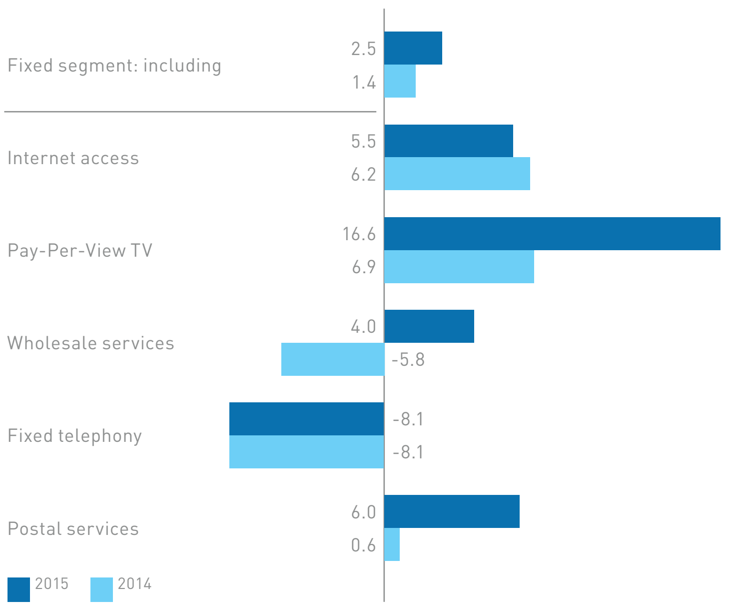
Industry Review

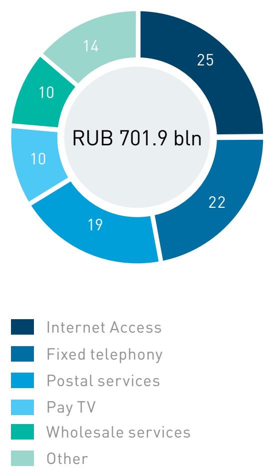
According to TMT Consulting analytical agency, the Russian market for telecommunications services with the exception of mobile communication segment in 2015 amounted to RUB 701.9 bln The annual growth rate amounted to 2.5 % against 1.4 % y-o-y.

In 2015, the volume of Internet access market for the first time in Russia exceeded the fixed telephony market.
The volume of the mobile communication market in 2015 amounted to RUB 958.6 bln, with increase by 0.5 % compared to 2014.

Dynamics of segments, %



Russian telecommunications market in 2015 (excl. mobile), %



The main growth drivers were the increase in ARPU for Pay TV service and the number of subscribers of premium Pay TV, as well as revenue growth in the segment of cross-border inter-carrier services, mainly due to the effect of changes in foreign currency exchange rates.

Currently, the major players in the Russian telecommunications market is Rostelecom, MTS, VimpelCom, Megaphone and Tele2 Russia - companies that provide a wide range of basic communication services and generating over 80 % of all revenues of the Russian telecommunications market. Despite the potential for the development of alternative players, 5 key market players claim for the major share in the growth of industry revenues both through geographic expansion and growth in the region and through M&A transactions.

MARKET BY CUSTOMER SEGMENTS B2C

B2C

Over 2/3 of the Russian telecommunications market are formed by a segment of private users. Individuals dominate in terms of number of subscribers and revenues in the key market segments:

- Internet access - 70 %;
- Pay TV - over 95 %;
- Fixed telephony - 54 %;
- Mobile communications - 90 % of the service revenues;

B2B & B2G

B2B/B2G is the second most important segment in terms of the revenue volume. Corporate segment as a whole may be characterized by:

- a high level of saturation of most segments;
- a reduction in revenues in fixed telephony segment, trend to move from leased lines to VPN use;
- increasing pressure on the financial terms of the bidding from major customers, including the federal government customers;
- desire of customers to optimize capital costs for telecom solutions and, as a consequence, an increasing demand for rental services of telecom infrastructure (data centres);
- growing demand for solutions that increase the customer's operational efficiency (VAS and cloud-based solutions).

In 2015, it there were two trends in the customer's activity:

- optimization of expenses of big and medium-sized business;
- reconnection of the small businesses to the services as private users.

In previous years, an important factor of the segment growth was operators' involved in largescale government projects. Construction of most of the major government networks and the some major projects that will be implemented in the coming years will become a source of income mainly for a limited number of major operators.

B2O (wholesale segment)

In 2015, due to the prices denominated in currency, revenues of market players rose sharply from a number of services:

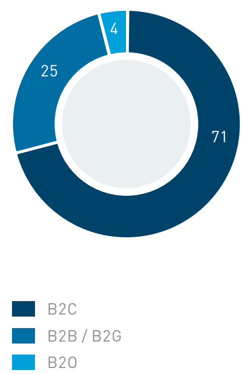
- Rent of international channels
- International IP transit
- International voice traffic transit
- Services through Europe - Asia transit route

In 2016, according to TMT Consulting analysts, most of these market segments will show growth of around 1 %. Exclusion can be a segment of through transit, having considerable potential, but depending on the willingness of foreign, especially Chinese, operators increase the capacity of acquired channels.

Key market trends in 2016:

- Reduction of fixed voice traffic.
- Decrease of revenues from the rent of channales by the operators.
- Reduced revenues from IP-transit, where undercompetition policy offer of a wider bandwidth for the same money no longer prevents the market from reduction; In addition, VPN becomes a common alternative to IP-transit.
- Optimization of the costs by the operators on operation through infrastructure sharing and outsourcing of some network infrastructure operation functions.

Structure of the telecom market by customer type 2015, %



Source: TMT Consulting

COMPANY ON THE MARKET

Rostelecom is the undisputed market leader in fixedline services. Rostelecom provides a wide range of services and enters the new market segments. Last year, the Company continued steady growth in high-tech sectors, developing broadband Internet access and data transfer, interactive services, data centres, cloud-based services, VPN, video conferencing services, and intelligent network services.
The Company also maintained its leadership in the traditional fixed-line telephony markets.
The company managed to gain the position of an absolute leader of the telecommunications services market for Russian government authorities at all levels, government agencies and organizations.

KEY COMPETITIVE ADVANTAGES IN THE KEY MARKETS:

1. Russia's largest fixed network infrastructure
2. Nation-wide operations scale
3. Unique content proposition
4. Stable high level of brand awareness and customer base loyalty

Basic Brand Health KPI 2015

	Local communication		DLD/ILD communication		Pay TV		Broadband	
	Rostelecom	Immediate competitor	Rostelecom	Immediate competitor	Rostelecom	Immediate competitor	Rostelecom	Immediate competitor
Aided awareness	91	31	97	28	79(+4)	53	81	54
Unaided awareness	78	24	90	17	55	39	59	39
First mentioning	64(+3)	18	79(+4)	9	22	19	23	18
Past use	74	19	86(+4)	9	28	23	29	21
Current use	68	18	82(+4)	6(-4)	23	20	24	18
Main operator	–	–	82(+4)	6(-4)	23	20	–	–
Future use	64	19	76(+5)	6	23	19	24	18

Rostelecom is ahead of all competitors in this category

Positions of Rostelecom and its immediate competitor by indicators in the category are shown

Further development
The key task of the Company may be identified as improving customer care through the expansion of the range of content and digital services and the transition to a model of an integrated digital services provider.