

Conference Transcription

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**Sistema Second
Quarter 2012
Financial Results**

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SECOND QUARTER 2012 FINANCIAL RESULTS
September 13th, 2012, 9:00 AM ET
Chairperson: Evgeniy Chuikov (Mgmt.)

Operator: Ladies and gentlemen, welcome to the Sistema Second Quarter 2012 Financial Results call on the 13th of September, 2012. Throughout today's recorded presentation, all participants will be in a listen-only mode. After the presentation, there will be an opportunity to ask questions. If any participant has difficulty hearing the presentation, please press the star followed by the zero on your telephone for operator assistance.

Before we start, we would like to draw your attention to the fact that some of the information during this call contains projections or other forward-looking statements regarding future events or the future financial performance of Sistema. You can identify forward-looking statements by terms such as expect, believe, anticipate, estimate, intend, will, could, may or might, (inaudible) of such terms or other similar expressions. We wish to caution you that these statements are only predictions and that actual events or results may differ materially. We do not intend to update these statements to reflect events and circumstances occurring after today's date or to reflect the occurrence of unanticipated events.

Many factors could cause the actual results to differ materially from those contained in our projections or forward-looking statements, including among others deteriorating economic and credit conditions, our competitive environment, risks associated with operating in Russia, rapid technology and market change in our industry, as well as many other risks specifically related to Sistema and its operations.

I will now hand the conference over to Evgeniy Chuikov. Please go ahead, sir.

Evgeniy Chuikov: Welcome everyone and thank you for dialing in to discuss Sistema's second quarter financial results. Participating today are Mikhail Shamolin, our President and CEO; Alexey Buyanov, Senior Vice President and CFO; and myself, Evgeniy Chuikov, Head of Investor Relations. You can find a presentation of today's results on our website at sistema.ru, and I will now turn the call over to Mikhail for his comments.

Mikhail Shamolin: Good afternoon and thank you for joining us to discuss Sistema's second quarter 2012 results. Sistema today reported a solid set of numbers reflecting good underlying growth across key investments. The group financials in the reporting period were affected by two key items: firstly, the significant ruble depreciation against the dollar of 11% on the year, and write-offs in connection with MTS operations in Uzbekistan. With both factors aside, our revenue and OIBDA showed consistent growth

year-on-year in rubles with 3.9 and 2.7% increase respectively. Our net income without one-off rose 23% to \$408 million. We reduced SG&A expenses by 7.7%, while more importantly we maintained a net debt position of \$5 million versus \$1.4 billion in the comparable period last year. These results were primarily driven by steady operational growth in core assets. At MTS, sustained growth in usage of voice and data products resulted in 10% year-on-year growth in revenues in rubles and double-digit increase in ARPU and MOU. The company's margins showed excellent improvement and increased by 2.4 percentage points to 44% as the effects of the management strategy and stabilised competitive filtered through. We are also pleased to see MTS restart its operations in Turkmenistan with the successful launch earlier this month.

Turning to Bashneft, the company reported good operational momentum with net operating cash flow more than double year-on-year in the second quarter despite a substantial increase in export duty in the reporting period. Bashneft's production increased 2% compared to second quarter 2011 and remained largely flat as guided versus first quarter this year. Importantly, these results were achieved at a time of softening oil prices, which in the period fell 9% compared to Q1 2012 and 6% versus Q2 2011. Importantly, the company is resolving licence issues around Trebs and Titov and field development remains much on track.

In the developing assets portfolio, we've seen good progress being made in several investments. Detsky mir narrowed its OIBDA loss substantially and reduced SG&A expenses despite 19% expansion in retail space year-on-year. The company rolled out 11 new stores in Q2 and has delivered a 12% increase in sales in rubles year-on-year. RTI deconsolidated Intracom, reducing debt by 17% quarter-on-quarter, completed its consolidation of Sitronics, and will soon complete its merger with NVision. Looking at the developing assets portfolio overall, despite certain aforementioned factors influencing revenue and OIBDA numbers, all of the companies except Shyam are on track for OIBDA break-even by end of this year.

Now to M&A. Turning our attention to other events in the quarter, as you have seen, we have made steady progress with our buyback program. To date, we have acquired 4.3 million GDRs and 10.6 million ordinary shares, having spent approximately \$100 million. This program will run through to the 15th of October and we will review and assess it once complete. In the second quarter, we also announced the major divestment of the power generating unit of Bashkirenergo. The deal will bring Sistema 14 billion rubles and is due to be completed before year-end. This is the second major divestment in two years and further establishes our track record in securing very attractive monetisation for our investments.

Overall in the reporting period, seven deals were announced by the holding company at the portfolio level. Some of these are smaller acquisitions by our invested companies, they are significant as they

expand our presence and add important scale to each business. There are several deals we are working on at the holding company level. At this stage, it is too early to reveal the details but we hope some of them will reach investment decision shortly. These are mid-sized acquisitions which are consistent with our strategy in sectors of interest such as infrastructure, transport, agriculture and resources.

Finally, I'd like to turn our attention briefly to the situation in India and SSTL. As many of you have seen, the auction dates have now been set for the fourth quarter with all cancelled licences, including SSTL's, extended to January 2013 to allow operators to take part in the process. However, Sistema and SSTL have not taken any decision on auction participation and strongly believe that the price recommended by the Indian government significantly damages the telecom industry's prospects. Our focus at the moment is on the curative petition we filed in May and which we hope will be reviewed in the coming weeks. Our decision on auction participation will depend on the status of this petition. In the meantime, SSTL continues to manage its costs tightly and we will see further effects starting from Q3.

I will now turn the call over to Alexey Buyanov who will discuss our financials in more detail. Alexey, please go ahead.

Alexey Buyanov:

Thank you Mikhail. Good morning and good afternoon ladies and gentlemen. As Mikhail mentioned, our results were significantly impacted by the events in Uzbekistan and macroeconomic factors such as lower oil prices and ruble depreciation. Despite these factors, the performance of the Group and individual companies remained very strong.

Before I take you through the details in each portfolio, I would like to draw your attention to our net income which without one-off has increased by 22.8% year-on-year to \$408 million. One of the key reasons for this is the significant reduction of the Group's SG&A expenses by 10% year-on-year. The key contribution to these results came from MTS which reduced expenses by 15%. The core assets portfolio reported a 5.9% year-on-year decline in revenues mainly due to ruble depreciation against the U.S. dollar and lower oil prices and export sales at Bashneft. The portfolio's OIBDA without the one-off declined year-on-year as a result of higher oil export duties and oil product excise rates faced by Bashneft. The core assets portfolio's net income without the one-off amounted to \$569 million.

The main factors affecting the performance of our developing assets portfolio was the deconsolidation of the tour operating and retail businesses of Intourist and Intracom Telecom in RTI. As a consequence, the portfolio's revenue decreased by 14.1% year-on-year to \$941.5 million while OIBDA loss expanded reflecting the aforementioned deconsolidation and also increased loan provisions at MTS Bank. You can

see the Group financial results as well as by portfolio in more detail in the presentation published on our website.

Net cash provided by operations in the second quarter of 2012 increased by 38.8% year-on-year and by 34.7% quarter-on-quarter to 1 billion 683 million. In particular, the significant rise in operating cash flow was seen in Bashneft which enabled the company to increase capex and reduce net debt. In the reporting period, the Group paid 60 million for the acquisition of businesses. The Group also spent 627 million to increase its share in subsidiaries such as Bashneft and Sitronics.

Turning to our debt position in the second quarter, total debt amounted to \$15.7 billion U.S. compared to \$16.7 billion in the first quarter. The 6.4% decrease resulted primarily from lower debt at MTS and Bashneft as well as the consolidation of Intracom Telecom from RTI and ruble depreciation. The Group's net debt amounted to \$13 billion at the end of June compared to \$14.2 billion at the end of June 2011. The Group's debt currency profile demonstrates limited currency exposure with its share of Russian ruble-denominated loans amounting to 70% of the total debt at the Group level and to 66% at the corporate holding level. The total debt at the corporate holding level decreased by 7% year-on-year, totaling \$1.6 billion while the net debt stood at \$5 million. The change in debt quarter-on-quarter was primarily driven by the successful placement of 500 million Eurobonds denominated in U.S. dollars with interest of 6.95%. We believe that the current debt and cash management policies are in line with the financial strategies of the corporation. In the second quarter, two international agencies – Moody's and Fitch – confirmed the corporation's credit ratings at high "BB-" and "Ba3". Overall, the group's debt profile at the end of the reporting period is well balanced with respect to its maturity structure and currency exposure.

In the second quarter, intragroup annual dividends declared by MTS and Bashneft and attributable to the corporate holding level amounted in total to \$860 million. The cash inflows from dividends received in the third quarter contributed in strong cash position of the corporate holding level.

With this, I would like to thank you for attention and hand the call over to Evgeniy again.

Evgeniy Chuikov: Thanks Alexey. I think we're now ready to take questions.

Operator: Thank you, sir. If any participant would like to ask a question, please press the star followed by the one on your telephone. To cancel this request, please press the star followed by the two. Your questions will be polled in the order they are received, and there will be a short pause whilst participants register for a question.

Thank you. The first question comes from Alexei Gogolev from JP Morgan. Please go ahead with your question.

Alexei Gogolev: Good afternoon, Mikhail. I would like to clarify the statement that you just made and just for us to understand – so you will not be making a decision regarding India until there is some sort of an announcement by the Supreme Court? And it also says here in your presentation that this will be some time in the fourth quarter. However, to apply and take part in the auctions, I believe the application needs to be sent until October 19. So can you confirm that if there is no ruling by the Supreme Court until that date, you will announce some sort of a decision whether or not you will stay in India?

Mikhail Shamolin: Well, I think you'll definitely know our decision by October 19.

Alexei Gogolev: Okay, thank you. And also with regards to your M&A plans, it says here in the presentation that potential new project pipeline is up to 1.5 to \$2 billion. So I was just wondering whether there is something substantial in the pipeline, or you are just looking at small projects like the ones that were acquired in the second quarter.

Mikhail Shamolin: We have four projects with the average size of around 400 million, and one project with a size of a billion—over a billion.

Alexei Gogolev: Great. Thank you very much, Mikhail.

Operator: Thank you. The next question comes from Igor Semenov from Deutsche Bank. Please go ahead with your question.

Igor Semenov: Yes, hi. Thank you. I just wanted to ask you about the buyback. You said you will review, but what do you mean by the original deadline. What are your initial thoughts? Are you most likely to stop at whatever level you complete, or you will do the full \$300 million?

Mikhail Shamolin: We haven't really discussed this thoroughly with the shareholders and the Board yet. I think we have to see exactly how much money we'll spend by October 15, and then we'll make a decision. We cannot just extend the buyback. We have to announce a new one, and I think we'll make our decision by then. We don't have a decision yet.

Igor Semenov: But as management, would your preference be to do the full 300?

Mikhail Shamolin: We'll see where the market goes. We started the buyback when the shares were quite cheap, and we believe it was a very good time. Right now, the stock has come up significantly and we'll have to review and understand where it goes before we make a decision. It's still cheap, though. It's still cheap, so we do not exclude—I don't want to give you a definitive answer. We don't exclude but we don't confirm. It's really sort of we haven't decided yet.

Igor Semenov: A question for Alexey on your holding company debt levels. Can you quickly run through the net cash position, it's pretty much zero, so just you raised the—

Alexey Buyanov: I'm sorry, you're breaking up, Igor. Can you repeat the last question?

Igor Semenov: Yes. You had a net cash at the end of Q1. Now it's pretty much zero. Could you just explain the movements?

Alexey Buyanov: There was an interruption in your question, but I got the whole idea that... Well, the answer is that most of the cash still stays on the deposits, and this is short investments. And with debt—well, no big changes because we're practically at the same level as it was in Q1 with additional money we've got. There were some investments, which are minor. All the rest are on the deposits.

Igor Semenov: Right, okay. Thank you.

Operator: Thank you. The next question comes from Anna Kurbatova from Gazprombank. Please go ahead with your question.

Anna Kurbatova: Thank you, good afternoon. Could you tell us whether the proceeds from the Bashkirenergo deal will increase your dividend pay for 2012, so as far as your dividend policy suggests that you spend part of the cash deal profits on dividends. Thank you.

Mikhail Shamolin: Yes, our intention is to do exactly as it says in our dividend policy, which is to share part of the dividends—or part of the proceeds, profit of the sale with the shareholders. But of course, we'll announce about the dividends once the time is due, which is spring next year.

Anna Kurbatova: Thank you. And could you also clarify – you mentioned October 19 is the date for some decision on India. Could you clarify please, what will happen on that date? Thank you.

Mikhail Shamolin: This date is the date when according to the existing timetable, we are supposed to claim our interest in the auction to reacquire back the frequency which was taken away from us by the decision of Indian Supreme Court. So by that date, we will decide whether we participate in the auctions or not participate in the auctions, and if we do not participate in the auctions, then we'll have to decide what we do with the remaining business and our investment in India overall.

Anna Kurbatova: Thank you very much. That's very clear.

Operator: Thank you. The next question comes from Viacheslav Shilin from Deutsche Bank. Please go ahead with your question.

Viacheslav Shilin: Good afternoon everyone. Just wanted to ask you to clarify how exactly you calculate net debt at the consolidated level, and particularly I'm interested on the composition of the line item in your financial statement which is called short-term investments, which grew by almost three times year-on-year—I'm sorry, from December 11. What it is composed of that would be most interesting to know? Thank you.

Alexey Buyanov: Well, we're just talking only about highly liquid deposits which can be converted into cash within a few days without any material discounts to the bottom line. But we do not use the definition of cash equivalents due to the longer terms stated in the contract. With debt, we just do have some debt papers which are liquid as well in our portfolio, and which is not cash as well.

Viacheslav Shilin: So the \$2.794 billion is composed of bank deposits and—

Alexey Buyanov: Yes, this is mainly deposits.

Viacheslav Shilin: And investments in the bonds?

Alexey Buyanov: There are some amounts invested there.

Viacheslav Shilin: Okay, but from the liquidity standpoint, this is almost equal to cash equivalents?

Alexey Buyanov: In a big way, yes. While there are no such definition for cash equivalents as it is defined in the financial statements. Yes, that's right.

Viacheslav Shilin: Okay, but when you calculate your net debt position, do you consider it—do you deduct it from your total debt, this 2.794?

Alexey Buyanov: We just do as it is stated in the financials and don't take in consideration the bonds and short-term investments.

Viacheslav Shilin: Okay. All right, thank you.

Operator: Thank you. The next question comes from Constantine Lykhman from Revelation Capital. Please go ahead with your question.

Constantine Lykhman: Good afternoon, gentlemen. Thank you for a great presentation and for the opportunity to ask questions. The first question I have is actually on the buyback, and Mikhail has already mentioned that you will make the decision by the 15th of October when the current programme is scheduled to end. The question I actually have is you mentioned that the decision was made because the company's stock price was cheap and is still cheap, but does the company consider in making that decision, do you consider the relative cheapness of Sistema stock, as effectively investment in sum-of-the parts, because obviously it's an investment company now. And on that basis, I would probably say that it is still grossly undervalued and

therefore, yes, it still had a good run but it's still trades at a significant discount, whether that will have a bearing on the decision you make to extend or indeed approve a new buyback programme.

Mikhail Shamolin: Well of course, all of the above. We still consider our stock to be cheap. We still consider the discount to be quite large, and all of those points will be taken into consideration while we make a decision whether to continue to buyback or not.

Constantine Lykhman: Okay, great. As a follow-up question I had, does the company—have you actually made any decision as to what to do with the stock you are buying, those depositary receipts and local shares? I think you'd like to cancel them, or are you still considering that?

Mikhail Shamolin: Well just even at the beginning, we were having an intention to consider, but from the technical point of view just to do this, it is—well, on the corporate side it's a nightmare to do so. And with that at the moment, we just keep it as treasury shares and we'd see what should be done with it further on, not now.

Constantine Lykhman: Okay, thank you. Okay, that's it.

Operator: Once again, if any participant would like to ask a question, please press the star followed by the one on your telephone. To cancel this request, please press the star followed by the two. Your questions will be polled in the order they are received, and there will be a short pause whilst participants register for a question.

Thank you. The next question comes from Anna Lepetukhina from Troika Dialog. Please go ahead with your question.

Anna Lepetukhina: Yes, hello. My first question is on the amount of short-term investments at the holding level. Can you please disclose this amount given that it impacts your net debt position?

Alexey Buyanov: Well, it is just almost the short-term investments—well, (audio interference).

Operator: Thank you.

Alexey Buyanov: Excuse me. Anna, this is 1.3 billion.

Anna Lepetukhina: 1.3 billion at the end of the second quarter, yes?

Alexey Buyanov: Yes.

Anna Lepetukhina: Thank you. And I have one more question on Sistema Mass-Media. In July, you sold the TV channel, Moscovia. Then also recently the press disclosed that you made the decision to withdraw your participation in the

reorganization of Lenfilm. Can you probably shed some light on your strategy regarding this business unit, whether you want to strengthen position in some segment? Also, can you please give the breakdown of revenues for Sistema Mass-Media because you have quite high spikes in revenue growth from growth to decline, so what is the main contributor to revenues in this business unit? Thank you.

Mikhail Shamolin: The main contributor of revenue to this business is the so-called RWS – Russian World Studios, which is basically a film production, mostly TV series production business. That’s the main cash generator. We have been taking a number of radical steps to reduce losses and improve financial performance of SMM this year, including closing studios in Moscow at the factory, where we were paying very high rent payments, and moving all the production to St. Petersburg to the studios where we actually own the space and equipment and therefore reduce the final rental payments. Also, as you noted, we sold Moscovia actually at a profit, so that was a very accretive transaction for us, and we are optimising other aspects of the business.

Our strategy with SMM is basically twofold. One is to develop IPTV business on the basis of Stream, brand; and secondly, develop VOD again on the basis of the former Omlet and now Stream platform. We have developed this platform. We have made it available on many TV screens, especially connected TVs which are now being actively sold and distributed in the Russian market. And we also are transferring a large part of our content aggregation and distribution business, which was acquired before by MTS on the open market from outside contractors, so we are pulling a lot of this business inside our stream and I believe that could give a boost to SMM revenues and OIBDA. Even though you probably know the size of this business is fairly small and at this point insignificant for Sistema, but we are hoping that IPTV and VOD strategy can give this business a new boost.

Anna Lepetukhina: But just to follow up, so you’re planning on organic growth, or you’ll also consider M&As in this segment?

Mikhail Shamolin: No, so far we are looking at organic growth. We are not considering any serious M&As in this area, given the complexity and competition and not very high return on investment in the media business today in Russia.

Anna Lepetukhina: Thank you very much.

Operator: Thank you. The next question comes from Alexander Vengranovich from Otkritie Capital. Please go ahead with your question.

Alexander Vengranovich: Yes, good afternoon. I have a follow-up question on India. Are you currently engaged in any negotiations with other market players in the market to create a strategic alliance or just jointly participate in the auctions to reduce your exposure? And if not, do you also consider some

scale-down of your investment there by participation in the auctions for only a limited amount of districts? Thank you.

Mikhail Shamolin: Yes, we are considering all kinds of scenarios now and we are involved in all kinds of discussions with all kinds of players, but we don't have a scenario which we are ready to announce just yet. We are considering everything from complete closing down the business, writing it off and moving on, to all kinds of potential industry consolidation scenarios. But we don't have a definitive answer for you at this point.

Alexander Vengranovich: Okay, thank you.

Operator: Thank you. The next question is a follow-up from Igor Semenov from Deutsche Bank. Please go ahead with your question.

Igor Semenov: Yes, hi. I just wanted to go back to the buyback. I mean, what do you do with the shares acquired? I understand the technical difficulties with dealing with (audio interference).

Mikhail Shamolin: Yes, I think Alexey Buyanov has answered this question already. Those shares are at this point treasury shares. Our intention was and is to cancel them, but we haven't found a way to do this yet so they continue being treasury shares at this point.

Operator: Sir, does that answer your question? Thank you. The next question comes from Ksenya Arutyunova from RMG Securities. Please go ahead with your question.

Ksenya Arutyunova: Yes, hello everyone. Just a small question on the Medsi revenues. You said that the 11% contraction of revenues was owed to the decrease in the average check due to changes in the policies of insurance companies. Could you please give some more color on that – is it of, like, one-off nature, or we should expect continuing negative effect from that?

Mikhail Shamolin: No, I believe it has a lot to do with the transition from old management to new management. A lot of those insurance contracts have been optimised, and I am looking at this as a one-off event. There is plan how to recover those revenues back that management is executing, and on top of that we will see new revenues flowing in from SUE (GUP) that has been acquired, those four new hospital and five clinics starting the fourth quarter, so you will see a significant revenue increase by year-end as compared to 2011, as well as OIBDA.

Ksenya Arutyunova: Okay, thank you very much. That's very helpful.

Operator: Thank you. And the final question comes from Anna Kurbatova from Gazprombank. Please go ahead with your question.

Anna Kurbatova: Yes, thank you very much. Could you give some more color on your future M&A deals? I mean, not mentioning, of course, the names of the companies you are interested in, but in general are those companies already OIBDA positive? What are you planning in general? You are planning to address some reorganisation, and value extraction from the reorganisation or you see a potential in some of your future acquisition, like the potential in market growth and duty amount in Russia. So should we see some kind of new Bashneft story or it will be some different things? Thank you very much.

Mikhail Shamolin: We are looking at both sort of a new Bashneft story and a few other investments in different industries which are just basically value accretive in nature. I don't think I can go in much more detail at this point, since all of those transactions are still in the process of internal discussions and debates, and we haven't closed a single deal yet on that.

Anna Kurbatova: Thank you, okay.

Operator: We have no further questions. Please continue with any further points you wish to raise.

Evgeniy Chuikov: Thank you everyone again for joining us today. I think that's it. We'll wrap this conference now. Thank you.

Operator: This concludes today's presentation. Thank you for your participation and you may now disconnect.

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