



Strategy Update

December 2013



Agenda

1

Rostelecom strategy update
Sergey Kalugin, CEO

2

Creating T2-RTK Holding - national mobile player
Maria Florentieva, Vice President, Strategy and Investor Relations

3

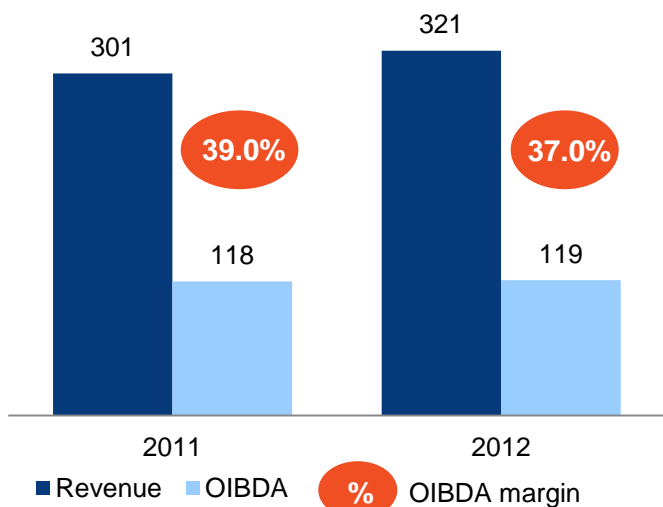
Q&A

1. Rostelecom strategy update

Rostelecom business mix

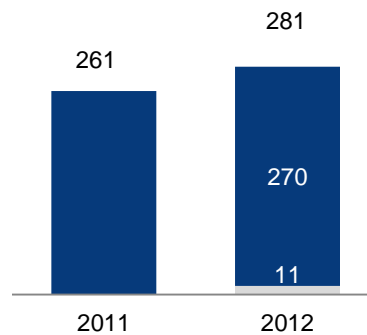
Rostelecom (consolidated)

Revenue and OIBDA, RUB bn

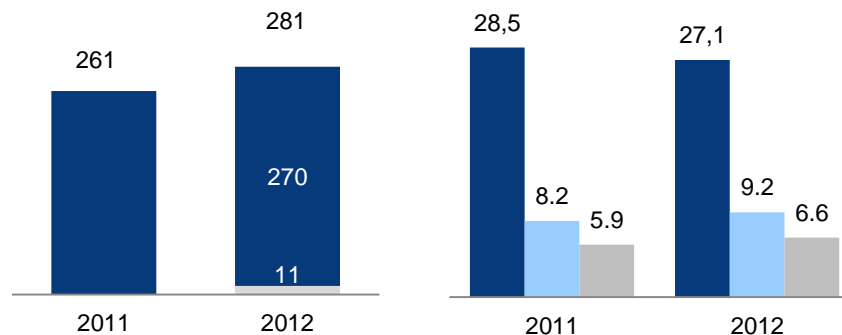


Fixed-line business

Revenue, RUB bn

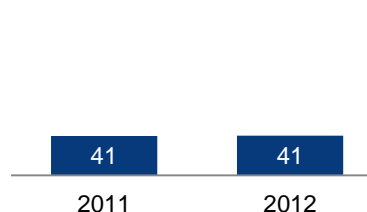


Fixed-line RGUs⁽¹⁾, mln

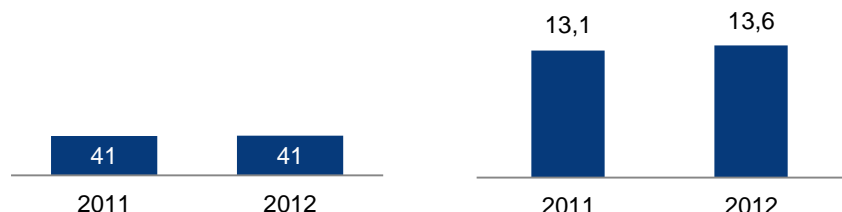


Mobile business

Revenue, RUB bn



Mobile subs, mln



Rostelecom strategic priorities

Fixed-line business

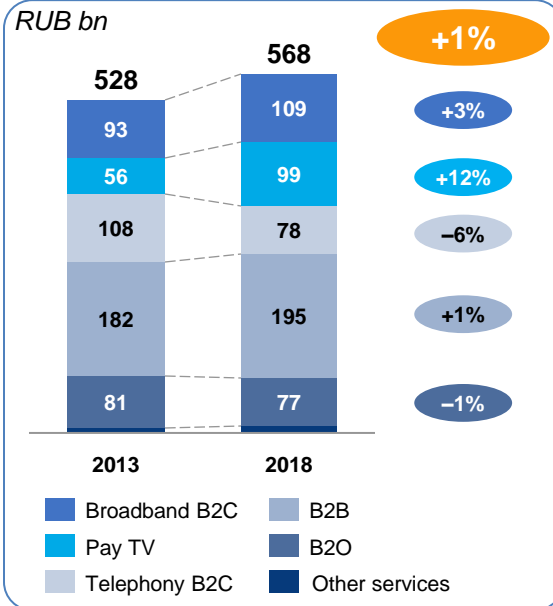
- ✓ **Accelerated expansion of fiber last mile** to unlock value of the largest fixed-line network in Russia
- ✓ **Strengthening** competitive advantage in **bandwidth to household** and «heavy» content delivery
- ✓ **Bundling of services** to reduce churn rates – Triple play and other
- ✓ **Leadership in Pay-TV** market and investing into content
- ✓ **Focus** on **digital platforms** and **services**
– OTT, SaaS and other

Mobile services business

- ✓ **Joint venture with Tele2 Russia** - creation of a national mobile operator
 - **Sufficient scale** to compete with MTS, MegaFon, VimpelCom
 - **Effective utilization of 3G/4G licenses** coupled with substantial capex savings and B/S deleveraging
- ✓ Accelerate roll-out of **3G/4G networks nationwide**
- ✓ Capitalise on the **mobile broadband** opportunity
- ✓ Maintain **high level of operational efficiency**
- ✓ Convergent offerings: mobile as part of **4-Play bundles**
- ✓ Continue to use Rostelecom backbone and backhaul

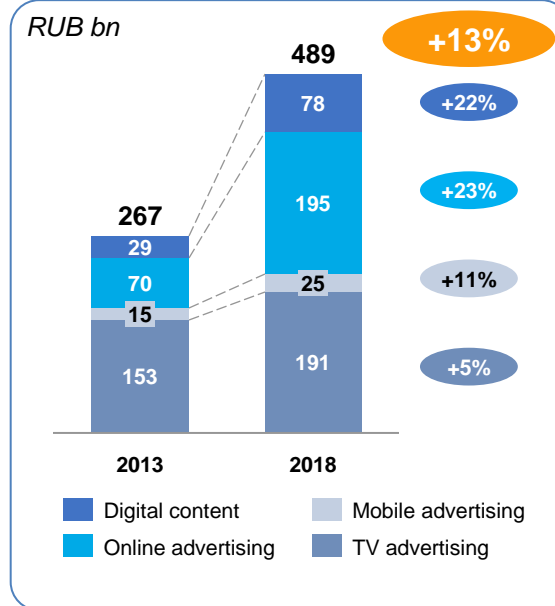
Russian TMT market forecasts: key segments

Fixed and Pay TV



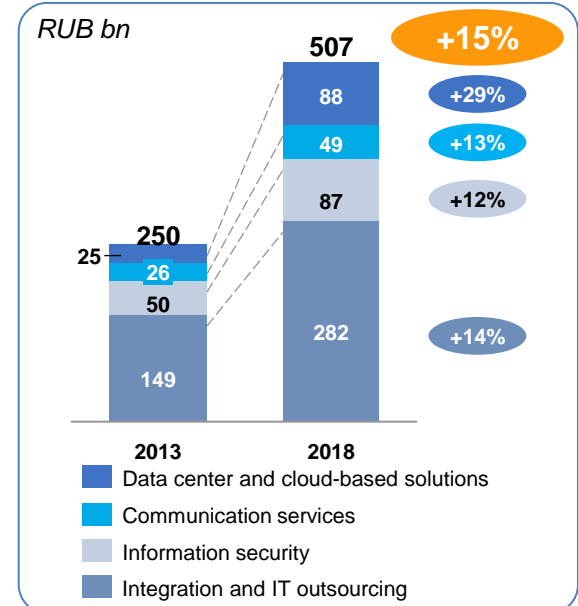
- Stagnation as a result of decline in fixed voice and slowdown in broadband segment growth
- Pay TV market will continue to grow as consumers are willing to pay for diverse and high-quality content
- The fastest growing segments are OTT¹ and IPTV

Digital media and advertising



- Transition from analog to digital content distribution
- Significant growth in online advertising market, primarily, in search advertising. In addition, rapid growth is observed in mobile and online video advertising

IT and ICT services

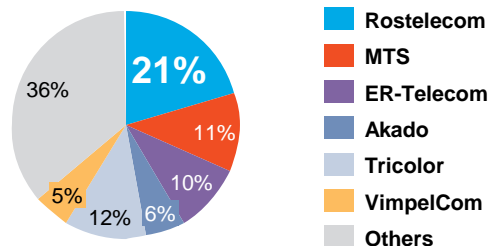


- Rising demand from government and business for outsourcing of data storage and processing
- Corporate clients' cost optimization for communication and IT services
- Transition to IT-outsourcing model

Rostelecom current position in B2C segment

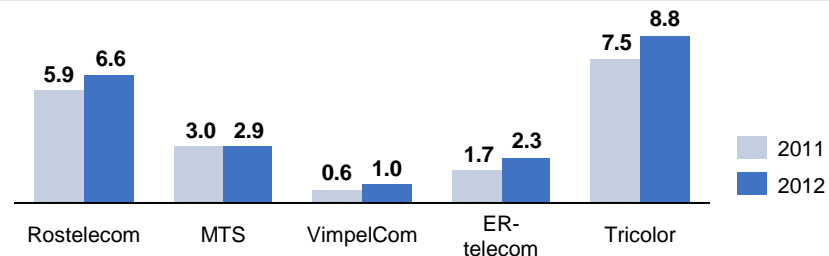
Pay TV

Market share, %, 3Q2013



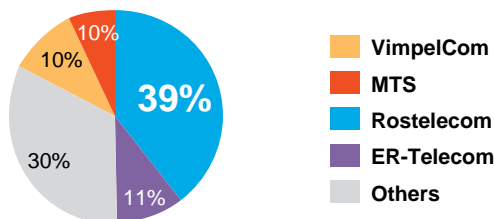
- Rostelecom is the leader in Pay TV market. Company's revenue market share in IPTV reached 55% in 3Q2013
- IPTV is the key growth driver in this segment. Rostelecom subscriber base increased by 49% y-o-y and reached 1.8m subscribers in 3Q2013

Pay TV subscribers¹, mln



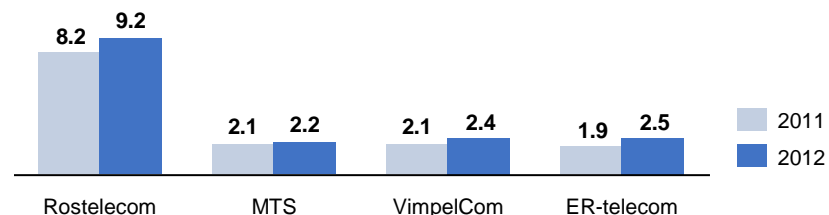
Broadband

Market share, %, 3Q2013



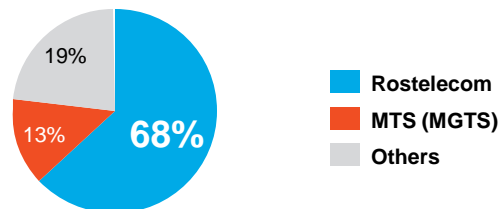
- Rostelecom is the largest provider of fixed broadband services in Russia
- As of 3Q2013 the number of fiber optic subscribers increased by 40% y-o-y to 3.5m subscribers, while the total subscribers base increased by 10% y-o-y and amounted to 9.8m

Fixed broadband subscribers, mln



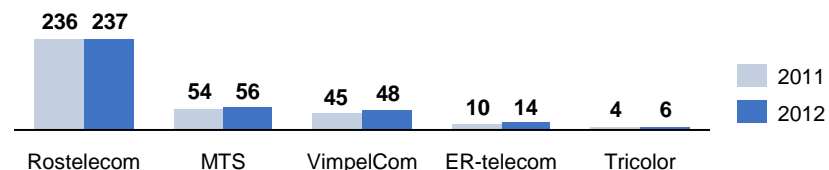
Fixed-line telephony

Market share, %, 3Q2013



- Rostelecom market share was stable in 2012-2013
- As of 3Q 2013 the company served 25.9m subscribers (6% decrease versus 3Q 2012)

Revenue from fixed-line telephony, broadband and Pay TV², RUB bn



Source: iKS-Consulting, ACM Consulting, operators data

Note: All data shown includes Russia only. Rostelecom numbers are provided without Svyazinvest

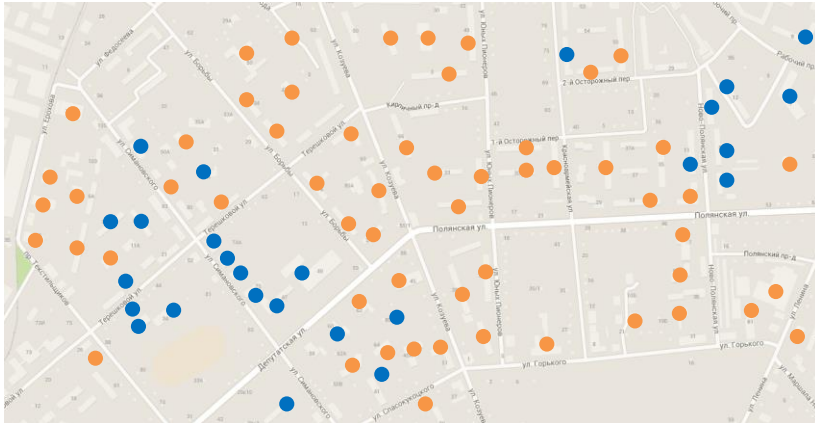
¹ For Tricolor TV only paying subscribers are taken into account

² For VimpelCom revenue is translated in RUB at CBR exchange rate for the relevant period

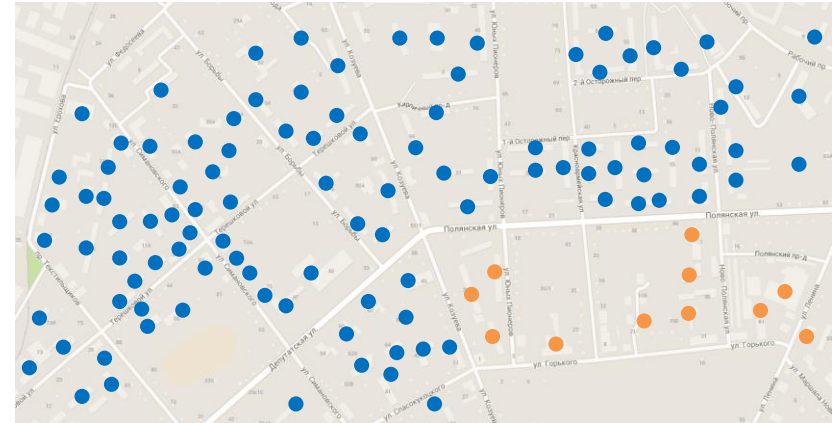
Key strategic pillars of Rostelecom fixed-line business



From single-point roll-out today...



...to systematic approach to network development



● xDSL ● PON

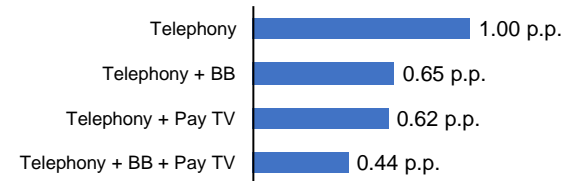
- New strategy for household coverage – “Broadband conveyor”, which involves cluster-based roll-out, covering all households in city regions. Single-point roll-out is only allowed in up to 20% of households
- Ensure continuity of the priority access technology for the existing network. All new backbone segments are PON-ready
- Decommission telephony lines and exchanges in regions where supported by the business case
- Use CPEs with multiple interfaces (Ethernet, RJ, RF, WiFi 2.4 / 5GHz)
- Use wireless access as replacement for last mile in regions with low population density
- Target households covered by the end of 2016 – 33m – all households in high and medium rise buildings
- Sign framework agreements and decrease procurement costs by switching to standardised network architecture and equipment

Development of differentiated offerings for B2C subscribers

Telephony

- Differentiated tariffs for Inter-regional and international calls
- Bundling with Broadband and Pay TV services to reduce churn and maintain subscriber levels

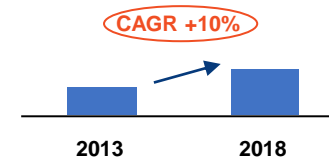
Effect of bundled services on the level of churn



Broadband

- Speeds 10% higher versus competitors, for the same monthly tariffs
- Exclusive speed of 1Gbit/s for top-end tariff

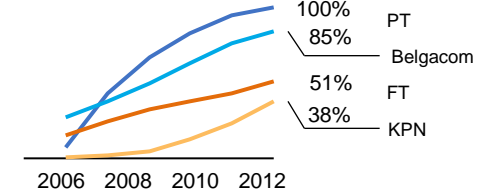
Rostelecom B2C Broadband subscribers



Pay TV

- Interactive TV with unique content proposition (HD, exclusive channels, VoD²)
- OTT platform (TV Everywhere)³

TV subscribers as % of Broadband subscribers¹, %



New services

- Financial services
- Smart house / Safe house
- Online and mobile commerce
- Payment for goods and services, cash services, credits, overdrafts and deposits, money transfers
- Home monitoring, control on water and electricity costs with smart meters, remote control of electrical appliances, remote monitoring of health
- Mobile and online payments, use of personal mobile and fixed line telephony accounts as electronic wallet

2b Pay TV segment strategy

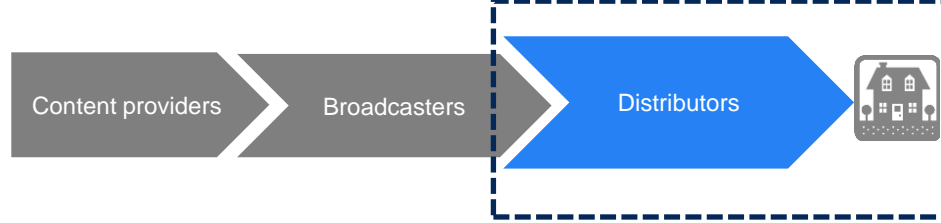
1
Network improvement in order to increase ARPU

- Increase speed and network capacity in order to switch subscribers to bundled services with higher ARPU
- Examples: roll out FTTH VDSL networks in Europe, upgrade of cable networks



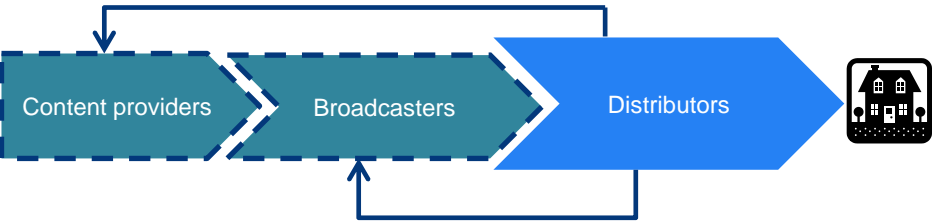
2
Provide best-in-class services to enhance customer loyalty

- State of the art technology, high speed network as an instrument for cross selling and client retention
- Examples: LGI Set-Top-Boxes (stickiness) and Free TV offerings (cross-selling)



3
Vertical integration with content providers to avoid intermediaries

- Acquisition or merger with content providers to prevent emergence of intermediaries
- Examples: Comcast / NBC Universal



4
Providing fixed and mobile services in bundled offerings

- Acquire expertise in fixed line business to provide attractive bundled offerings
- Examples: Vodafone acquisition of CWW



5
Expand digital coverage, allowing monetisation content independent of the platform

- Expand digital coverage to allow monetisation of content on all platforms
- Examples: digital and related business of P7S1, increase in VoD for RTL



B2B and B2Gs products development

Large corporate clients

- Package solutions for companies with requirements of large, high capacity, reliable and secure networks
- Core services: VPN, WAN, Broadband, data centers hosting, fixed voice
- Cloud computing services O7: call center, unified communications, web-video- conference communications, telepresence and broadcast, information security, managed services, content filtering
- Integrated solutions

SME

- Full Package Products for sub-segments
- Package: Broadband + fixed voice, option – VPN + hosting
- Cloud computing services O7: Hosted PBX, virtual office, web-video- conference communications
- M2M services: transport and logistics, CCTV monitoring

Implementing client service best practices

	Key initiatives	Targets
Call center	<ul style="list-style-type: none"> Unified call-center on the base of common IT infrastructure Unified call number for client services and client call rebalancing system Unified SLA 	<ul style="list-style-type: none"> 90% calls processed at first attempt 95% client satisfaction rate
Online client services	<ul style="list-style-type: none"> Multiplatform web-interface: rt.ru portal and 'my account' service Focus on customer self-service through web-channels 	<ul style="list-style-type: none"> > 50% share of remote channels
Retail distribution	<ul style="list-style-type: none"> Restructuring of retail distribution network: carve-out of retail chain operations into separate entity, retail chain optimisation, franchising opportunities Rebranding of the distribution network to increase sales and improve brand awareness Focus on efficiency of distribution network (margins) 	<ul style="list-style-type: none"> 20% share of channel in revenues 2x decrease of distribution network OPEX
2nd and 3rd support lines	<ul style="list-style-type: none"> Standardisation of maintenance process Centralisation of network monitoring and management Upgrade incentive system for maintenance staff with key focus on quality of service 	<ul style="list-style-type: none"> Less than 2% share of repetitive requests Less than 24h request processing time
Corporate and SME accounts	<p>Client-centric approach for large corporate clients:</p> <ul style="list-style-type: none"> Personal account manager to provide assistance on key customer support and services questions Dedicated technical support line, quality of service (QoS) management <p>Differentiated approach for SME clients:</p> <ul style="list-style-type: none"> Standardised SLA depending on service package Dedicated sales and support channels with unified business processes 	<ul style="list-style-type: none"> 90% calls processed at first attempt 3% lost calls rate (LCR) 80% service level commitment

4 Organizational transformation

Organizational transformation initiatives

- Centralisation of support functions: IT, backoffice, etc.
- Creation of competence centers at macro branches level
- Outsourcing of certain business functions and related optimisation of organizational structure

'Ideal branch' model

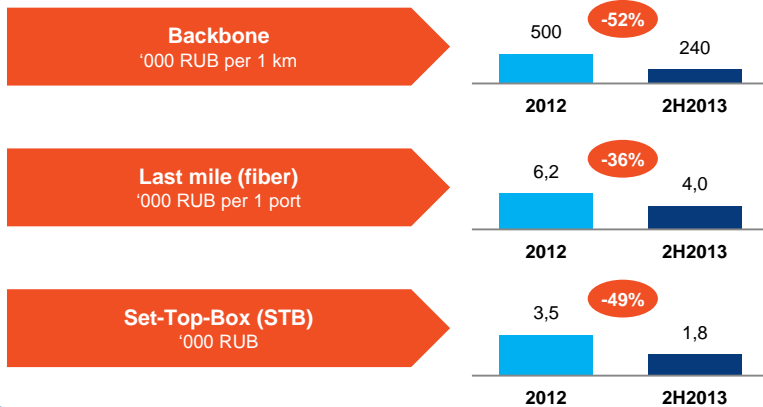
- Development of 'ideal' operational model with solid scalability potential on the base of some pre-selected local branch
 - Pilot project in Voronezh branch
- Replication of developed operational model at regional branches level
- 'Ideal branch' project is expected to be instrumental for the whole organizational process and should also set the ground for CRM and other IT systems

Corporate culture transformation and sustainability improvement

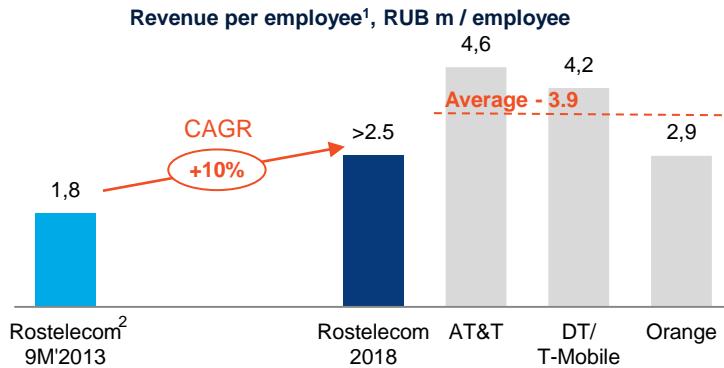
- Management efficiency: lead by example, mentorship, commitment, encouragement and staff training
- Customer-oriented approach, continuous improvement
- Motivate to action and evaluate on real achievements
- Simplicity and delegation: facilitate accomplishment of the objectives and empowerment

Focus on improvement of operational and investment efficiency

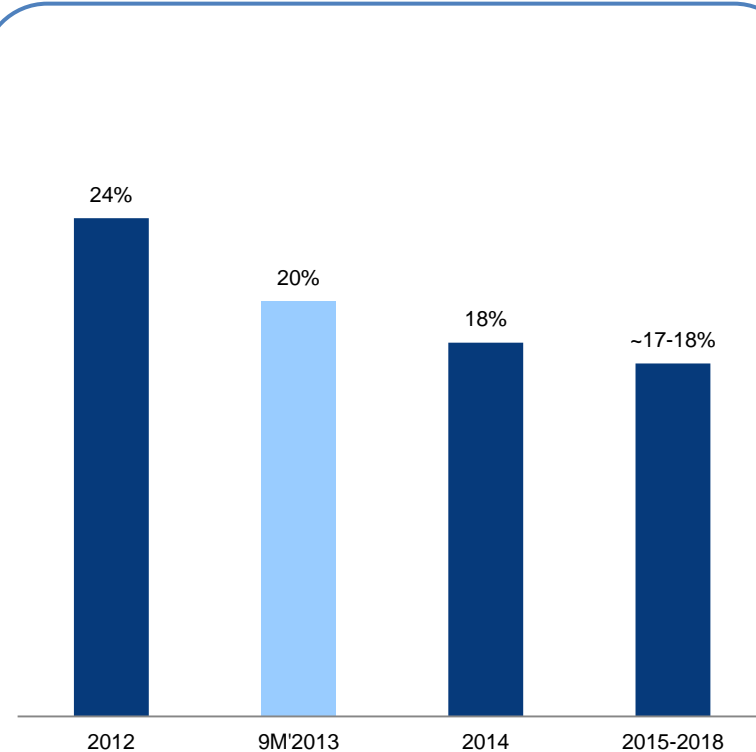
Procurement optimization



Headcount optimisation



CAPEX / Revenue, %

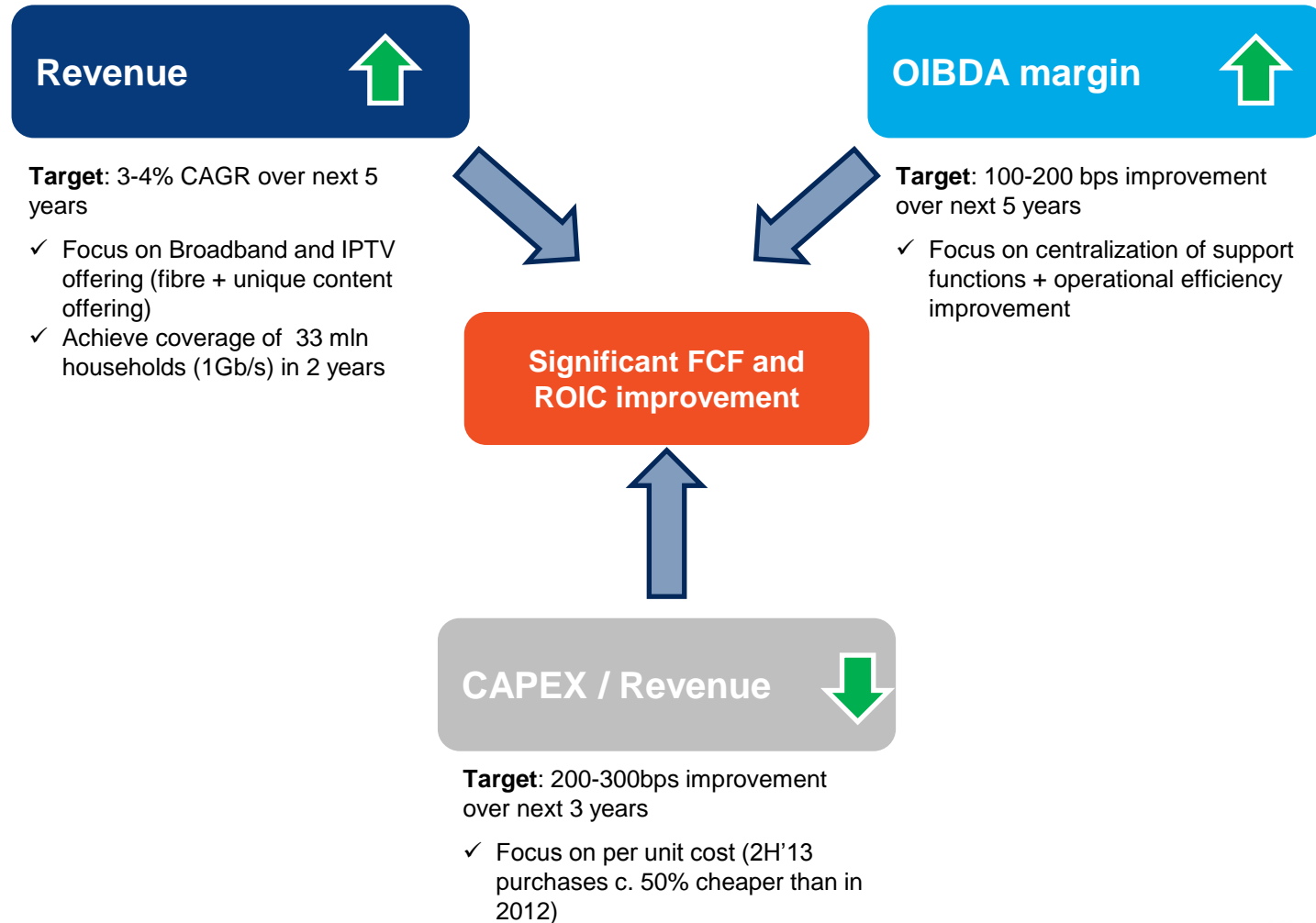


Source: Companies data

Notes: ¹ Data on international operators (incl. their mobile business) is PPP (purchasing power parity) adjusted

² Calculated as annualized revenue for 9m 2013 divided by number of employees as of the end of 3Q2013

Focus on shareholder value



2. Creating T2-RTK Holding – national mobile player

Joint venture with Tele2 Russia: transaction highlights

- Rostelecom and Tele2 Russia to merge their mobile assets to form a new national mobile operator T2 RTK Holding (or “JV”) in the largest in-market consolidation in Russian telecom space
- Subject to receipt of necessary regulatory and corporate approvals and successful completion of all transaction stages, Rostelecom will get 45% ownership in JV and is expected to become the largest single beneficial shareholder
- Transaction will be effected in two stages

Stage 1:

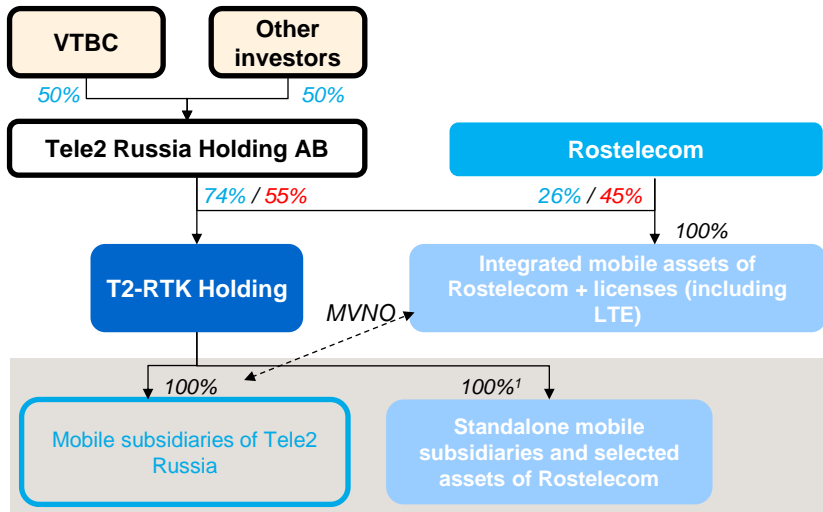
- Rostelecom will contribute its standalone mobile subsidiaries and certain mobile assets (except for its spectrum in the 450MHz band), including SkyLink, along with associated net debt of approximately RUB 34bn
- Tele2 Russia will contribute all its mobile assets, along with associated net debt of approximately RUB 27bn

Stage 2:

- Rostelecom will transfer its integrated mobile businesses and integrated licenses (including LTE), subject to an internal reorganisation required to effect the transfer
- Before completion of Stage 2, JV will get access to Rostelecom spectrum assets through MVNO arrangements
- Transaction was approved by Rostelecom Board of Directors on December 12, 2013

Transaction structure

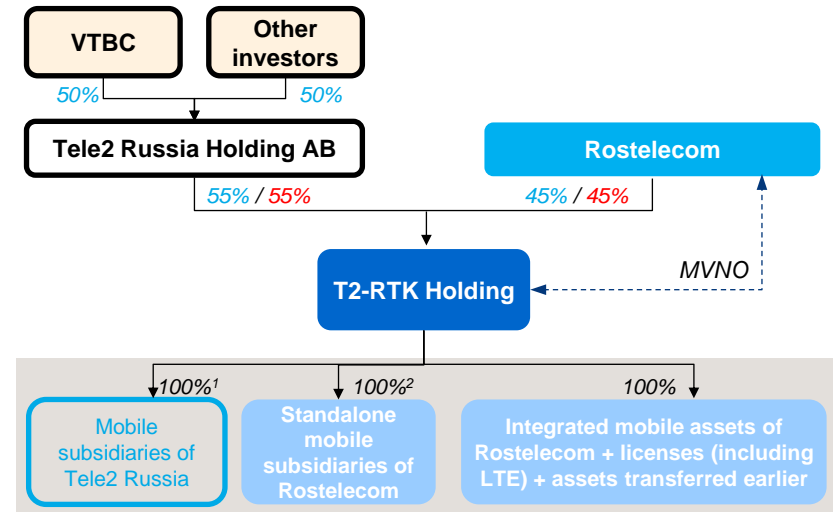
1 Stage 1 – transfer of mobile subsidiaries



Economic rights / Voting rights

- Rostelecom contributes its standalone mobile subsidiaries (including SkyLink), selected assets, along with associated net debt of c. RUB 34bn, and receives 26% economic stake in JV (45% voting rights)
- Tele2 Russia contributes all of its mobile assets, along with associated net debt of c. RUB 27bn, and receives 74% economic stake in JV (55% voting rights)
- JV gets access to Rostelecom integrated spectrum assets through MVNO arrangements

2 Stage 2 – transfer of integrated mobile assets



- Rostelecom transfers its integrated mobile businesses and licenses (including LTE), subject to an internal reorganisation required to effect the transfer
- Upon successful completion of Stage 2, Rostelecom's economic stake will increase from 26% to 45%
- Rostelecom will enter into MVNO agreement with JV for LTE to provide 4-play services

¹ In CJSC Acos: 94,4456%; in CJSC SkyLink: 50% (effectively 100% of the charter equity); in OJSC Apex: 93.49%; in CJSC TSRS: 40%

Transaction rationale (1/4)

Key considerations

Strategically important transaction for Rostelecom

- Reinforce Rostelecom's mobile strategy by creating mobile operator with sufficient scale to compete nationwide
- Rostelecom is expected to be the largest single beneficial owner in the JV
 - Pre-emptive rights in the event of a strategic sale by Tele2 Russia and right to acquire additional equity interests (up to the controlling stake) in the event of an IPO
- Retention of upside from mobile-fixed synergies and future convergence

Builds long-term shareholder value

- Substantial operational and financial upside from strengthened competitive position
- Significant synergy potential on capex and opex
- Release of cash flows at Rostelecom level

Transaction rationale (2/4)

Re-positioning Rostelecom's mobile assets through JV with Tele2 Russia

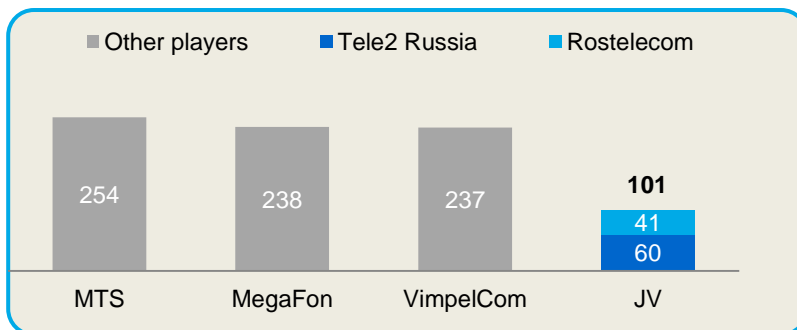
Benefits for Rostelecom

- ✓ **Increased scale**
 - Over 37m subscribers
 - Over 16% market share (by subscribers)
- ✓ **Full national license coverage**
- ✓ **Increased footprint**
 - From 35 to 64¹ operational regions
- ✓ **Capture mobile data growth opportunity**
- ✓ **Provide convergent services**
- ✓ **Ability to accelerate 3G/4G networks roll-out**
- ✓ **Accelerate monetization of licence portfolio**
- ✓ **Capitalize on Tele2 Russia's know-how and impressive track record: from a newcomer to niche player successfully competing with BIG-3**

Key combination parameters

	Rostelecom mobile	Tele2 Russia
Regions covered ³	35	41
Subscribers (mm) ³	14.1	23.7
Revenue (RUB bn) ⁴	41	60
Market share ⁶	6%	10%

Mobile revenues 2012 (RUB bn)²



Nationwide license coverage



Population coverage ⁵	100%
Licenses held (by region of RF):	
700 MHz (LTE)	83 regions
800 MHz (LTE)	83 regions
900 MHz (2G)	26 regions
1800 MHz (2G / LTE ⁵)	78 regions
2100 MHz (3G / UMTS)	71 regions
2300 MHz (LTE)	39 regions
2600 MHz (LTE)	83 regions

Transaction rationale (3/4)

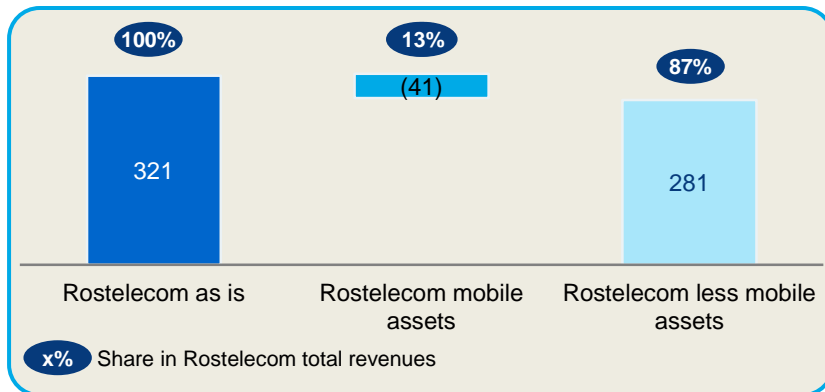
Substantial synergy potential

Area	Synergies
Revenue	<ul style="list-style-type: none">✓ Upsell existing Tele2 Russia subscribers high speed mobile data packages✓ Cross-selling fixed line services to mobile subscribers✓ Converged proposition for Rostelecom subscribers: offer mobile services bundled with Rostelecom fixed line services✓ Increased revenues from international roaming due to renegotiated tariffs for Tele2 Russia
Network & IT	<ul style="list-style-type: none">✓ Site rationalisation in Rostelecom and Tele2 Russia overlapping regions✓ Efficient 3G and 4G roll-out through colocation on existing Tele2 Russia sites✓ Efficient 4G network roll-out in Tele2 Russia regions due to wide spectrum bandwidth✓ Backhaul, backbone and core network consolidation✓ Optimisation of roaming costs✓ Consolidate and simplify IT and billing
Distribution & marketing	<ul style="list-style-type: none">✓ Increased bargaining power with federal distributors✓ Rationalisation of retail network by leveraging Rostelecom retail locations and Tele2 Russia's monobrand stores✓ Reduction in marketing costs
Other synergies	<ul style="list-style-type: none">✓ Leveraging Tele2 Russia know-how and business development track record to launch a national operator with uniform high standard of operation across the country and efficient central management function✓ Elimination of overlapping functions✓ Efficiencies in property management and procurement

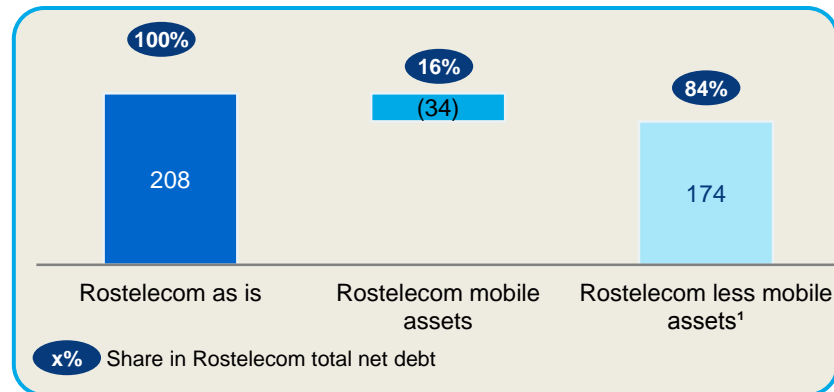
Transaction rationale (4/4)

Release of cash flows at Rostelecom level

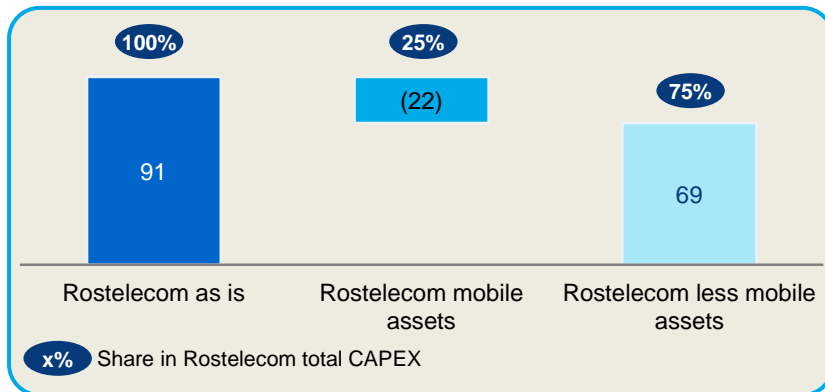
Revenue 2012 (RUB bn)



Net debt as of 3Q'13 (RUB bn)



CAPEX 2012 (RUB bn)

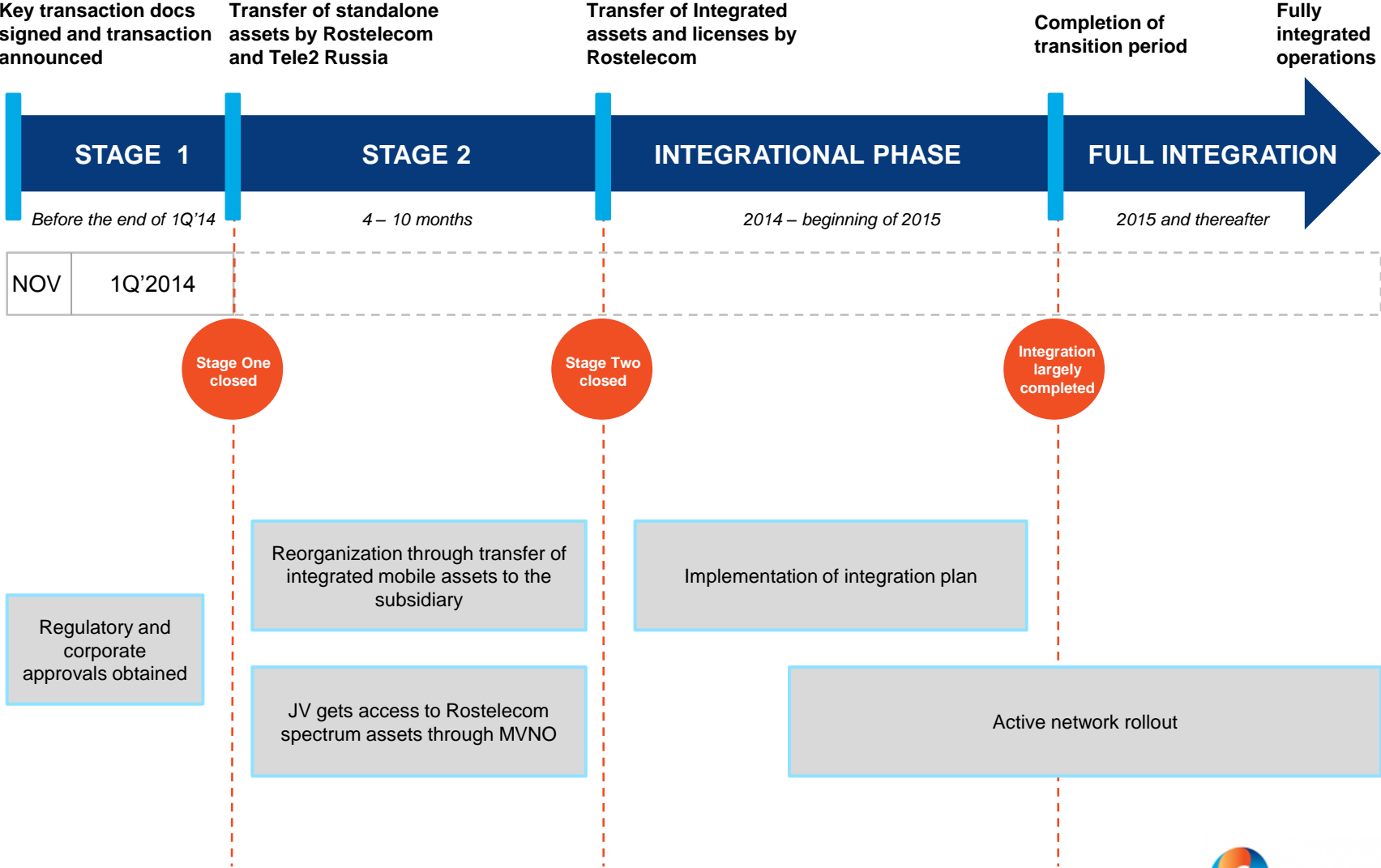


Carve-out impact

- **Additional cash flow released**
 - Substantial savings of mobile CAPEX, particularly from capital intensive roll-out of 3G/4G networks
- **Balance sheet is strengthened**
 - Elimination of debt related to mobile operations
- **Minor impact on top line**
 - Large scale of fixed line business compared to mobile

Source: Company data including CDMA subscribers
¹ Rostelecom's net debt less net debt transferred to JV

Indicative transaction timetable



3. Q&A

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