2013 were as follows:

	2014	2013
Trade receivables	15,163	11,619
Inventories	362,836	192,873
Accrued liabilities under the loyalty program	69,403	70,761
Losses carried forward	23,893	10,113
Accrued expenses and other temporary differences	228,841	224,724
Total current deferred tax assets	**700,136**	**510,090**
Losses carried forward	8,608	92,787
Less: valuation allowance	(1,873)	(6,654)
Total long-term deferred tax assets	**6,735**	**86,133**
Property, plant and equipment	(10,570)	(25,889)
Accrued supplier bonuses and marketing compensations	-	(52,661)
Other	(24,424)	(10,094)
Total long-term deferred tax liabilities	**(34,994)**	**(88,644)**

14. SHARE-BASED PAYMENTS

Long-Term Incentive Plan

In August 2014, the Group's Board of Directors approved an employee long-term incentive plan (the "Incentive Plan"). Under the conditions of the Incentive Plan, certain employees at senior levels are entitled to share-based compensation, so-called "phantom" shares, that are to be granted by the Group in annual tranches over 2014-2016. The phantom shares vest on 31 December 2016 contingent on continued employment with the Group and certain established targets relating to the increase in the Group's market value. The phantom shares vest automatically upon a successful initial public offering by the Group or upon the sale by the Group's controlling shareholder of a certain stake in the Group to a third-party investor. Upon redemption of phantom shares, a participant receives either a respective number of shares in the Company or cash consideration computed on the basis of the market value of one ordinary share of the Company.

Phantom shares granted by the Group to the participants of the Incentive Plan as well as other changes in phantom shares outstanding are summarized below:

	Number of phantom shares	Weighted average exercise price
Outstanding at 31 December 2013	**-**	**-**
Granted during the period	2,648,588	-
Forfeited / canceled during the period	-	-
Outstanding at 31 December 2014	**2,648,588**	**-**
Exercisable at 31 December 2014	-	-

As at 31 December 2014, the Group recognized liabilities of RUB 20,347 thousand in relation to the Incentive Plan. The respective expense was recognized as Selling, General and Administrative expenses in the consolidated statements of operations and comprehensive income. At 31 December 2014 there was approximately RUB 69,585 thousand of total unrecognized compensation cost related to share-based compensation arrangements granted under the Incentive Plan. This cost is expected to be recognized over a weighted-average period of 3 years.

(in thousands of Russian Rubles, unless otherwise stated)

When estimating its liability under the Incentive Plan the Group assumed that the fair value of one phantom share approximates the fair value of one ordinary share of the Company (being RUB 32.9 per share), and that 10% of employees participating in the Incentive Plan will resign from the Group before their rights vest.

Share-based compensation of the General Director

In December 2014, the Board of Directors approved payment of one-off stock based compensation to the Group's General Director. Compensation of RUB 373,134 thousand was paid in cash and used by the General Director to acquire 7,984,499 shares in the Company which were taken from treasury shares carried on the Group's balance sheet. Gain on sale of treasury shares to the General Director of RUB 177,091 thousand was recognised in equity as additional paid-in capital.

15. REVENUE

The Group’s revenue for the years ended 31 December 2014 and 2013 was as follows:

	2014	2013
Retail, excluding luxury and the online store	44,405,304	35,146,752
Luxury	587,787	605,462
Online store	442,569	227,299
Other	10,419	21,415
Total	**45,446,079**	**36,000,928**

The Group’s retail sales in the Moscow Region, including the luxury market, for the years ended 31 December 2014 and 2013 amounted to RUB 14,990,844 thousand and RUB 13,068,317 thousand, respectively, which represents a significant geographical concentration in one region. Revenue from ELC-branded stores, shown within retail revenue, for the years ended 31 December 2014 and 2013 amounted to RUB 812,815 thousand and RUB 605,175 thousand, respectively.

16. SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

The Group’s selling, general and administrative expenses for the years ended 31 December 2014 and 2013 were as follows:

	2014	2013
Rent and utility	5,798,620	4,715,319
Payroll	5,216,991	4,491,937
Advertising and marketing expenses	781,861	567,149
Banking services	303,133	235,643
Repair and maintenance	256,589	227,395
Security expenses	226,362	263,861
Promotional materials	180,393	173,476
Fines for cancellation of orders from luxury good suppliers	119,594	-
Support of software	90,138	91,467
Communication expenses	73,512	61,244
Consulting services	66,038	52,294
Travel	57,682	47,836
Write-off of accounts receivable	48,186	-
Taxes (other than income tax)	47,317	45,001
Stationary and other materials	16,600	27,198
Other	239,558	155,313
Total	**13,522,574**	**11,155,133**

(in thousands of Russian Rubles, unless otherwise stated)

17. DERIVATIVE INSTRUMENTS

During 2014, the Group entered into foreign currency forward contracts to economically hedge the USD and EUR merchandise purchases from its suppliers. The Group entered into these contracts in order to reduce its exposure to the variability in expected cash outflows attributable to changes in foreign currency rates. The Group's foreign exchange forward contracts typically matured within 12 months and did not require the Group to post collateral.

As at 31 December 2014 all foreign currency forward contracts were settled. During 2014 gains from foreign exchange forward contracts amounted to RUB 232,981 thousand and were included in the foreign exchange loss line item in the consolidated statement of operations and comprehensive income.

18. SHARE CAPITAL

All share and per share information for all periods herein retroactively reflect the Company's 250,000-for-1 stock split, which was effective on 18 February 2014.

As at 31 December 2014 and 2013, the share capital of the Company was as follows:

	Outstanding ordinary shares	Issued ordinary shares	Authorised ordinary shares
At 31 December 2013	554,000,000	739,000,000	739,000,000
Sale of treasury shares to the General Director	7,984,499	-	-
Transfer of treasury shares to shareholders in course of reorganization	177,015,501	-	-
At 31 December 2014	**739,000,000**	**739,000,000**	**739,000,000**

All ordinary shares have a par value of RUB 0.0004 per share.

Treasury shares

In September 2013 following the approval by the Board of Directors, the Group purchased 185,000,000 issued ordinary shares of the Company from OJSC Sberbank of Russia for total cash consideration of RUB 4,542,514 thousand.

In December 2014, the Group sold 7,984,499 treasury shares to the General Director (Note 14), and the remaining treasury shares were transferred to the Group's shareholders – Sistema and subsidiaries – as part of reorganisation (Note 1).

Dividends declared

In accordance with the Russian legislation, earnings available for dividends are limited to retained earnings of the Company, calculated in accordance with statutory rules in local currency On 30 June 2014 the Annual General Meeting approved dividends of RUB 846,776 thousand for 2013. On 17 November 2014, an Extraordinary General Meeting approved dividends for 2011, 2013 and 9 months of 2014 of RUB 1,628,757 thousand. Dividends attributable to treasury shares of RUB 619,721 thousand were fully eliminated when preparing these consolidated financial statements.

(in thousands of Russian Rubles, unless otherwise stated)

19. CONTINGENCIES

Operating leases – The Group leases retail space through lease contracts which expire in various years through 2023, all of which are classified as operating leases. Although the store leases are generally long term, all of the store lease contracts contain provisions that enable the Group to cancel the lease provided the Group either pays a penalty, which typically consists of a payment equal to approximately two to three months rent or sends an advance notice to the lessor.

Future minimum rental payments under non-cancellable operating leases in effect as at 31 December 2014 are as follows:

2015	6,962,552
2016	7,293,186
2017	7,631,025
2018	7,983,331
2019	8,290,381
Thereafter	8,746,352
Total	**46,906,827**

Legal – In the ordinary course of business, the Group may be a party to various legal and tax proceedings, and be subject to claims. In the opinion of management, the Group's liability, if any, in all pending litigation, other legal proceeding or other matters, will not have a material effect on the financial condition, results of operations or liquidity of the Group.

Taxation – Laws and regulations affecting businesses in the Russian Federation continue to change rapidly. These changes are characterized by different interpretations and arbitrary application by the authorities. Management's interpretation of such legislation as applied to the activity of the Group may be challenged by the relevant regional and federal authorities. The tax authorities in the Russian Federation frequently take an assertive position in their interpretation of the legislation and assessments and as a result, it is possible that transactions and activities may be challenged. As a result, significant additional taxes, penalties and interest may be assessed. Under certain circumstances reviews may cover longer periods. Where uncertainty exists, the Group has accrued tax liabilities as management's best estimate of the probable outflow of resources which will be required to settle such liabilities. Management believes that it has adequately provided for tax liabilities based on its interpretations of tax legislation. However, the relevant authorities may have differing interpretations, and the effects could be significant.

Prior to 1 July 2013 the VAT legislation of the Russian Federation provided no clear guidance on the assessment and payment of VAT related to bonuses from suppliers. In April 2013 an amendment to the Tax Code was adopted in Russia with the purpose to clarify the VAT rules going forward. The amendment is effective 1 July 2013 and does not apply retrospectively. In the normal course of business, the Group receives various bonuses, discounts and reimbursement of marketing expenses from suppliers. The Group believes that it has correctly interpreted the current tax legislation with regard to this issue in accordance with the accepted industry practice both before and after 1 July 2013 and no additional tax liabilities will arise in connection with bonuses received from suppliers. Management qualifies the risk of assessment of additional taxes with regards to VAT as medium for the period preceding 1 July 2013, due to unclear legislation and contradictory court practice, and estimates that the amount of risk, in the case that it occurs, will not exceed 1% of the Group's consolidated revenues for the annual period.

(in thousands of Russian Rubles, unless otherwise stated)

20. RELATED PARTY TRANSACTIONS

During the years ended 31 December 2014 and 2013 the Group entered into transactions with fellow subsidiaries of Sistema as follows:

Rent and utility expenses – During the years ended 31 December 2014 and 2013, the Group incurred costs payable under contracts with Detsky Mir – Roznichnye Aktivy, a subsidiary of Sistema, of approximately RUB 43,986 thousand and RUB 44,014 thousand, respectively.

Communication expenses – During the years ended 31 December 2014 and 2013, the Group incurred costs payable to MTS, a subsidiary of Sistema, of approximately RUB 39,523 thousand and RUB 26,434 thousand, respectively.

Advertising and marketing expenses – During the years ended 31 December 2014 and 2013 the Group incurred Advertising and marketing expenses payable to PA Maxima, an affiliate of Sistema, in the amount of approximately RUB 19,458 thousand and RUB 16,402 thousand, respectively.

For the year ended 31 December 2014, the Group also incurred advertising and marketing expenses payable to MTS, a subsidiary of Sistema, of RUB 269,457 thousand (2013: nil).

Security expenses – During the years ended 31 December 2014 and 2013 the Group incurred security expenses payable to LLC PSE AB-Safety, a subsidiary of Sistema, in the amount of approximately RUB 13,390 thousand. (2013: nil).

Acquisition of property, plant and equipment – During the years ended 31 December 2014 and 2013 the Group purchased property, plant and equipment from CJSC NVision Group, a subsidiary of Sistema, in the amount of approximately RUB 17,395 thousand and RUB 28,086 thousand, respectively.

Related party balances as at 31 December 2014 and 2013 are disclosed in the corresponding notes to the consolidated financial statements.

21. SUBSEQUENT EVENTS

The Group has evaluated subsequent events through 27 February 2014, the date on which the consolidated financial statements are available to be issued.

V.S. Chirakhov	**A.V. Mrinskaya**
Chief Executive Officer	Chief Financial Officer
OJSC DETSKY MIR	OJSC DETSKY MIR

27 February 2015

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