Consolidated Financial Statements and Independent Auditor's Report

MTS Armenia CJSC

31 December 2018

Grant Thornton

Independent auditor's report

Գրանթ Թորնթոն ՓԲԸ
ՀՀ, ք.Երևան 0012
Վաղարշյան 8/1

Հ. + 374 10 260 964
Ֆ.+ 374 10 260 961

Grant Thornton CJSC
8/1 Vagharshyan Str.
0012 Yerevan, Armenia

T + 374 10 260 964
F + 374 10 260 961

To the shareholders of MTS Armenia CJSC

Opinion

We have audited the consolidated financial statements of MTS Armenia CJSC (the "Company") and its subsidiaries (together the "Group"), which comprise the consolidated statement of financial position as of 31 December 2018, and the consolidated statement of profit or loss and other comprehensive income, consolidated statement of changes in equity and consolidated statement of cash flows for the year then ended, and notes to the consolidated financial statements, including a summary of significant accounting policies.

In our opinion, the accompanying consolidated financial statements give a true and fair view of the consolidated financial position of the Group as of 31 December 2018, and of its consolidated financial performance and its consolidated cash flows for the year then ended in accordance with International Financial Reporting Standards ("IFRSs").

Basis for Opinion

We conducted our audit in accordance with International Standards on Auditing ("ISAs"). Our responsibilities under those standards are further described in the *Auditor's Responsibilities for the Audit of the Financial Statements* section of our report. We are independent of the Group in accordance with the International Ethics Standards Board for Accountants' Code of Ethics for Professional Accountants (the "IESBA Code") together with the ethical requirements that are relevant to our audit of the financial statements in the Republic of Armenia, and we have fulfilled our other ethical responsibilities in accordance with those ethical requirements. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our opinion.

Key Audit Matters

Key audit matters are those matters that, in our professional judgment, were of most significance in our audit of the consolidated financial statements of the current period. These matters were addressed in the context of our audit of the consolidated financial statements as a whole, and in forming our opinion thereon, and we do not provide a separate opinion on these matters.

Adoption of IFRS 16 Leases

As disclosed in note 2.5 to the consolidated financial statements the Group has early adopted IFRS 16 *Leases*. The new standard was applied as of 1 January 2018. The Group elected not to restate prior period financial statements in accordance with IAS 8 and recognize cumulative effect of initially applying the standard at the date of initial application, i.e. 1 January 2018.

We consider initial application of IFRS 16 to be a key audit matter since adoption of the standard required Group management to modify existing business processes, introduce changes in the IT system, elaborate new control procedures. Application of IFRS 16 had a material impact on the consolidated financial statements and required management to make significant judgments, in particular, in determining whether the contract is, or contains, a lease, the lease term and discount rates.

Our procedures in relation to the above matter included consideration of the accounting policy applied and whether it was in accordance with IFRS 16. We have applied test of details on a sample of lease contracts to determine propriety of the accounting treatment used, estimates and judgements made.

In addition, we have examined internal controls over recording of lease agreements in the appropriate register and identification of key inputs required in measurement of right-of-use assets and lease liabilities.

We also reviewed the completeness and assessed the consistency of disclosures in the consolidated financial statements with the requirements of the new standard.

Responsibilities of Management and Those Charged with Governance for the Consolidated Financial Statements

Management is responsible for the preparation and fair presentation of the consolidated financial statements in accordance with IFRSs, and for such internal control as management determines is necessary to enable the preparation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

In preparing the consolidated financial statements, management is responsible for assessing the Group's ability to continue as a going concern, disclosing, as applicable, matters related to going concern and using the going concern basis of accounting unless management either intends to liquidate the Group or to cease operations, or has no realistic alternative but to do so.

Those charged with governance are responsible for overseeing the Group's financial reporting process.

Auditor's Responsibilities for the Audit of the Consolidated Financial Statements

Our objectives are to obtain reasonable assurance about whether the consolidated financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance, but is not a guarantee that an audit conducted in accordance with ISAs will always detect a material misstatement when it exists. Misstatements can arise from fraud or error and are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users taken on the basis of these consolidated financial statements.

As part of an audit in accordance with ISAs, we exercise professional judgment and maintain professional skepticism throughout the audit. We also:

- Identify and assess the risks of material misstatement of the consolidated financial statements, whether due to fraud or error, design and perform audit procedures responsive to those risks, and obtain audit evidence that is sufficient and appropriate to provide a basis for our opinion. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control.

- Obtain an understanding of internal control relevant to the audit 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 Group's internal control.

- Evaluate the appropriateness of accounting policies used and the reasonableness of accounting estimates and related disclosures made by management.

- Conclude on the appropriateness of management's use of the going concern basis of accounting and, based on the audit evidence obtained, whether a material uncertainty exists related to events or conditions that may cast significant doubt on the Group's ability to continue as a going concern. If we conclude that a material uncertainty exists, we are required to draw attention in our auditor's report to the related disclosures in the consolidated financial statements or, if such disclosures are inadequate, to modify our opinion. Our conclusions are based on the audit evidence obtained up to the date of our auditor's report. However, future events or conditions may cause the Group to cease to continue as a going concern.

- Evaluate the overall presentation, structure and content of the consolidated financial statements, including the disclosures, and whether the consolidated financial statements represent the underlying transactions and events in a manner that achieves fair presentation.

- Obtain sufficient appropriate audit evidence regarding the financial information of the entities or business activities within the Group to express an opinion on the consolidated financial statements. We are responsible for the direction, supervision and performance of the group audit. We remain solely responsible for our audit opinion.

We communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit and significant audit findings, including any significant deficiencies in internal control that we identify during our audit.

Gagik Gyulbudaghyan
Managing Partner

Lilit Arabajyan, FCCA
Engagement Partner

6 June 2019

Consolidated statement of financial position

In thousand drams	Note	As of 31 December 2018	As of 31 December 2017
Assets			
Non-current assets			
Property and equipment	4	33,404,594	33,591,391
Right-of-use assets	5	6,934,139	-
Intangible assets	6	6,550,477	4,838,666
Unsecured borrowings	7	638,689	17,594,904
Deferred income tax assets	8	1,304,538	831,134
Trade and other receivables	9	1,109,290	407,265
Bank deposits	10	967,500	-
		50,909,227	57,263,360
Current assets			
Inventories	11	1,932,776	2,074,381
Trade and other receivables	9	9,914,032	16,581,386
Unsecured borrowings	7	3,450	8,280
Short-term loans to employees		289,332	260,236
Current income tax assets		308	1,378,537
Bank deposits	10	8,230,693	4,923,812
Cash and bank balances	12	27,319,950	3,114,803
		47,690,541	28,341,435
Total assets		98,599,768	85,604,795

Consolidated statement of financial position (continued)

In thousand drams	Note	As of 31 December 2018	As of 31 December 2017
Equity and liabilities			
Capital and reserves	13		
Share capital		550,000	550,000
Reserve capital		82,500	82,500
Accumulated profit		80,726,900	76,796,626
		81,359,400	77,429,126
Non-current liabilities			
Lease obligations	14	5,983,578	-
Contract liabilities	15	106,435	108,053
Trade and other payables	16	890,100	-
Grants related to assets		-	585,003
		6,980,113	693,056
Current liabilities			
Lease obligations	14	1,301,990	-
Contract liabilities	15	1,440,582	1,670,593
Trade and other payables	16	7,517,683	5,812,020
		10,260,255	7,482,613
Total equity and liabilities		98,599,768	85,604,795

The consolidated financial statements were approved on 6 June 2019 by:

Ralph Yirikyan

General Director

Gayane Kananyan

Chief Accountant

The consolidated statement of financial position is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 11 to 40.

Consolidated statement of profit or loss and other comprehensive income

In thousand drams	Note	Year ended 31 December 2018	Year ended 31 December 2017
Contract revenue			
Mobile services	17	51,032,925	51,757,502
Fixed line services		1,538,015	1,326,256
Revenue from sale of goods		5,198,269	3,677,280
Other revenue		128,039	87,534
Other income			
Other operating income		608,202	700,803
		58,505,450	57,549,375
Depreciation and amortization		(14,235,819)	(12,044,640)
Interconnection and roaming costs	18	(7,043,368)	(7,504,384)
Payroll and employee benefits		(7,440,460)	(6,807,088)
Other network operating costs	19	(5,197,696)	(7,018,323)
Management and consulting fees		(2,545,351)	(2,631,701)
Cost of sold goods		(4,723,293)	(3,257,118)
Other operating expenses	20	(6,269,682)	(6,256,803)
		(47,455,669)	(45,520,057)
Results from operating activities		11,049,781	12,029,318
Finance income	21	794,330	633,353
Finance cost		(854,952)	-
Gain/(loss) from exchange rate differences, net	22	81,623	(72,950)
Profit before income tax		11,070,782	12,589,721
Income tax expense	23	(2,429,967)	(2,793,104)
Profit for the year		8,640,815	9,796,617
Other comprehensive income		-	-
Total comprehensive income for the year		8,640,815	9,796,617

The consolidated statement of profit or loss and other comprehensive income is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 11 to 40.

Consolidated statement of changes in equity

In thousand drams	Share capital	Reserve capital	Accumulated profit	Total
as of 1 January 2017	550,000	82,500	83,500,009	84,132,509
Profit for the year	-	-	9,796,617	9,796,617
Total comprehensive income for the year	-	-	9,796,617	9,796,617
Dividends	-	-	(16,500,000)	(16,500,000)
Transactions with owners	-	-	(16,500,000)	(16,500,000)
as of 31 December 2017	550,000	82,500	76,796,626	77,429,126
Adjustment from the adoption of new IFRSs	-	-	(210,541)	(210,541)
as of 1 January 2018	550,000	82,500	76,586,085	77,218,585
Profit for the year	-	-	8,640,815	8,640,815
Total comprehensive income for the year	-	-	8,640,815	8,640,815
Dividends	-	-	(4,500,000)	(4,500,000)
Transactions with owners	-	-	(4,500,000)	(4,500,000)
as of 31 December 2018	550,000	82,500	80,726,900	81,359,400

The initial application of IFRS 9 has led to an adjustment in retained earnings of drams 210,541 thousand.

The consolidated statement of changes in equity is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 11 to 40.

Consolidated statement of cash flows

In thousand drams	Year ended 31 December 2018	Year ended 31 December 2017
Cash flows from operating activities		
Profit for the year	8,640,815	9,796,617
Adjustments for:		
Depreciation, amortization and impairment	14,250,757	12,091,215
Loss on disposal of property, equipment and intangible assets	357,263	319,181
Income tax expense	2,429,967	2,793,104
Finance income	(794,330)	(633,353)
Finance cost	854,952	-
Income from grants	(138,767)	(74,649)
Foreign exchange (gain)/loss	(81,623)	72,950
Operating profit before working capital changes	25,519,034	24,365,065
Change in trade and other receivables	5,594,946	6,399,992
Change in inventories	141,605	(334,222)
Change in borrowings provided to employees	(29,096)	(195,060)
Change in contract liabilities	(231,629)	(249,131)
Change in trade and other payables	1,401,614	(749,689)
Cash generated from operations	32,396,474	29,236,955
Interest paid	(854,952)	-
Income tax paid	(1,525,142)	(1,019,300)
Net cash from operating activities	30,016,380	28,217,655
Cash flows from investing activities		
Acquisition of property, equipment and intangible assets	(13,381,947)	(7,785,727)
Proceeds from disposal of property and equipment	69,786	228,110
Repayment of borrowings provided	10,126,645	8,276
Interest income received	7,657,213	217,712
Deposits made	(11,118,655)	(10,845,370)
Deposits repaid	6,828,830	6,382,104
Net cash generated from/(used in) investing activities	181,872	(11,794,895)
Cash flows from financing activities		
Lease obligation paid	(1,541,485)	-
Dividends paid	(4,500,000)	(16,500,000)
Net cash used in financing activities	(6,041,485)	(16,500,000)
Net increase/(decrease) in cash and bank balances	24,156,767	(77,240)
Foreign exchange effect on cash	48,380	5,113
Cash and bank balances at the beginning of the year	3,114,803	3,186,930
Cash and bank balances at the end of the year	27,319,950	3,114,803

The consolidated statement of cash flows is to be read in conjunction with the notes to and forming part of the consolidated financial statements set out on pages 11 to 40.