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NOTHING IN THIS ELECTRONIC TRANSMISSION CONSTITUTES AN OFFER OF SECURITIES FOR SALE IN ANY JURISDICTION WHERE IT IS UNLAWFUL TO DO SO. THE SECURITIES HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN ACCORDANCE WITH RULE 144A UNDER THE U.S. SECURITIES ACT ("RULE 144A") TO A PERSON THAT THE HOLDER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A (A "QIB"), OR (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES.

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You are reminded that this document has been delivered to you on the basis that you are a person into whose possession this document may be lawfully delivered in accordance with the laws of the jurisdiction in which you are located and you may not, nor are you authorized to, deliver this document to any other person.

The materials relating to the offering do not constitute, and may not be used in connection with, an offer or solicitation in any place where offers or solicitations are not permitted by law. If a jurisdiction requires that the offering be made by a licensed broker or dealer and the underwriters or any affiliate of the underwriters is a licensed broker or dealer in that jurisdiction, the offering shall be deemed to be made by the underwriters or such affiliate on behalf of Sistema in such jurisdiction.

Under no circumstances shall this document constitute an offer to sell or the solicitation of an offer to buy nor shall there be any sale of these securities in any jurisdiction in which such offer, solicitation or sale would be unlawful. Recipients of this document who intend to subscribe for or purchase the securities are reminded that any subscription or purchase may only be made on the basis of the information contained in the final offering memorandum. This document may only be communicated to persons in the United Kingdom in circumstances where section 21(1) of the Financial Services and Markets Act 2000 does not apply to Sistema.

This document has been 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 Credit Suisse First Boston (Europe) Limited or Morgan Stanley & Co. International Limited nor any person who controls it nor any director, officer, employee nor agent of it or affiliate of any such person accepts any liability or responsibility whatsoever in respect of any difference between the document distributed to you in electronic format and the hard copy version available to you on request from Credit Suisse First Boston (Europe) Limited or Morgan Stanley & Co. International Limited.

JOINT-STOCK FINANCIAL CORPORATION
SISTEMA

1,592,663 Shares
in the form of Global Depositary Receipts
Offer Price: $17.00 per GDR

The Company—

- We are Joint Stock Financial Corporation Sistema, or Sistema, the largest private sector consumer services company in the Russian Federation, or Russia, and the Commonwealth of Independent States, or the CIS. We have over 35 million customers and operate and manage market-leading businesses in fast growing service-based industries, including telecommunications, technology, insurance, banking, real estate, retail and media.

The Offering—

- We are offering 1,550,000 common shares, with a nominal value of 90 rubles per share, of Sistema (hereinafter, the Shares) in an international offering in the form of 77,500,000 global depositary receipts, or GDRs, with no par value and with 50 GDRs representing one Share. In addition, certain of our shareholders (hereinafter, the Selling Shareholders) are offering 42,663 Shares as part of the international offering in the form of 2,133,150 GDRs.
- The GDRs are being offered in the United States to qualified institutional buyers, or QIBs, as defined in, and in reliance on, Rule 144A under the U.S. Securities Act of 1933 (hereinafter, the Securities Act), and outside the United States to certain persons in offshore transactions in reliance on Regulation S under the Securities Act, or Regulation S.
- The Selling Shareholders have granted the Joint Global Coordinators an option, exercisable within 30 days after the closing of the offering, which is expected to occur on or about February 11, 2005 (hereinafter, the Closing Date), to purchase up to 238,900 additional Shares in the form of 11,945,000 GDRs, solely to cover over-allotments, if any, in the offering and/or to cover short positions relating to stabilization activities.

The Sistema Shares—

- Our existing shares have been listed on the Russian Trading System Stock Exchange (hereinafter, the RTS Stock Exchange) and the Moscow Stock Exchange since October 28, 2004 and November 4, 2004, respectively, but are not currently traded. Accordingly, no pricing or trading volume information is available in respect of the Shares. Trading in the Shares on the RTS Stock Exchange and the Moscow Stock Exchange is expected to commence within six months from their respective listing dates. Prices for Shares traded on the RTS Stock Exchange may not reflect the underlying value of the GDRs. Prior to the offering described herein, there has been no market for the GDRs.

Listing—

- Application has been made (i) to the UK Financial Services Authority (hereinafter, the UK Listing Authority) in its capacity as competent authority under the Financial Services and Markets Act 2000 (hereinafter, FSMA) for a listing of up to 193,000,000 GDRs, consisting of up to 79,633,150 GDRs to be issued on the Closing Date, up to 11,945,000 additional GDRs to be issued pursuant to the over-allotment option, as described herein, and up to 101,421,850 additional GDRs to be issued from time to time against the deposit of Shares with Deutsche Bank Trust Company Americas, as depositary, to be admitted to the official list of the UK Listing Authority (hereinafter, the Official List) and (ii) to the London Stock Exchange plc (hereinafter, the London Stock Exchange) for such GDRs to be admitted to trading on the London Stock Exchange's market for listed securities. Admission to the Official List together with admission to trading on the London Stock Exchange's market for listed securities constitute admission to official listing on a stock exchange. Application has also been made to have the Rule 144A GDRs (as defined herein) designated eligible for trading in The PORTAL Market of the NASDAQ Stock Market, Inc. (hereinafter, PORTAL).

Risk Factors—

- **For a discussion of certain risk factors that should be considered in connection with an investment in the GDRs representing the Shares, see "Risk Factors" beginning on page 13.**

GDRs—

- **The GDRs are of a specialist nature and should only be bought and traded by investors who are particularly knowledgeable in investment matters.**
- The Shares and the GDRs have not been and will not be registered under the Securities Act and may not be offered or sold within the United States, except to QIBs in reliance on the exemption from the registration requirements of the Securities Act provided by Rule 144A under the Securities Act, or Rule 144A, or outside the United States to certain persons in offshore transactions in reliance on Regulation S. Prospective purchasers are hereby notified that sellers of the GDRs 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 and the GDRs, see "Description of the Global Depositary Receipts."

Delivery and Settlement—

- The GDRs are offered by the Underwriters, as named in "Plan of Distribution," when, as and if delivered to and accepted by the Underwriters and subject to their right to reject orders in whole or in part. The GDRs will be issued in global form and will be evidenced by a Master Rule 144A GDR registered in the name of Cede & Co., as nominee for The Depository Trust Company (hereinafter, DTC), and a Master Regulation S GDR (together with the Master Rule 144A GDR, the Master GDRs) registered in the name of BT Globenet Nominees Limited, as nominee for Deutsche Bank AG London, as common depositary for Euroclear Bank S.A./N.V., as operator of the Euroclear System (hereinafter, Euroclear) and Clearstream Banking, société anonyme (hereinafter, Clearstream). It is expected that delivery of the GDRs will be made against payment therefor in U.S. dollars in same day funds through the facilities of DTC, Euroclear and Clearstream on or about February 11, 2005. See "Settlement and Delivery."
- The proceeds of this offering will be held in escrow and escrow-type accounts, and trading in the GDRs on the London Stock Exchange will be subject to cancellation until the placement report for the newly issued common shares being offered by us (hereinafter, the placement report) is registered by the Russian Federal Service for the Financial Markets. If the placement report is not registered within 60 days after the Closing Date (or such later date as we and the Selling Shareholders agree with the Underwriters), the escrowed proceeds plus interest, if any, received on the funds held in escrow and escrow-type accounts will be refunded to the holders of the GDRs at or about the time of such cancellation, regardless of the then-prevailing market price of the GDRs, subject to applicable withholding taxes. However, the return of funds may be delayed due to Russian currency control, banking or securities regulations or practices and may be prevented if there is a change in such regulations or practices.

Joint Global Coordinators

Credit Suisse First Boston **Morgan Stanley**

Co-Lead Managers

Deutsche UFG **ING Financial Markets**
Renaissance Capital **Troika Dialog**

Dated February 9, 2005

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IMPORTANT INFORMATION ABOUT THIS OFFERING MEMORANDUM

This offering memorandum is based on information provided by us and other sources believed by us to be reliable. The Underwriters are not responsible for, and are not making any representation or warranty to you concerning our future performance or the accuracy or completeness of this offering memorandum.

This offering memorandum, including the financial information and the appendix included herein, comprises listing particulars given in compliance with the listing rules made by the UK Listing Authority for the purpose of giving information with regard to Sistema and its subsidiaries (the Sistema Group), the GDRs and the Shares.

We accept responsibility for the information contained in this offering memorandum, and to the best of our knowledge and belief (having taken reasonable care to ensure that such is the case), the information contained in this offering memorandum is in accordance with the facts and does not omit anything likely to affect the import of such information.

In making an investment decision regarding the Shares and the GDRs offered hereby, you must rely on your own examination of our company and the terms of the offering, including the merits and risks involved. You should rely only on the information contained in this offering memorandum. We have not, and the Underwriters have not, authorized 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 as of the date on the front cover of this offering memorandum only. Our business, financial condition, results of operations and the information set forth in this offering memorandum may have changed since that date.

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 and the GDRs. We are not, and the Underwriters are not, making any representation to any offeree or purchaser of the Shares and the GDRs regarding the legality of an investment in the Shares and the GDRs by such offeree or purchaser under appropriate investment or similar laws.

Credit Suisse First Boston (Europe) Limited and Morgan Stanley & Co. International Limited are acting exclusively for us 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.

We obtained the market data used in this offering memorandum from internal surveys, industry sources and currently available information. We have obtained information regarding the Russian Federation and its economy from various government publications and other sources. Although we believe that our sources are reliable, you should keep in mind that we have not independently verified information we have obtained from industry and government sources and that information from our internal surveys has not been verified by any independent sources. We accept responsibility for having correctly reproduced information obtained from industry publications or public sources.

The contents of our websites do not form any part of this offering memorandum.

We may withdraw the offering at any time, and we and the Underwriters reserve the right to reject any offer to purchase the Shares and the GDRs in whole or in part and to sell to any prospective investor less than the full amount of the Shares and the GDRs sought by such investor. The Underwriters and certain related entities may acquire a portion of the Shares and the GDRs for their own accounts.

The distribution of this offering memorandum and the offer and sale of the Shares and the GDRs may be restricted by law in certain jurisdictions. You must inform yourself about, and observe, any such restrictions. See "Description of the Global Depositary Receipts" 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 and the GDRs or possess or distribute this offering memorandum and must obtain any consent, approval or permission required for your purchase, offer or sale of the Shares and the GDRs 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. We are not, and the Underwriters are not, making an offer to sell the Shares and the GDRs or a solicitation of an offer to buy any of the Shares and the GDRs to any person in any jurisdiction except where such an offer or solicitation is permitted.

The Shares and the GDRs have not been approved or disapproved by the U.S. Securities and Exchange Commission (hereinafter, the SEC), any state securities commission in the United States or any other U.S. regulatory authority, nor have any of the foregoing authorities passed upon or endorsed the merits of the offering of the Shares and the GDRs or the accuracy or adequacy of this offering memorandum. Any representation to the contrary is a criminal offence in the United States.

NOTICE TO U.K. INVESTORS

This offering memorandum is only being distributed to and is only directed at (i) persons who are outside the United Kingdom or (ii) investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (the Order) or (iii) high net worth entities, and other persons to whom it may lawfully be communicated, falling within Article 49(2)(a)-(d) of the Order (all such persons together being referred to as "relevant persons"). The Shares and the GDRs are only available to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such securities will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely on this offering memorandum or any of its contents.

NOTICE TO NEW HAMPSHIRE RESIDENTS

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES ("RSA 421-B") WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE HAS PASSED IN ANY WAY UPON THE MERITS OR QUALIFICATIONS OF, OR RECOMMENDED OR GIVEN APPROVAL TO, ANY PERSON, SECURITY OR TRANSACTION. IT IS UNLAWFUL TO MAKE, OR CAUSE TO BE MADE, TO ANY PROSPECTIVE PURCHASER, CUSTOMER OR CLIENT ANY REPRESENTATION INCONSISTENT WITH THE PROVISIONS OF THIS PARAGRAPH.

STABILIZATION

In connection with the offering, Credit Suisse First Boston (Europe) Limited or any person acting for it may over-allot or effect transactions with a view to supporting the market price of the Shares and the GDRs at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there will be no obligation on Credit Suisse First Boston (Europe) Limited or any of its agents to do this. Such stabilizing, if commenced, may be discontinued at any time, and must be brought to an end after a limited period.

CURRENCIES AND EXCHANGE RATES

In this offering memorandum, references to "U.S. dollars" or "$" are to the currency of the United States, references to "rubles" or "RUR" are to the currency of the Russian Federation and references to "euro" or "€" are to the currency of the member states of the European Union participating in the European Monetary Union.

Starting from January 1, 2003, the Russian economy ceased to be considered highly inflationary for accounting purposes. We have determined that for the fiscal year beginning January 1, 2003 the functional currency of the Moscow City Telephone Network, or MGTS, ROSNO, Kuban-GSM, Mikron, Detsky Mir, Detsky Mir Center, Sistema Mass Media and Concern RTI is the ruble. Accordingly, the reporting currency amounts for these subsidiaries were translated into their functional currency at the exchange rate current at January 1, 2003. These amounts became the new accounting basis for the non-monetary assets and liabilities. The functional currency of Ukrainian Mobile Communications, or UMC, is the Ukrainian hryvnia, referred to herein as hryvnia, and the functional currency of STROM telecom is the Czech krona. We believe that the U.S. dollar is still the appropriate functional currency for our other subsidiaries due to pervasive use of the U.S. dollar in their operations. Our reporting currency is the U.S. dollar.

The following tables show, for the periods indicated, certain information regarding the exchange rate between the ruble and the U.S. dollar, based on the official exchange rate quoted by the Central

Bank of Russia. These rates may differ from the actual rates used in the preparation of our financial statements and other financial information appearing in this offering memorandum.

	Rubles per U.S. dollar			
Years ended December 31,	High	Low	Average[(1)]	Period end
2000	28.87	26.90	28.13	28.16
2001	30.30	28.16	29.22	30.14
2002	31.86	30.14	31.39	31.78
2003	31.89	29.25	30.67	29.45
2004	29.45	27.75	28.73	27.75

(1) The average of the exchange rates on the last business day of each full month during the relevant period.

	Rubles per U.S. dollar	
Months	High	Low
August 2004	29.28	29.14
September 2004	29.26	29.21
October 2004	29.22	28.77
November 2004	28.78	28.24
December 2004	28.15	27.75
January 2005	28.16	27.75

The exchange rate between the ruble and the U.S. dollar on February 7, 2005 was 27.98 rubles per $1.00.

No representation is made that the ruble or U.S. dollar amounts in this offering memorandum could have been converted into U.S. dollars or rubles, as the case may be, at any particular rate or at all. The ruble is generally not convertible outside Russia. A market exists within Russia for the conversion of rubles into other currencies, but the limited availability of other currencies may tend to inflate their values relative to the ruble.

Certain amounts that appear in this offering memorandum have been subject to rounding adjustments; accordingly, figures shown as totals in certain tables may not be an arithmetic aggregation of the figures that precede them.

LIMITATION ON ENFORCEMENT OF CIVIL LIABILITIES

All of our directors and executive officers named in this offering memorandum reside outside the United States and the United Kingdom. All or a substantial portion of their and our assets are located outside the United States and the United Kingdom, principally in the Russian Federation. As a result, it may not be possible for you to:

- effect service of process within the United States or the United Kingdom upon any of our directors and executive officers named in this offering memorandum; or
- enforce, in the United States or the United Kingdom, court judgments obtained in courts of the United States or the United Kingdom, as the case may be, against us or any of our directors and executive officers named in this offering memorandum in any action, including actions under the civil liability provisions of federal securities laws 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 States or the United Kingdom, liabilities predicated upon U.S. or U.K. securities laws.

Judgments rendered by a court in any jurisdiction outside the Russian Federation will be recognized by courts in Russia only if an international treaty providing for 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 is adopted in Russia providing for the recognition and enforcement of foreign court judgments. No such treaty exists between the United States or the United Kingdom and the Russian Federation for the reciprocal enforcement of foreign court judgments and no relevant federal law on enforcement of foreign court judgments has been adopted in the Russian Federation.

The Deposit Agreements for the GDRs provide for actions brought against us by any party to the Deposit Agreements to be settled by arbitration in London, England, in accordance with the rules of the London Court of International Arbitration. The Russian Federation is a party to the United Nations (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards. However, it may be difficult to enforce arbitral awards in the Russian Federation due to:

- the inexperience of Russian courts in international commercial transactions;
- official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors; and
- Russian courts' inability to enforce such orders and corruption.

We have appointed CT Corporation System as our agent for service of process in any suit, action or proceeding with respect to the GDRs. However, such appointment may not be respected by a Russian court.

For a further description of the risks relating to your ability to enforce court judgments against us or any of our directors and executive officers, see "Risk Factors—Risks Relating to the GDRs and the Trading Market—You may have limited recourse against us and our directors and executive officers because we generally conduct our operations outside the United States and the United Kingdom and all of our directors and executive officers reside outside the United States and the United Kingdom."

FORWARD-LOOKING STATEMENTS

Certain statements in this offering memorandum are not historical facts and are "forward-looking" within the meaning of Section 27A of the Securities Act and Section 21E of the U.S. Securities Exchange Act of 1934 (hereinafter, the Exchange Act). Forward-looking statements appear in various locations, including, without limitation, under the headings "Offering Memorandum Summary," "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. Forward-looking statements include statements concerning our plans, objectives, goals, strategies, future events, future revenues or performance, capital expenditures, financing needs, plans or intentions relating to acquisitions, our competitive strengths and weaknesses, our business strategy and the trends we anticipate in the industries and the political and legal environment in which we operate and other information that is not historical information.

Words such as "believe," "anticipate," "estimate," "expect," "intend," "predict," "project," "could," "may," "will," "plan" and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements.

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. These risks, uncertainties and other factors include, among other things, those listed under "Risk Factors," as well as those included elsewhere in this offering memorandum. You 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:

- changes in political, social, legal or economic conditions in Russia and the CIS;
- the effects of, and changes in, the policies of the government of the Russian Federation, including the President and his administration, the Prime Minister, the Cabinet and the Prosecutor General and his office;
- our ability to obtain necessary regulatory approvals and licenses for our businesses;
- our ability to service our existing indebtedness;
- our ability to fund our future operations and capital needs through borrowing or otherwise;
- our ability to successfully implement any of our business strategies;
- our ability to integrate our businesses, including recently acquired businesses, and to realize anticipated cost savings and operational benefits from such integration;
- our ability to reorganize our telecommunications subsidiaries and achieve anticipated cost savings and to integrate recently acquired businesses;
- our ability to divest non-core assets and businesses on favorable terms;
- our expectations about growth in demand for our products and services;
- the effects of competition;
- the effects of international political events;
- inflation, interest rate and exchange rate fluctuations; and
- our success in identifying other risks to our businesses and managing the risks of the aforementioned factors.

This list of important factors is not exhaustive. When relying on forward-looking statements, you 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.

AVAILABLE INFORMATION

For so long as any Rule 144A GDRs (or the Shares represented thereby) are "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act, Sistema will, during any period in which it is 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 Rule 144A GDRs or to any prospective purchaser of such restricted Rule 144A GDRs 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.

Unless otherwise noted, Sistema's ownership interests in its subsidiaries are presented as of December 31, 2004, and all of these subsidiaries continue to be part of the Sistema group as of the date of this offering memorandum.

OFFERING MEMORANDUM SUMMARY

This summary highlights certain aspects of our business and the offering, but you should read the entire offering memorandum, including the financial statements and related notes, before making an investment decision. In this offering memorandum, unless the context otherwise requires, the terms "we," "us," "our" and other similar terms refer to the consolidated businesses of Sistema and its subsidiaries. You should carefully consider the information set forth under the heading "Risk Factors."

Sistema

We are the largest private sector consumer services company in Russia and the CIS, and we have over 35 million customers. Our business is developing, managing and realizing the value of market-leading businesses in the markets in which we have a presence. We operate in a few select service-based industries offering the potential for rapid growth of our businesses. Given the scale, scope and market position of our existing operations, we are uniquely positioned to exploit the growth in consumer and corporate purchasing power in the countries in which we operate. We currently operate principally in the following sectors: telecommunications, technology, insurance, banking, real estate, retail and media. Our revenues were $3,759.9 million for the year ended December 31, 2003 and $4,135.9 million for the nine months ended September 30, 2004, and our operating income before depreciation and amortization for the same periods was $1,626.7 million and $1,847.2 million, respectively.

Telecommunications. The companies in our Telecommunications Segment form the largest privately held telecommunications group in Russia in terms of revenues and number of subscribers. The segment has two divisions: wireless communications services and fixed line communications services. Our wireless telecommunications services division consists of Mobile TeleSystems, or MTS, the largest wireless operator in Russia and the CIS, and Sky-Link, a CDMA-2000 operator in Moscow, St. Petersburg and the surrounding regions. We beneficially own a 50.6% interest in MTS, which generated net standalone revenues of $2,546.2 million and $2,807.3 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively.

Our fixed line communications services division consists of MGTS, the incumbent PSTN operator in Moscow, and Comstar United TeleSystems, or Comstar UTS, a leading provider of unregulated telecommunications services in Moscow. MGTS had approximately 4.2 million active lines in service as of September 30, 2004, and Comstar UTS had over 26,200 corporate and public sector customers and approximately 394,019 Internet subscribers, of which 47,338 were ADSL subscribers. Sistema has management control of these two businesses. We beneficially own 46% of MGTS. Our voting interest in MGTS is equal to 56%. Comstar UTS is currently being formed as a single legal entity and integrated business through the restructuring of our interests in existing alternative operators and Internet service provider businesses including Comstar, MTU-Inform, Telmos, Golden Line and MTU-Intel. We plan to complete the restructuring during 2005. Upon completion of the restructuring, we expect that Sistema will own at least a 51% stake in Comstar UTS and MGTS will own at least an additional 45% stake in Comstar UTS. Our Telecommunications Segment accounted for 81.0% of our consolidated revenues and 98.6% of our consolidated operating income before depreciation and amortization for the nine months ended September 30, 2004.

Technology. Our Technology Segment consists of CSC and its subsidiaries. The segment has four divisions: telecommunications equipment and software; IT and systems integration; semiconductor design and manufacturing; and electronic devices and consumer electronics. For the nine months ended September 30, 2004, our Technology Segment accounted for 6.8% of our consolidated revenues.

Insurance. Through ROSNO and its subsidiaries, we are one of the leading providers of insurance, reinsurance and related products in the Russian insurance market. ROSNO's principal activities are non-life and life insurance, as well as insurance-related services, such as obligatory insurance. We have a strategic partnership with ROSNO's 47% shareholder, Allianz, one of the largest European insurance companies. Our Insurance Segment accounted for 4.5% of our consolidated revenues for the nine months ended September 30, 2004.

Banking. Our Banking Segment is represented by MBRD, a joint stock bank incorporated in 1993. MBRD has historically performed internal treasury functions for us and our subsidiaries. However, we intend to develop MBRD's business, particularly in the retail banking sector. MBRD has a history of steady development despite several recent financial crises in Russia. Our Banking Segment accounted for 0.8% of our consolidated revenues for the nine months ended September 30, 2004.

Real Estate. We are a leading real estate owner, developer and manager predominantly focused on the Moscow market in the segments of Class A and B offices, elite housing, cottages and land development. We have been in the real estate business since the early 1990s, making real estate one of our first businesses. Since 1994, we have successfully completed more than 20 projects totaling over 150,000 sq.m. of space, utilizing funding from internal sources and from third parties. Our real estate strategy is two-pronged: (i) continue to develop, redevelop and build profitable projects on our current sites or sites to be sourced by us in the future through our extensive network of market contacts and (ii) redevelop those properties in our significant real estate holdings that are no longer fully used by our operations.

Retail. We are the largest retailer of children's goods in Russia through our children's goods retailer Detsky Mir. Detsky Mir is among the most recognized brands in Russia. As of September 30, 2004, we operated seven stores in Moscow, including the flagship Detsky Mir store in central Moscow, and two stores outside of Moscow with a total retail space of 21,719 sq.m. We plan to expand Detsky Mir by opening new stores in Moscow and other Russian cities and to undertake a significant refurbishment of our flagship store.

Media. Our media business has historically operated in three main areas: advertising, print distribution and other media, which includes a number of secondary companies that operate in areas such as publishing, film production and news services. As a result of a recent strategic review of our activities, we will be focusing on the development of our pay-TV and interactive services, including multiple distribution platforms (video over DSL, MMDS, HFC cable) and content aggregation and production.

Other Businesses. Our other businesses include travel services, international operations, radio and space technology, pharmaceuticals and biotechnology, as well as the operations of our parent company.

Our Other Businesses Segment, which includes our real estate, retail and media businesses for financial reporting purposes, accounted for 6.8% of our consolidated revenues for the nine months ended September 30, 2004.

Strategy

Our strategy is to capitalize on our competitive advantages to build market-leading businesses in select sectors which exploit the growth in consumer and corporate purchasing power in the Russian and CIS markets.

Competitive Strengths

- ***Track Record of Creating and Realizing Shareholder Value.*** We have a considerable track record of successful investments in Russia and the CIS. Our track record is a key factor in attracting further management expertise, strategic partners and capital to our businesses.

- ***Access to Attractive Investment Opportunities.*** We enjoy a competitive advantage in sourcing new investment opportunities due to the scale and scope of our operations, our track record of successful strategic partnerships and our network of relationships in the corporate and public sectors.
- ***Unmatched Customer Base.*** Our businesses collectively have one of the largest customer bases in Russia and the CIS, with over 35 million customers. Our customer base is a testament to our strength in services-based industries and provides us with unparalleled insight into consumer behavior and market trends. This allows us to maintain leadership in our existing businesses, exploit cross-selling opportunities between our businesses and identify potential investments in new sectors more quickly than our competitors.
- ***Superior Pool of Management Resources.*** We have developed a unique pool of management resources combining entrepreneurs with proven ability to create and develop successful businesses, managers with diverse industry and government experience and younger, Western-educated professionals. We have a successful track record of retaining our senior managers and ensuring their career development through exposure to a broad range of industries, enabled by the scope of our operations.
- ***Successful Partnerships.*** We have a track record of successful partnerships with leading international companies such as Deutsche Telekom with respect to our telecommunication business, Allianz with respect to our insurance business and Siemens with respect to our technology business. We believe such partnerships help our businesses to develop more rapidly by providing us with strategic and operational expertise, as well as best-in-class management resources.
- ***Access to Capital.*** We believe that as a result of our track record of successful investments and the scale and scope of our operations, we have superior access to capital as compared to many of our competitors. We and our subsidiaries have a proven track record of attracting investment from the international capital markets, leading international companies and other third parties, in part, due to our leadership in financial transparency. This access to capital enables us to accelerate the development of our businesses and take advantage of new investment opportunities.
- ***High Corporate Governance and Financial Reporting Standards.*** We seek to adhere to high standards of financial disclosure and corporate governance. Our financial statements have been prepared in accordance with U.S. GAAP since 1998. Standard & Poor's awarded our subsidiary MTS one of the highest corporate governance rankings of any Russian company. Our commitment to high standards of corporate governance is critical to attracting capital and ensuring the long-term development of our businesses.

Investment and Operating Principles

- ***We Employ a Return-Based Approach to Investments.*** We employ a disciplined approach to our investment decisions with the aim of maximizing returns for our shareholders. Our internal performance benchmarks require that our businesses achieve certain operational, revenue and profitability targets, which also reflect the nature of these individual businesses. Progress against these targets is monitored and used to develop annual budgets, long-term business plans and capital allocation strategies. Companies that fail to achieve their objectives in a specified time frame generally cease to be beneficiaries of direct investments from Sistema and, should they continue to fall short of our objectives, may be sold. Similarly, we may dispose of businesses in industries that have largely fulfilled their growth potential.

- ***We Have a Focused Approach to Growth Opportunities.*** We have finite financial and managerial resources and, therefore, we concentrate our resources on select sectors in which we believe we can capitalize on our competitive advantages to build market-leading businesses. We exploit our close understanding of the markets in which we operate, as well as our established corporate and government relationships to source attractive investment opportunities in a variety of industries at an early stage. In doing so, we capitalize on our management team, which brings substantial experience of growing businesses across a broad range of sectors in Russia and the CIS. Our business development strategy is focused on achieving growth both through organic development of our businesses and through acquisitions. We provide capital, management, administrative and other resources to accelerate the business plans of our companies through business line extension, geographic expansion, participation in industry consolidation and cross-selling with our other businesses. We constantly evaluate potential entry into new high-growth sectors that may meet our investment requirements. We also evaluate selective international expansion opportunities in cases where we can capitalize on our competitive strengths. Where appropriate, we will accelerate the development of our businesses by capitalizing on our ability to access the international capital markets.

- ***We Actively Manage Our Investments.*** We have management control of our key businesses and operate as an active investor. We contribute significant management and other resources to accelerating the development of our businesses, particularly in the early stages of their life-cycles. For example, the rapid growth of our telecommunications businesses is largely a function of our ability to attract and retain skilled management. Continuing to attract and retain top quality managers to develop our businesses will remain one of our key priorities in the future.

- ***We Seek to Develop Strategic Partnerships.*** Strategic partners have also played an important role in the development of certain of our businesses. Our strategic partnerships with Deutsche Telekom and Allianz have accelerated the growth of our wireless communications and insurance businesses, respectively. We have also recently concluded a long-term partnership agreement with Siemens to assist in the development of our technology business. We will evaluate the potential to enter into further strategic partnerships in certain of our other businesses wherever a strategic partner can add significant value to that business through their brand strength, intellectual property contribution, operational expertise or international presence.

- ***We Exploit Intra-Group Synergies.*** As the largest private sector consumer services company in Russia and the CIS, we believe our businesses present certain cross-selling opportunities, as well as the potential to benefit from economies of scale in their purchasing and selling activity. We also endeavor to capitalize on our vertical integration capabilities and exploit synergy opportunities, for example, by taking advantage of our combined customer base of over 35 million customers in Russia and the CIS.

Recent Developments

In line with our strategy of pursuing profitable growth opportunities, we are currently reviewing a potential opportunity to invest in India's mobile telecommunications market, partially using debt financing from the Russian Government, involving a swap of Indian sovereign debt from Russia to Sistema. In December 2004, we entered into a preliminary and non-binding agreement with Sterling Infotech Limited, or Sterling, a conglomerate that owns mobile telecommunications assets in India. The parties intend that Sistema will form a wholly owned subsidiary in India to acquire 51% of Sterling's subsidiary, Aircel Televentures Limited, or ATVL, through the injection of $450 million in the equity capital of ATVL.

ATVL currently holds 100% of Aircel Limited and Aircel Cellular Limited, leading mobile telecommunications operators in the Tamil Nadu and Chennai regions. It is intended that by the time of completion, ATVL would also own 100% of Dishnet Wireless Limited, a greenfield operation holding Unified Access Services (UAS) licenses in seven circles in North-Eastern India with plans to acquire UAS licenses in three additional circles.

Completion of this transaction is subject to a number of conditions, including reaching an agreement on the terms of a share purchase agreement and a shareholders' agreement with Sterling, obtaining favorable debt financing from the Russian Government or governmental agency for the transaction and receipt of the required regulatory approvals.

Corporate Information

Sistema was incorporated in the Russian Federation on July 16, 1993, as a joint stock company for an unlimited duration and it operates under the laws of the Russian Federation. Sistema is registered at the Moscow Department of the Ministry of Taxes and Duties of the Russian Federation, with registration number 1027700003891. Sistema's main administrative office is located at 10, Leontievsky pereulok, Moscow 125009, Russian Federation and its registered office is 17/8/9 Prechistenka Str., Building 1, Moscow 119034, Russian Federation.

THE OFFERING

The Company	Joint Stock Financial Corporation Sistema
The Selling Shareholders	Vladimir P. Evtushenkov, Alexander L. Leiviman, Evgeny G. Novitsky, Alexander I. Gorbatovsky, Alexander Y. Goncharuk, Dmitry L. Zubov, Vyacheslav I. Inozemtsev, Stanislav K. Arbiev, Mechislav V. Klimovich, Victor E. Bolshakov, Nikolay V. Mikhailov and Zelnik Holdings Limited.
The Offering	We and the Selling Shareholders intend to offer approximately 1,550,000 Shares and 42,663 Shares, respectively, in the form of 79,633,150 GDRs, with 50 GDRs representing one Share. Rule 144A GDRs are being sold within the United States only to QIBs in reliance on Rule 144A, and Regulation S GDRs are being offered and sold outside the United States to certain persons in offshore transactions in reliance on Regulation S. The GDRs will be issued by Deutsche Bank Trust Company Americas, as depositary (hereinafter, the Depositary).
The Shares	Our current share capital consists of 8,100,000 common shares, fully paid, issued and outstanding, with a nominal value of 90 rubles each. In addition, we are allowed by our charter to issue 1,550,000 common shares (authorized shares), each with a nominal value of 90 rubles, which are being issued in connection with this offering. Following the offering, Mr. Vladimir Evtushenkov, our controlling shareholder, will own 65.45% of our outstanding Shares, or 65.18% of our outstanding Shares if the Underwriters exercise their over-allotment option in full. Our Shares have the rights described under "Description of Share Capital and Certain Requirements of Russian Legislation."
The GDRs	Fifty GDRs will represent one Share on deposit with the Custodian. The GDRs will be issued by the Depositary pursuant to one of two separate deposit agreements, one relating to the Rule 144A GDRs (hereinafter, the Rule 144A Deposit Agreement) and one relating to the Regulation S GDRs (hereinafter, the Regulation S Deposit Agreement), among us, the Depositary and holders and beneficial owners from time to time of the relevant GDRs. The Rule 144A Deposit Agreement and the Regulation S Deposit Agreement are herein referred to as the Deposit Agreements. The Regulation S GDRs will be evidenced initially by a Master Regulation S GDR and the Rule 144A GDRs will be evidenced initially by a Master Rule 144A GDR, each to be issued by the Depositary pursuant to the relevant Deposit Agreement. The Master Regulation S GDR and the Master Rule 144A GDR are herein referred to as the Master GDRs. Pursuant to the Deposit Agreements, the Shares represented by the GDRs will be held in Russia by Deutsche Bank Ltd., as Custodian, for the benefit of the Depositary and, for the further benefit of, the holders and beneficial owners of GDRs.

	Except in the limited circumstances described herein, definitive GDR certificates will not be issued to holders in exchange for interests in the GDRs represented by the Master GDRs. Subject to the terms of the Deposit Agreements, interests in the Master Regulation S GDR may be exchanged for interests in the corresponding number of GDRs represented by the Master Rule 144A GDR, and vice versa.
Offer Price	$17.00 per GDR.
Closing Date	February 11, 2005
Over-Allotment Option	The Selling Shareholders have granted the Joint Global Coordinators an option, exercisable within 30 days after the Closing Date, to purchase up to 238,900 additional Shares in the form of 11,945,000 GDRs, solely to cover over-allotments, if any, in the offering and/or to cover short positions relating to stabilization activities.
Lock-up	We and the Selling Shareholders have agreed, as part of the Underwriting Agreement, subject to certain exceptions, not to issue, offer, sell, contract to sell, pledge, charge, grant options over or otherwise dispose of, directly or indirectly, any shares in us or securities convertible or exchangeable into or exercisable for any shares in us or warrants or other rights to purchase such shares or any security or financial product whose value is determined directly or indirectly by reference to the price of the underlying securities, including equity swaps, forward sales and options or GDRs representing the right to receive any such securities or publicly announce any intention to do any of the foregoing, for a period of 180 days from the Closing Date, without the prior written consent of the Joint Global Coordinators. See "Plan of Distribution."
Transfer Restrictions	The Shares and GDRs will be subject to certain restrictions on transfer as described under "Description of the Global Depositary Receipts."
Dividend Policy	Following the offering, we expect to declare and pay a nominal annual dividend, subject to any applicable Russian legal restrictions. In accordance with our strategy, we expect to reinvest a substantial majority of our cash flow into our existing business and new investment opportunities for the foreseeable future. See "Dividend Policy."

Listing and Market for the GDRs	Application has been made to (i) the UK Listing Authority for a listing of up to 193,000,000 GDRs, consisting of 79,633,150 GDRs to be issued on the Closing Date, up to 11,945,000 additional GDRs issued pursuant to the over-allotment option, as described herein, and up to 101,421,850 additional GDRs to be issued from time to time against the deposit of Shares with the Depositary, to be admitted to the Official List and (ii) the London Stock Exchange for such GDRs to be admitted to trading on the London Stock Exchange's market for listed securities. Application has also been made to have the Rule 144A GDRs designated eligible for trading in PORTAL. Our existing shares are listed on the RTS Stock Exchange and the Moscow Stock Exchange. Prior to the offering, there has been no market for the GDRs and no public trading in the Shares. Trading in the GDRs on the London Stock Exchange is expected to commence on a when and if issued basis on Wednesday, February 9, 2005. Admission to the Official List of the UK Listing Authority and to trading on the London Stock Exchange market for listed securities is expected to take place on Monday, February 14, 2005, following closing and settlement on Friday, February 11, 2005. Trading in the Shares on the RTS Stock Exchange and the Moscow Stock Exchange is expected to commence within six months from their respective listing dates. Additional Shares may be deposited, subject to the provisions set forth under "Description of the Global Depositary Receipts" and in the Deposit Agreements, with the Custodian against which the Depositary shall issue GDRs representing such Shares up to the maximum aggregate number of 193,000,000 GDRs. The maximum aggregate number of GDRs may be further increased from time to time on application by us to the UK Listing Authority if and to the extent any such additional GDRs are admitted to the Official List.
Settlement Procedures	Payment for the GDRs is expected to be made in U.S. dollars in same-day funds through the facilities of DTC, Euroclear and Clearstream. The Depositary has applied to DTC to have the Rule 144A GDRs accepted into DTC's book-entry settlement system. Upon acceptance by DTC, a single Master Rule 144A GDR will be held in book-entry form and will be issued to DTC and registered in the name of Cede & Co., as nominee for DTC. The Master Regulation S GDR will be registered in the name of BT Globenet Nominees Limited, as nominee for Deutsche Bank AG London, as common depositary for Euroclear and Clearstream. Euroclear and Clearstream are expected to accept the Regulation S GDRs for settlement in their respective book-entry settlement systems. Except in limited circumstances described herein, investors may hold beneficial interests in the GDRs evidenced by the corresponding Master GDR only through DTC, Euroclear or Clearstream, as applicable.

	Transfers within DTC, Euroclear and Clearstream will be in accordance with the usual rules and operating procedures of the relevant system. See "Settlement and Delivery."
Voting	The Deposit Agreements do not allow for the voting of fractional entitlements. Thus, you will need 50 GDRs to be entitled to one vote.
Use of Proceeds	The net proceeds we will receive from the offering, after deducting underwriting commissions and fees and expenses incurred in connection with the offering, will be approximately $1,284.4 million. We will not receive any of the proceeds from the sale of the GDRs representing Shares offered by the Selling Shareholders. See "Use of Proceeds."
Escrow of Proceeds and Registration of Placement Report	The proceeds of the offering will be held in escrow and escrow-type accounts and trading in the GDRs on the London Stock Exchange will be subject to cancellation until the placement report is registered by the Russian Federal Service for the Financial Markets (hereinafter, the Federal Service for the Financial Markets). If the placement report is not registered within 60 days after the Closing Date (or such later date as we and the Selling Shareholders agree with the Underwriters), the escrowed proceeds plus interest, if any, received on the funds held in escrow and escrow-type accounts will be refunded to the holders of the GDRs at or about the time of such cancellation, regardless of the then-prevailing market price of the GDRs, subject to applicable withholding taxes. However, the return of funds may be delayed due to Russian currency control, banking or securities regulations or practices and may be prevented if there is a change in such regulations or practices. Until the registration of the placement report by the Federal Service for the Financial Markets, all GDRs will be issued on a provisional basis and you will not be entitled to instruct the Depositary to exercise any voting rights on your behalf as our shareholder, and the Depositary and the Custodian will not exercise any voting rights as a shareholder. You may not withdraw Shares or other property on deposit with the Depositary in respect of the GDRs sold in the offering prior to the registration of the placement report. We may not file the placement report with the Federal Service for the Financial Markets until after the closing of the offering, and we intend to file the placement report as soon as practicable following the closing of the offering. Russian law requires that we file the placement report within 30 days following the closing. The Federal Service for the Financial Markets is statutorily required to make its decision within two weeks after we file the placement report but the current practice is that registration of a placement report takes between 30 and 44 days after filing.

See “Escrow of Proceeds and Registration of Placement Report” and “Risk Factors—Risks Relating to the GDRs and the Trading Market—You will not be able to withdraw the Shares underlying the GDRs prior to the registration of a placement report for the newly issued Shares, and the failure to register this placement report could result in the offering being withdrawn and newly issued Shares underlying the GDRs being cancelled” for additional information.

General Information . . . . It is expected that the Rule 144A GDRs will be accepted for clearance through the facilities of DTC and the Regulation S GDRs will be accepted for clearance through Euroclear and Clearstream. The security numbers for the GDRs offered hereby are as follows:

Regulation S GDRs	CUSIP: 48122U 20 4 ISIN: US48122U2042 Common Code: 021034240
Rule 144A GDRs	CUSIP: 48122U 10 5 ISIN: US48122U1051 Common Code: 021034495
London Stock Exchange trading symbol:	SSA
RTS Stock Exchange trading symbol:	AFKS
Moscow Stock Exchange trading symbol:	SUST
PORTAL trading symbol:	JSFCY

Risk Factors . . . . Prospective investors should carefully consider certain risks discussed under “Risk Factors.”

SUMMARY CONSOLIDATED HISTORICAL FINANCIAL DATA

The table below shows our historical financial information as of and for the years ended December 31, 2001, 2002 and 2003 and as of and for the nine months ended September 30, 2003 and 2004. This information has been extracted without material adjustment from our audited annual financial statements and unaudited interim financial statements included elsewhere in this offering memorandum, except as provided in the footnotes below. Our unaudited interim financial statements include all normal and recurring adjustments, which are, in our opinion, necessary for a fair presentation of our financial position at such dates and results of operations for such periods. The results of operations for the nine months ended September 30, 2004 are not necessarily indicative of the results for the full year.

The summary financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements included elsewhere in this offering memorandum.

Our financial statements have been prepared in accordance with the accounting principles generally accepted in the United States, or U.S. GAAP, since 1998. Although our results are presented in U.S. dollars, you should not construe those translations as a representation that those amounts could be converted from one currency to another at any particular rate or at all. The ruble generally is not convertible outside Russia. A market exists within Russia for the conversion of rubles into other currencies, but the limited availability of other currencies may tend to inflate their values relative to the ruble.

	Years ended December 31,			Nine months ended September 30,	
	2001[(1)]	2002[(1)]	2003[(1)]	2003[(1)]	2004[(1)]
	(Amounts in thousands, except per share amounts)				
Total revenues	$ 720,536	$ 889,506	$ 3,759,915	$ 2,608,597	$ 4,135,920
Total cost of sales, exclusive of depreciation and amortization shown separately below	(424,783)	(521,467)	(1,388,027)	(945,409)	(1,589,533)
Selling, general and administrative expenses	(95,272)	(141,401)	(689,057)	(489,282)	(679,629)
Depreciation and amortization	(59,978)	(72,042)	(520,976)	(354,330)	(540,679)
Goodwill impairment	—	—	(19,251)	(19,251)	—
Other operating (expenses)/income, net	(704)	12,762	(37,326)	(39,296)	(30,614)
Equity in net income of investees	96,635	124,625	465	1,295	12,942
Net gain on disposal of subsidiaries	4,452	3,787	—	(941)	(1,862)
Operating income	240,886	295,770	1,105,743	761,383	1,306,545
Interest income	1,812	1,622	19,341	14,743	17,370
Interest expense	(39,737)	(53,111)	(198,346)	(132,057)	(163,316)
Currency exchange and translation gain/(loss)	2,482	5,113	(3,015)	3,671	9,496
Income from continuing operations before income tax, minority interests and cumulative effect of a change in accounting principle	205,443	249,394	923,723	647,740	1,170,095
Income tax expense	(29,170)	(43,398)	(290,933)	(200,343)	(326,141)
Minority interest	(28,953)	(35,109)	(402,120)	(303,454)	(471,761)
Gain/(loss) from discontinued operations[(2)]	(5,886)	(3,156)	12,810	9,952	—
Gain on disposal of discontinued operations[(3)]	—	19,725	143,567	22,500	—
Cumulative effect of a change in accounting principle[(4)]	(6,179)	(21,480)	—	—	(35,472)
Net income	$ 135,255	$ 165,976	$ 387,047	$ 176,935	$ 336,721

	Years ended December 31,			Nine months ended September 30,	
	2001[1]	2002[1]	2003[1]	2003[1]	2004[1]
	(Amounts in thousands, except per share amounts)				
Consolidated cash flow data					
Net cash provided by operating activities	$ 27,006	$ 188,616	$ 986,402	$ 687,798	$ 1,496,130
Net cash used in investing activities	(248,143)	(151,505)	(2,365,236)	(1,895,872)	(1,287,156)
of which capital expenditures[5]	(145,245)	(150,759)	(1,159,294)	(766,924)	(1,063,326)
Net cash provided by financing activities	252,343	28,194	1,504,732	1,224,550	(183,592)
Consolidated balance sheet data (end of period)[6]					
Cash and cash equivalents[7]	$ 91,962	$ 157,267	$ 283,165	$ 173,743	$ 308,547
Short-term investments	86,187	164,315	278,850	240,939	178,964
Total assets	1,958,384	2,328,331	6,792,230	6,108,294	7,678,929
Total debt (long-term and short-term)[8]	525,174	607,984	2,685,440	2,403,197	2,539,977
of which capital lease obligations	18,995	36,664	16,330	18,389	6,927
Total liabilities	1,179,637	1,345,496	4,446,389	4,099,480	4,640,700
Total shareholders' equity	414,336	594,780	989,284	747,806	1,334,595
Earnings per share, basic and diluted					
Income from continuing operations before cumulative effect of a change in accounting principle	18.2	21.1	28.5	17.8	45.9
Gain/(loss) from discontinued operations	(0.7)	2.0	19.3	4.0	—
Cumulative effect of a change in accounting principle	(0.8)	(2.7)	—	—	(4.4)
Net income	16.7	20.5	47.8	21.8	41.6
Non-U.S. GAAP measure					
OIBDA[9]	$ 300,864	$ 367,812	$ 1,626,719	$ 1,115,713	$ 1,847,224

(1) For 2001 and 2002, we accounted for our investment in MTS under the equity method. Effective January 1, 2003, MTS' accounts have been consolidated in our financial statements, with pre-acquisition earnings on the additional 10% interest purchased in April 2003 included in minority interest in the statement of operations.

(2) Gain/(loss) from discontinued operations is shown net of the income tax effect of $0.5 million, $1.5 million, $3.6 million and $3.2 million for the years ended December 31, 2001, 2002 and 2003 and the nine months ended September 30, 2003, respectively.

(3) Gain on disposal of discontinued operations is shown net of the income tax effect of nil, $18.3 million and nil for the years ended December 31, 2002 and 2003 and the nine months ended September 30, 2003, respectively.

(4) Cumulative effect of a change in accounting principle is shown net of the income tax effect of $1.1 million, nil and nil for the years ended December 31, 2001 and 2002 and the nine months ended September 30, 2004, respectively.

(5) Represents the aggregate of purchases of property, plant and equipment and of intangible assets.

(6) Our consolidated balance sheet at September 30, 2003 is not included in this offering memorandum.

(7) Includes cash representing MBRD's minimum reserve deposit requirements with the Central Bank of Russia. Minimum reserve deposits with the Central Bank of Russia were $12.5 million and $45.7 million as of September 30, 2004 and December 31, 2003, respectively.

(8) Includes short-term notes payable, long-term debt, including current portion, and capital lease obligations, including current portion, but does not include bank deposits and notes issued and certain other liabilities. As of September 30, 2004 and December 31, 2003, bank deposits and notes issued included deposits repayable on demand of $89.9 million and $58.0 million, respectively, term deposits of $116.5 million and $67.4 million, respectively, and promissory notes issued of $33.4 million and $48.3 million, respectively.

(9) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and service debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

RISK FACTORS

An investment in the GDRs involves a high degree of risk. You should carefully consider the following information about these risks, together with the information contained in this offering memorandum, before you decide to buy the GDRs. If any of the following risks actually occurs, our business, prospects, financial condition or results of operations could be materially adversely affected. In that case, the value of the Shares and GDRs could also decline and you could lose all or part of your investment.

We have described the risks and uncertainties that our management believes are material, but these risks and uncertainties may not be the only ones we face. Additional risks and uncertainties, including those we currently are not aware of or deem immaterial, may also result in decreased revenues, increased expenses or other events that could result in a decline in the value of the Shares and GDRs.

Risks Relating to Business Operations in Emerging Markets

Emerging markets such as the Russian Federation and other CIS countries are subject to greater risks than more developed markets, including significant legal, economic and political risks.

Investors in emerging markets such as the Russian Federation and other CIS countries should be aware that these markets are subject to greater risk than more developed markets, including in some cases significant legal, economic and political risks. Investors should also note that emerging economies such as the economy of the Russian Federation and other CIS countries are subject to rapid change and that the information set out herein may become outdated relatively quickly. Accordingly, investors should exercise particular care in evaluating the risks involved and must decide for themselves whether, in light of those risks, their investment is appropriate. Generally, investment in emerging markets is only suitable for sophisticated investors who fully appreciate the significance of the risks involved and investors are urged to consult with their own legal and financial advisors before making an investment in the GDRs.

Risks Relating to Our Business

General Risks

We are dependent to a material extent on the success of MTS.

Our financial results are dependent to a material extent on the financial results of MTS. For the nine months ended September 30, 2004 and the full year ended December 31, 2003, MTS contributed $405.8 million and $249.5 million to our net income from continuing operations before cumulative effect of a change in accounting principle, respectively, whereas all other businesses had an aggregate net loss from continuing operations before cumulative effect of a change in accounting principle of $33.6 million and $18.8 million, respectively. See "—Risks Relating to Our Telecommunications Business" for a description of risks affecting MTS' financial performance. As a consequence, risks and events that have a material adverse effect on MTS' business, financial condition, results of operations or prospects could, in turn, have a material adverse effect on our business, financial condition, results of operations or prospects.

Rapid growth and expansion may cause us difficulty in obtaining adequate managerial and operational resources and strain our financial resources, restricting our ability to successfully expand our operations.

We have experienced substantial growth and development in a relatively short period of time, and we believe that our businesses will continue to grow for the foreseeable future. The operating complexity of our business, as well as the responsibilities of management, have increased as a result of this growth, placing significant strain on our managerial and operational resources. Our future operating results depend, in significant part, upon the continued contributions of a small number of our key senior management and technical personnel.

We will need to continue to improve our operational and financial systems and managerial controls and procedures to keep pace with our growth. We will also have to maintain close coordination among our logistical, technical, accounting, finance, marketing and sales personnel. Management of growth will require, among other things:

- the ability to integrate new acquisitions into our operations;
- continued development of financial and management controls and information technology systems and their implementation in newly acquired businesses;
- increased marketing activities; and
- hiring and training of new personnel.

Our success will depend, in part, on our ability to continue to attract, retain and motivate qualified personnel. Competition in Russia, and in the other countries where we operate, for personnel with relevant expertise is intense due to the small number of qualified individuals, and we attempt to structure our compensation packages in a manner consistent with the evolving standards of the Russian labor market. We are not insured against the detrimental effects to our business resulting from the loss or dismissal of our key personnel. Our inability to successfully manage our growth or personnel needs could have a material adverse effect on our business, financial condition and results of operations.

We cannot assure you of the successful integration of existing or newly acquired businesses. If we fail to integrate our businesses successfully, our rate of expansion could slow and our results of operations and financial condition could be materially adversely affected.

We have grown through numerous acquisitions and are in the process of integrating and restructuring some of our businesses, particularly the Telecommunications and Technology Segments and travel services business. We may make additional acquisitions in the future. See "Use of Proceeds" for a description of certain potential acquisitions. Achieving the benefits of our acquisitions and our restructuring efforts will depend, in part, on integrating our businesses in an efficient manner. We cannot assure you that such integration will happen or that it will happen in a timely manner.

The integration of our businesses, as well as of any businesses we may acquire in the future, requires significant time and effort from our senior management, who are also responsible for managing our existing operations. Integration of our businesses may be difficult, as our culture may differ from the cultures of the businesses we acquire or consolidate, unpopular cost cutting measures may be required and control over cash flows may be difficult to establish. Any difficulties encountered in the transition and integration process could have a material adverse effect on our results of operations. We cannot assure you that we will be successful in realizing any of the anticipated benefits of the companies that we are now in the process of integrating or that we may acquire in the future. If we do not realize these benefits, our results of operations could be materially adversely affected.

Our planned business combinations and restructurings may be delayed or fail to occur.

Completion of the pending or contemplated transactions described in this offering memorandum, including restructurings, business combinations, financings and public offerings by our subsidiaries, is, in each case, subject to a number of conditions, including corporate and governmental approvals. No assurance can be given that these pending or contemplated transactions will be completed on the terms and conditions described or at all.

For example, we are in the process of restructuring our alternative fixed line telecommunications subsidiaries, MTU-Inform, Telmos and Comstar, and our Internet service provider and data business, MTU Intel, into a single entity, Comstar UTS. We believe the creation of a single alternative fixed line operator will allow us to capture significant operating and investment synergies and enable us to compete more effectively in these markets. We expect to complete the restructuring in 2005, at which time we will own a majority stake in Comstar UTS. However, completion of the restructuring process is subject to a number of conditions, including corporate and governmental approvals. Our business, results of operations and prospects may suffer in the event that the restructuring is delayed or fails to occur. See "Business—Telecommunications—Alternative fixed line communication services" for additional detail regarding the restructuring.

Likewise, our planned sale of 25% plus one share of the outstanding share capital of MBRD to investors is subject to a number of conditions prior to completion. In the event that the sale is delayed or not consummated, we may not be able to implement our strategic plans to diversify and expand our banking operations and our results of operations and prospects could be materially adversely affected. See "Business—Banking—Overview" for additional details regarding our planned sale of a minority stake in MBRD to investors.

If any of our subsidiaries is forced into liquidation due to negative net assets, our results of operations could be materially adversely affected.

Under Russian legislation, if a stock company's net assets fall below its charter capital, it is required to decrease its charter capital and its creditors may accelerate their claims or demand early performance of obligations and payment of damages. If the net assets fall below the minimum statutory charter capital at the end of the second and each subsequent year of the company's existence, the company may be subject to involuntary liquidation. The net assets of some companies in our group are below the minimum legal requirements. However, as a practical matter, we believe that such companies are solvent, as they continue to meet all of their obligations to creditors, and that the risk of their liquidation is minimal. We are, nonetheless, taking action to rectify the situation. In a high-profile case, a Moscow court in 2001 ordered the liquidation of a company pursuant to the relevant legislation even though it had met all of its obligations to creditors. If involuntary liquidation were to occur, we would be forced to reorganize the operations we currently conduct through the affected members of our group. Any such liquidation could lead to additional costs, which could materially adversely affect our business, financial position and results of operations.

In the event that deficiencies or ambiguities in privatization legislation are successfully exploited to challenge our ownership in our privatized subsidiaries and we are unable to defeat these challenges, we risk losing our ownership interests in our subsidiaries or their assets, which could materially adversely affect our prospects, business and results of operations.

Our business includes a number of privatized companies, such as MGTS, Intourist and certain of our technology subsidiaries, and our business strategy will likely involve the acquisition of additional privatized companies. To the extent that privatization legislation is vague, inconsistent or in conflict with other legislation, including conflicts between federal and local privatization legislation, many privatizations are arguably deficient and, therefore, vulnerable to challenge, including selective challenges. For instance, a series of presidential decrees issued in 1991 and 1992 that granted to the Moscow City Government the right to adopt its own privatization procedures were subsequently held to be invalid by the Constitutional Court of the Russian Federation, which ruled, in part, that the presidential decrees addressed issues that were the subject of federal law. While this court ruling, in theory, did not require any implementing actions, the presidential decrees were not officially annulled by another presidential decree until 2000. In the event that any of our privatized companies are subject to challenge as having been improperly privatized and we are unable to defeat this claim, we risk losing our ownership interest in the company or its assets, which could materially adversely affect our prospects, business and results of operations.

In addition, under Russian law, transactions in shares may be invalidated on many grounds, including a sale of shares by a person without the right to dispose of such shares, breach of interested party and/or major transactions rules and failure to register the share transfer in the securities register. As a result, defects in earlier transactions in shares of our subsidiaries (where such shares were acquired from third parties) may cause our title to such shares to be subject to challenge.

If the Federal Antimonopoly Service or the Antimonopoly Committee of Ukraine were to conclude that we or MTS acquired or created a new company in contravention of antimonopoly legislation, it could impose administrative sanctions and require the divestiture of this company or other assets, which could have a material adverse effect on our and/or MTS' business and results of operations.

Our and MTS' businesses have grown substantially through the acquisition and formation of companies, many of which required the prior approval of, or subsequent notification to, the Federal Antimonopoly Service or its predecessor agencies. In part, relevant legislation in certain cases restricts the acquisition or formation of companies by groups of companies or individuals acting in concert without such prior approval or notification. While we and MTS believe that we have complied with the applicable legislation for our acquisitions and formation of new companies, this legislation is sometimes vague and subject to varying interpretations. If the Federal Antimonopoly Service were to conclude that an acquisition or formation of a new company was done in contravention of applicable legislation, it could impose administrative sanctions and require the divestiture of this company or other assets, which could have a material adverse effect on our and/or MTS' business and results of operations.

In addition, if MTS or any of its subsidiaries were to be classified by the Federal Antimonopoly Service or the Antimonopoly Committee of Ukraine, or the AMC, as a dominant market force or as having a dominant position in the market, the Federal Antimonopoly Service or the AMC would have the power to impose certain restrictions on their businesses. These restrictions could result in competitive disadvantages and could materially adversely affect the business and results of operations of these entities. See "—Risks Relating to Our Telecommunications Business—If MTS or any of its subsidiaries were found to have a dominant position in its markets, the government may regulate its tariffs and restrict its operations."

We may lose control over shares of subsidiaries or affiliates that currently are or may in the future become pledged to secure our credit facilities and other financings.

In past financings, we have pledged a significant percentage of shares we hold in some of our subsidiaries and affiliates, including MGTS (which in turn holds significant stakes in all our telecommunications subsidiaries except MTS and Sistema Telecom), MTS, certain of our technology and real estate subsidiaries, Intourist and Sistema Telecom. Any enforcement of such pledges could cause us to lose operational control over, and ultimately our shareholdings in, such subsidiaries and affiliates. In particular, a significant portion of our shares in MTS and MGTS are pledged in respect of such financings.

We have engaged and may continue to engage in transactions with related parties that may present conflicts of interest, potentially resulting in the conclusion of transactions on less favorable terms than could be obtained in arm's-length transactions.

We have engaged in transactions with affiliated parties and may continue to do so. For example, we have engaged in transactions with certain of our shareholders, directors and executive officers and companies controlled by them, including equity purchases and sales, supply contracts, loan arrangements and real property acquisitions. Conflicts of interest may arise between our affiliates and us, potentially resulting in the conclusion of transactions on terms not determined by market forces. See "Transactions with Affiliates."

If transactions of members of our group of companies and their predecessors-in-interest were to be challenged on the basis of non-compliance with applicable legal requirements, the remedies in the event of any successful challenge could include the invalidation of such transactions or the imposition of other liabilities on such group members.

Members of our group, or their predecessors-in-interest at different times, took a variety of actions relating to share issuances, share disposals and acquisitions, valuation of property, interested party transactions, major transactions and anti-monopoly issues that, if successfully challenged on the basis of non-compliance with applicable legal requirements by competent state authorities, counterparties in such transactions or shareholders of the relevant group members or their predecessors-in-interest, could result in the invalidation of such transactions or the imposition of other liabilities. Because applicable provisions of Russian law are subject to many different interpretations, we may not be able to successfully defend any challenge brought against such transactions, and the invalidation of any such transactions or imposition of any such liability may, individually or in the aggregate, have a material adverse effect on our business, financial condition and results of operations. See also "Risks Relating to the Russian Federation and Ukraine—Legal Risks and Uncertainties—Weaknesses relating to the legal system and legislation create an uncertain environment for investment and business activity, which could have a material adverse effect on the value of the GDRs."

In the event that the minority shareholders of our subsidiaries were to successfully challenge past interested party transactions or do not approve interested party transactions in the future, we could be limited in our operational flexibility and our results of operations could be materially adversely affected.

We own less than 100% of the equity in many of our subsidiaries, with the remaining equity balance being held by minority shareholders. These subsidiaries have in the past carried out, and continue to carry out, numerous transactions with us and our other subsidiaries which may be considered "interested party transactions" under Russian law, requiring approval by disinterested directors, disinterested independent directors or disinterested shareholders. See "Transactions with Affiliates." These transactions have not always been properly approved and, therefore, may be challenged by minority shareholders. In addition, Russian law requires a three-quarters majority vote of the holders of voting stock present at a shareholders meeting to approve certain transactions, including, for example, charter amendments, major transactions involving assets in excess of 50% of the assets of the company, repurchase by the company of shares and share issuances. In some cases, minority shareholders may not approve interested party transactions requiring their approval or other transactions requiring supermajority approval. In the event that these minority shareholders were to successfully challenge past interested party transactions, or do not approve interested party or other transactions in the future, we could be limited in our operational flexibility and our results of operations could be materially adversely affected.

Computer viruses may harm or disrupt our telecommunications and IT networks.

As telecommunications and IT networks increase in size and complexity, they are becoming increasingly susceptible to computer viruses. These viruses can potentially spread throughout a network system, slowing the network and disrupting service. In the event that any of our telecommunications or IT networks are the target of a virus, we may be unable to maintain the integrity of such networks and software operations, which could have a material adverse effect on our business and results of operations.

Risks Relating to Our Telecommunications Business

If MTS' purchase of UMC is found to have violated Ukrainian law or the purchase is unwound, MTS' business, prospects and results of operations would be materially adversely affected.

On June 7, 2004, the General Prosecutor of Ukraine filed a claim against MTS and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to MTS. The complaint also sought an order prohibiting MTS from alienating 51% of its stake in UMC until the claim was resolved on the merits. The claim was based on a provision of the Ukrainian privatization law that included Ukrtelecom among a list of "strategic" state holdings prohibited from alienating or encumbering its assets during the course of its privatization. While the Ukrainian Cabinet of Ministers in May 2001 issued a decree specifically authorizing the sale by Ukrtelecom of its entire stake in UMC, the General Prosecutor asserted that the decree contradicted the privatization law and that the sale by Ukrtelecom was, therefore, illegal and should be unwound. On August 12, 2004, the Kiev Commercial Court rejected the General Prosecutor's claim.

On August 26, 2004, the General Prosecutor requested the Ukrainian Constitutional Court to review whether certain provisions of the Ukrainian privatization law limiting the alienation of assets by privatized companies were applicable to the sale by Ukrtelecom of UMC shares to MTS.

If the Constitutional Court of Ukraine determines that Ukrtelecom's sale of its stake in UMC contradicted the terms of the Ukrainian privatization law, the General Prosecutor would be able to request the Kiev Commercial Court to reopen the case based on new circumstances and could potentially include additional plaintiffs that were not parties to the original proceeding and/or additional claims.

In addition, as UMC was formed during the time when Ukraine's legislative framework was developing in an uncertain legal environment, its formation and capital structure may also be subject to challenges. In the event that MTS' purchase of UMC is found to have violated Ukrainian law or the purchase is unwound, in whole or in part, MTS' business, prospects and results of operations would be materially adversely affected.

Increased competition and a more diverse subscriber base have resulted in decreasing average monthly service revenues per subscriber, which may materially adversely affect MTS' results of operations.

While MTS' subscriber base and revenues are growing as it continues to grow its operations, its average monthly service revenues per subscriber, or ARPU, are decreasing. For example, MTS' ARPU in Russia for the years ended 2001, 2002 and 2003 and for the nine months ended September 30, 2004 was $36, $23, $17 and $14, respectively. MTS expects its ARPU to continue to decrease due to tariff decreases, lower tariffs in the regions outside of the Moscow license area and the increase of mass-market subscribers as a proportion of its overall subscriber mix. See "Management's Discussion and Analysis of Financial Condition and Results of Operations." This decrease in MTS' ARPU could materially adversely affect its results of operations.

MTS faces increasing competition from existing licensees that may result in reduced operating margins and loss of market share, as well as different pricing, service or marketing policies.

The Russian wireless telecommunication services market is becoming increasingly competitive. The trend in Russian government licensing policies has been to increase competition among wireless telecommunication service providers. Russian regulatory authorities have moved from granting exclusive licenses for each technology standard per region to granting multiple licenses covering the same territory. Increased competition may result in reduced operating margins and loss of market share, as well as different pricing, service or marketing policies.

MTS' failure to implement the necessary infrastructure to manage its growth could have a material adverse effect on its business and results of operations.

MTS' billing system registers and debits the account of a subscriber for calls made by such subscriber after such calls are made. There could be potential delays between the time that a subscriber's balance reaches zero and the disconnection of such subscriber from MTS' network. During the first quarter of 2003, certain dealers and subscribers together fraudulently exploited these billing time lags by placing a sizeable amount of domestic and international long distance calls using subscriber accounts registered under false names. MTS discovered this fraud in March 2003, and it estimates that it incurred approximately $16.7 million in losses during 2003 as a result of this dealer fraud. MTS has taken measures that it believes will prevent further use of this scheme, such as requiring its subscribers to activate their long distance services in person at its service centers. This, in turn, may cause MTS to lose subscribers who view the new requirement as burdensome and materially adversely affect its market share. MTS has also canceled its contracts with certain dealers who had the highest numbers of fraudulent accounts.

The failure or breakdown of key components of MTS' infrastructure in the future, including its billing system, could have a material adverse effect on its business and results of operations.

A merger between MTS' two largest competitors would result in a change in its relative market share in the Russian wireless communications market.

In August 2003, Russian financial industrial conglomerate Alfa Group, which owns a 25.1% stake in Vimpelcom, announced its purchase of CT-Mobile, which owns a 25.1% stake in MegaFon. This acquisition gives Alfa Group a 25.1% blocking stake in MegaFon and the press reported that Alfa Group might seek to merge Vimpelcom and MegaFon, Russia's second and third largest wireless communications providers and MTS' two largest competitors. Though it is unclear whether such merger might occur, in the event that it does, it would result in a change in MTS' relative market share in the Russian wireless communications market.

If MTS cannot successfully develop its network or integrate its acquired businesses, it will be unable to expand its subscriber base and maintain its profitability.

MTS plans to expand its network infrastructure in the following ways:

- extend coverage and increase the capacity of its existing network in the Moscow and regional license areas;
- further develop its operations in Ukraine and Uzbekistan and make investments in MTS Belarus; and
- introduce service in the regions in which it has licenses and has not yet commenced operations.

MTS' ability to increase its subscriber base depends upon the success of its network expansion. MTS has expended considerable amounts of resources to enable this expansion. Limited information regarding the markets into which MTS has or is considering expanding, either through acquisitions or new licenses, complicates the development of accurate forecasts of future revenues from those regions, increasing the risk that it may overestimate these revenues.

In addition, MTS has expanded its network through acquisitions and it may continue to engage in further acquisitions. MTS may not be able to integrate previous or future acquisitions successfully or operate them profitably. Such integration requires significant time and effort from its senior management, who are also responsible for managing its existing operations. Such integration may also be difficult as its technical systems may differ from those of the acquired businesses, unpopular cost cutting measures may be required and control of cash flow may be difficult to establish. Any difficulties encountered in the transition and integration process could have a material adverse effect on MTS' results of operations.

MTS may also face risks during the course of its expansion into countries outside of the Russian Federation. Differing cultures and uncertain business operating environments could lead to the lower profitability and higher risks to our business.

The buildout of MTS' network is also subject to risks and uncertainties, which could delay the introduction of service in some areas and increase the cost of network construction, including difficulty in obtaining base station sites on commercially attractive terms. In addition, telecommunications equipment used in Russia is subject to governmental certification, which must be renewed at least every three years. Telecommunications equipment used in Ukraine is also subject to obligatory certification requirements. The failure of any equipment MTS uses to receive timely certification or re-certification could also hinder its expansion plans. To the extent MTS fails to expand its network on a timely basis, it could experience difficulty in expanding its subscriber base.

If MTS cannot interconnect cost-effectively with other telecommunications operators, it may be unable to provide services at competitive prices and therefore lose market share and revenues.

MTS' ability to provide commercially viable services depends on its ability to continue to interconnect cost-effectively with MGTS in Russia, Ukrtelecom in Ukraine and other local, domestic and international telecommunications operators. Fees for interconnection are established by agreements with network operators and vary, depending on the network used, the nature of the call and the call destination. MTS has entered into interconnection agreements with several local, domestic and international telecommunications operators, including MGTS and Rostelecom in Russia and Utel and Ukrtelecom in Ukraine. Interconnection with these operators is required to complete calls originating on MTS' network but terminating outside of it and to complete calls to its subscribers originating outside of MTS' network.

The Russian government plans to privatize Svyazinvest, a holding company that controls several regional fixed line operators. The Ukrainian government plans to privatize Ukrtelecom, which has an over 80% market share of all fixed line telecommunications services in Ukraine. The timing of these privatizations is not yet known, and it is unclear how these privatizations will affect MTS' interconnection arrangements and costs.

Although Russian legislation requires that operators of public switched telephone networks may not refuse to provide interconnections or discriminate against one operator to the benefit of another, MTS believes that, in practice, some public network operators attempt to impede wireless operators by delaying interconnection applications and by charging varying interconnect rates to different wireless operators and, in particular, more favorable rates to local wireless operators, potentially enabling MTS' competitors to offer lower prices. Any difficulties or delays in interconnecting cost-effectively with other networks could hinder MTS' ability to provide services at competitive prices or at all, causing it to lose market share and revenues, which could have a material adverse effect on its business and results of operations.

Governmental regulation of MTS' interconnect rates in Ukraine could have a material adverse effect on its results of operations.

Under the Telecommunications Law adopted in 2003 in Ukraine, the National Commission for the Regulation of Communications, or the NCRC, commencing January 1, 2005, is entitled to regulate the tariffs for public telecommunications services rendered by fixed line operators, whereas the wireless operators (including UMC) are entitled to set their retail tariffs and negotiate interconnect rates with other operators. However, the NCRC would be entitled to regulate the interconnect rates of any wireless operator declared a "dominant market force" by the AMC. Government regulation of MTS' interconnect rates could cause its interconnect revenues to decrease or be limited, which could have a material adverse effect on its results of operations. See also "—General Risks—If the Federal Antimonopoly Service or the Antimonopoly Committee of Ukraine were to conclude that we or MTS acquired or created a new company in contravention of antimonopoly legislation, it could impose administrative sanctions and require the divestiture of this company or other assets, which could have a material adverse effect on our and/or MTS' business and results of operations" and "—If MTS or any of its subsidiaries were found to have a dominant position in its markets, the government may regulate its tariffs and restrict its operations."

In addition, MTS believes that the state-owned fixed line operator monopolies, Ukrtelecom and Utel, are currently able to influence telecommunications policy and regulation and may cause substantial increases in interconnect rates for access to fixed operators' networks by the wireless operators. Such increases could cause MTS' costs to increase, which could have a material adverse effect on its results of operations.

If frequencies currently assigned to MTS are reassigned to other users or if MTS fails to obtain renewals of its frequency allocations, its network capacity will be constrained and its ability to expand limited, resulting in a loss of market share and lower revenues.

There is a limited number of frequencies available for wireless operators in each of the regions in which MTS operates or holds licenses to operate. MTS is dependent on access to adequate spectrum allocation in each market in which it operates in order to maintain and expand its subscriber base. While MTS believes that its current spectrum allocations are sufficient, frequency may not be allocated to it in the future in the quantities, with the geographic span and for time periods that would allow it to provide wireless services on a commercially feasible basis throughout all of its license areas. For example, the availability of frequencies in the GSM 900 MHz band in Ukraine is limited by the fact that the Ukrainian military has a number of frequencies for its exclusive use. While future capacity constraints could be reduced by an increase in the GSM frequencies allocated to MTS, including additional frequencies in the GSM 1800 MHz band, it may not be awarded some or any of the remaining GSM spectrum. In addition, the Ukrainian government is currently delaying the allocation of new frequencies to wireless communications operators in Ukraine which, in turn, may constrain MTS' network capacity in those areas of Ukraine characterized by high subscriber usage.

A loss of assigned spectrum allocation, which is not replaced by other adequate allocations, could also have a substantial adverse impact on MTS' network capacity. For example, on September 5, 2000, MTS received a letter from the State Service for Communication Control, a department of the Ministry of Information Technologies and Communications, informing it of the cancellation of the approval the State Service for Communication Control had given it in May 2000 for certain frequencies within the 900 MHz band in order to install base stations with restricted emanation, which it used primarily for the development of its network in the underground stations of the Moscow subway system. While the Department of Communications Control, also under the Ministry of Information Technologies and Communications, halted the implementation of this letter on September 14, 2000, and the Ministry of Information Technologies and Communications reinstated these frequency allocations to MTS on November 14, 2000, future such attempts may be made to remove frequency allocations from it. In addition, frequency allocations are often issued for periods that are shorter than the terms of the licenses, and such allocations may not be renewed in a timely manner or at all. If MTS' frequencies are revoked or it is unable to renew its frequency allocations, its network capacity would be constrained and its ability to expand limited, resulting in a loss of market share and lower revenues.

Because MTS lacks a comprehensive back-up system for its network and insurance for its computer systems, a network or computer systems failure could prevent it from operating its business and lead to a loss of subscribers, damage to its reputation, penalties and violations of the terms of its licenses and subscriber contracts.

MTS has back-up capacity for its network management, operations and maintenance systems, but automatic transfer to back-up capacity is limited. In the event that the primary network management center was unable to function, significant disruptions to its systems would occur, including its inability to provide services. Disruptions in MTS' services occurred in the Moscow license area on August 3, 2000, December 15, 2000, January 23, 2001 and May 30, 2003, and in the Kiev license area on August 31, 2004 and September 1-2, 2004. These types of disruptions may recur, which could lead to a loss of subscribers, damage to MTS' reputation, penalties and violations of the terms of its licenses and subscriber contracts.

MTS' computer and communications hardware is protected through physical and software safeguards. However, it is still vulnerable to fire, storm, flood, loss of power, telecommunications failures, interconnection failures, physical or software break-ins, viruses and similar events. MTS does not carry business interruption insurance to protect it in the event of a catastrophe, even though such an event could have a material adverse effect on its business.

Suspension or termination of our telecommunications licenses could have a material adverse effect on our business and results of operations.

Our telecommunications licenses contain various requirements. These include participation in a federal communications network, adherence to technical standards, investment in network infrastructure and employment of Russian technical personnel. Our fixed line and wireless businesses are required to provide certain services to the federal government and public switched telephone network, or PSTN, subscribers at regulated tariffs. The amount and pricing of such services are subject to change and, if they were to materially and adversely change, our operating revenues would be adversely affected.

Our licenses expire periodically and may be renewed upon application to the Federal Service for Supervision in the Area of Communications. Officials of the Ministry of Information Technologies and Communications have broad discretion in deciding whether to renew a license, and we cannot assure you that our licenses will be renewed after expiration.

In addition, most of MTS' current licenses provide for payments to be made to finance telecommunication infrastructure improvements, which in the aggregate could total approximately $103.6 million as of September 30, 2004. However, no decisions regulating the terms and conditions of such payments have been formulated. Accordingly, MTS has made no payments to date pursuant to any of the current licenses, which could require such payments. Each of MTS' licenses also requires service to be started by a specific date, and most contain further requirements as to network capacity and territorial coverage to be reached by specified dates.

If we fail to comply with the requirements of applicable Russian, Ukrainian or other legislation or we fail to meet any terms of our licenses, our licenses and other authorizations necessary for our telecommunications operations may be suspended or terminated. A suspension or termination of our licenses or other necessary governmental authorizations could have a material adverse effect on our business and results of operations.

Failure to renew MTS' licenses or receive renewed licenses with similar terms to its existing licenses could have a material adverse effect on its business and results of operations.

MTS' licenses expire in various years from 2005 to 2016 and may be renewed in Russia and Ukraine upon application to the Federal Service for Supervision in the Area of Communications and the NCRC, respectively. Government officials have broad discretion in deciding whether to renew a license, and may not renew MTS' licenses after expiration. If MTS' licenses are renewed, they may be renewed with additional obligations, including payment obligations. Failure to renew MTS' licenses or receive renewed licenses with similar terms to its existing licenses could significantly diminish its service area, which could have a material adverse effect on our business and results of operations.

MTS may be unable to obtain licenses for third-generation, or UMTS, wireless services on commercially reasonable terms or at all, which would hinder it from competing effectively with operators who are able to provide these services and limit its ability to expand its services.

The Ministry of Information Technologies and Communications has previously stated that it expected to announce the procedures for the award of licenses for UMTS wireless services during 2002, and then during 2003. To date, however, no procedures have been announced. Depending upon the procedures adopted, MTS may be unable to obtain UMTS licenses on commercially reasonable terms or at all. Failure to obtain UMTS licenses for the Moscow and other license areas or Ukraine (although MTS does not believe that the award of UMTS licenses in Ukraine is imminent) would hinder MTS from competing effectively with operators who are able to provide these services and limit its ability to expand its services, which could have a material adverse effect on its prospects, business and results of operations.

In addition, MTS employs technology based primarily on the Global System for Mobile Communications, or GSM, standard. The UMTS standard is significantly superior to existing second-generation standards such as GSM. The adoption of UMTS may consequently increase the competition MTS faces. The technology MTS currently uses may become obsolete or uncompetitive, and if MTS is not able to develop a strategy compatible with this or any other new technology, it may not be able to acquire new technologies necessary to compete on reasonable terms. In addition, expenditures in connection with new technology may adversely affect its ability to expand in other areas.

Licenses for the use of code division multiple access, or CDMA, technology have already been granted for the provision of fixed wireless services in a number of regions throughout Russia. CDMA is a second-generation digital cellular telephony technology that can be used for the provision of both wireless and fixed services. Although CDMA technology is currently classified in Russia as a fixed radio telephone service, it may be used for wireless communications, and it may be offered for use via portable handsets. If CDMA operators were able to obtain permission to offer wireless CDMA services, MTS would face increased competition.

Because of limitations on the rights of license holders and the need to have a license reissued in the event of a merger, MTS' ability to integrate its networks may be restricted, thus preventing it from offering integrated network services.

As MTS' regional development program proceeds, it intends to integrate its various networks to create a single, unified GSM network. The Federal Law on Communications and other telecommunications regulations prohibit the transfer or assignment of licenses and require that telecommunications services must be provided by the licensee only. Further, applicable regulations require that agreements for the provision of telecommunications services must be concluded and performed only by the licensee. This requirement has been an important factor in MTS' recent acquisitions. As MTS is unable to buy licenses, it must instead purchase the company holding the license. MTS must also continue to operate through such company in its license area by entering into agency, lease, services and similar agreements.

MTS has entered into a series of agreements with a number of its subsidiaries for the provision of network construction services, the lease of wireless switching centers and related services. The government may change its position and view these agreements as violating the general prohibition on the transfer or assignment of licenses. For example, in 2003, the government challenged Vimpelcom on the grounds that it was illegally operating in Moscow pursuant to a license issued to its 100% owned subsidiary rather than to Vimpelcom itself.

Additionally, Russian law requires that, in the event of a merger, a license held by either of the merging entities must be reissued to the successor entity, rather than simply transferred. MTS intends to continue to merge with its wholly-owned subsidiaries as part of its efforts to integrate its networks; however, a failure to receive a new license as part of a merger would result in the loss of its ability to operate in that license area.

Restrictions on MTS' ability to enter into contracts with its subsidiaries, or the failure to receive a new license in the event of a merger, would restrict its ability to create a single, unified GSM network, reducing its ability to attract and retain subscribers and compete with a federal, nation-wide licensee in the event that such a license was granted.

All or part of MTS' subscriber database, containing private information relating to its subscribers, was illegally copied and stolen in early 2003, and is currently publicly sold in Russia.

In January 2003, MTS discovered that its database of subscribers, containing private subscriber information, was illegally copied and stolen. The database contained information such as the names, addresses, home phone numbers, passport details, individual tax numbers and other personal information of approximately 5 million of MTS' subscribers. This database is currently being sold in Russia. In addition, in May 2003, certain subscriber databases of several operators in the North-West region, including those of MTS, MegaFon, Delta Telecom and two other operators, were stolen and are currently being sold.

In December 2003, MTS completed its internal investigation relating to the theft of its subscriber databases and found that these incidents were due to weaknesses in its internal security in relation to physical access to such information. MTS has taken measures that it believes will prevent such incidents from occurring in the future, but such incidents may recur in the future.

In January 2003, lawsuits were filed by two of MTS' subscribers seeking compensation for damages resulting from the leak of the subscribers' confidential information. While the subscribers subsequently withdrew their claims, if similar lawsuits are successful in the future, MTS might have to pay significant damages, including consequential damages, which could have a material adverse effect on its results of operations. Future breaches of security may also negatively impact MTS' reputation and its brand image and lead to a loss of market share, which could materially adversely affect its business, prospects and results of operations.

If MTS is unable to maintain its favorable brand image, it may be unable to attract new subscribers and retain existing subscribers, leading to loss of market share and revenues.

MTS' ability to attract new subscribers and retain existing subscribers depends, in part, on its ability to maintain what it believes to be its favorable brand image. Negative rumors regarding MTS or MTS' services could negatively affect this brand image, which could lead to loss of market share and revenues.

If MTS or any of its subsidiaries were found to have a dominant position in its markets, the government may regulate its tariffs and restrict its operations.

Under Russian legislation, the Federal Antimonopoly Service may categorize a company as a dominant force in a market. Current Russian legislation does not clearly define "market" in terms of the types of services or the geographic area. As of September 30, 2004, MTS OJSC and MTS' subsidiaries CJSC Kuban-GSM, Tomsk Cellular Communications LLC, CJSC Siberian Cellular

System-900 and CJSC UDN 900 are categorized as companies with a market share exceeding 35%. This classification, in turn, gives the Federal Antimonopoly Service the power to impose certain restrictions on the businesses of those entities.

Additionally, UMC, which has over a 50% market share of the Ukrainian wireless communications market, can be categorized as a company with a dominant position in the market and become subject to specific government-imposed restrictions. While UMC is currently not categorized as a company with a dominant position in the market, it reduced certain of its tariffs at the recommendation of the AMC in April 2004. See "Regulation—Telecommunications—Regulation in Ukraine—Competition" for additional information.

If MTS or any of its subsidiaries were classified as a dominant market force or as having a dominant position in the market, the imposition of government-determined tariffs could result in competitive disadvantages, and its business and results of operations could be materially adversely affected. Additionally, restrictions on expansion or government-mandated withdrawal from regions or markets could reduce MTS' subscriber base and prevent it from implementing its business strategy. Moreover, MTS could be required to make additional license applications at an additional unexpected cost.

MTS is substantially dependent on a single supplier of billing system software, which may hinder its ability to control its costs and expand its network.

MTS is substantially dependent on a single Russian supplier of its billing system equipment and software. As MTS has expanded and its subscriber base has grown, it has routinely required upgrades to its billing systems to manage the increased capacity. Because of the high cost of investing in and installing billing systems, MTS' ability to change its suppliers is limited. As a result, MTS' billing system supplier has the ability to unilaterally increase the costs for system and software upgrades to above-market prices which, in turn, may hinder its ability to control its costs and expand its network.

The public switched telephone networks have reached capacity limits and need modernization, which may inconvenience MTS' subscribers and may require it to make substantial investments in public switched telephone networks.

Due to the recent growth in fixed and wireless telephone use in Moscow, the city's "095" code has reached numbering capacity limits and an additional code or codes are expected to be introduced in the future. Calls between a new code and another code will require callers to dial through "8," the long distance dialing prefix, which is also used by our "federal" number subscribers. The overtaxing of these long distance lines may inconvenience MTS' federal number subscribers by causing incoming and outgoing calls to have lower completion rates. Resolving these issues will require additional investment. In addition, continued growth in local, long distance and international traffic, including that generated by MTS' subscribers, may require substantial investment in public switched telephone networks.

Although the operators of public switched telephone networks are normally responsible for these investments, their weak financial condition may prevent them from making these investments. Since MTS is financially strong relative to these public network operators, it may be compelled to make such investments on their behalf, placing an additional burden on its financial and human resources. Additionally, assuming MTS does make such investments, it may not own the assets resulting from such investment. While MTS cannot estimate the financial and operating burdens associated with such investments, they may be substantial.

Alleged medical risks of cellular technology may subject MTS to negative publicity or litigation, decrease its access to base station sites, diminish subscriber usage and hinder access to additional financing.

Electromagnetic emissions from transmitter masts and mobile handsets may harm the health of individuals exposed for long periods of time to these emissions. The actual or perceived health risks of transmitter masts and mobile handsets could materially adversely affect MTS by reducing subscriber growth, reducing usage per subscriber, increasing the number of product liability lawsuits, increasing the difficulty in obtaining or maintaining sites for base stations, and/or reducing the financing available to the wireless communications industry.

Our subsidiary, MGTS, is subject to extensive regulation of its tariffs, and these tariffs do not, and may not in the future, fully compensate us for the cost of providing required services.

As the PSTN operator in Moscow, MGTS is considered a monopoly under Russian antitrust regulations. Consequently, the Federal Tariffs Service regulates MGTS' tariffs for most services provided to its PSTN subscribers, including installation fees, monthly subscription fees (for subscribers to the unlimited tariff plan) and local call charges (for subscribers who do not use the unlimited tariff plan). Furthermore, MGTS is required to provide discounts to certain categories of residential subscribers, such as pensioners and military veterans. The tariffs set by the Federal Tariffs Service currently do not fully compensate us for the costs of providing these and other services to residential and government subscribers. If our costs increase without a corresponding increase in tariffs, this discrepancy will increase. Although we are permitted to petition the Federal Tariffs Service for increases in tariffs based on such criteria as inflation, increased costs and the need for network investments, we cannot assure you that any requested increases will be granted or that the Federal Tariffs Service will adequately take such factors into account in setting tariffs. If the tariffs applicable to MGTS do not compensate us for the cost of providing services, our business and results of operations could be materially adversely affected.

Much of MGTS' infrastructure is outdated, and we may be required to make significant investments to modernize it.

A significant proportion of MGTS' infrastructure has not been modernized due to a lack of financing. For example, only approximately 19% of its automatic telephone exchanges were digitized as of September 30, 2004. MGTS' network switching equipment may become obsolete or unusable, in which case we may be required to make significant investments to modernize MGTS' infrastructure in order to meet its requirement to provide telephony services as a PSTN operator. In addition, MGTS' numbering capacity in direct Moscow numbers with the "095" access code is approaching its physical limits, which may result in MGTS being required to make significant investments to expand its network capacity. The overburdening of MGTS' infrastructure may inconvenience MTS' federal number subscribers by causing incoming and outgoing calls to have lower completion rates. MGTS has invested approximately $128.6 million for the nine months ended September 30, 2004 and plans to invest approximately $42.0 million in the remainder of 2004 to upgrade its infrastructure.

Svyazinvest, a minority shareholder in our subsidiary MGTS, may block or significantly delay adoption of strategic decisions relating to the development of MGTS.

Svyazinvest owns 28% of the outstanding shares of MGTS. This stake allows Svyazinvest to block certain decisions of MGTS requiring a supermajority vote of shareholders under Russian law, including amendments to MGTS' charter, the issuance of additional shares and the approval of certain material transactions. Svyazinvest is a state-controlled company, and some of its activities are subject to the approval of the Russian Government and authorized ministries of the Russian Government. These governmental bodies may have conflicting interests and lengthy approval processes. The dependence on Svyazinvest for corporate approvals could significantly delay, or make impossible, the adoption by

MGTS of strategic decisions relating to the development of MGTS that are beneficial to MGTS' business.

Because no standard definition of a subscriber exists in the telecommunications industry, comparisons between subscriber data of different telecommunications companies may be difficult to draw.

The methodology for calculation of subscriber numbers varies substantially in the telecommunications industry, resulting in variances in reported subscriber numbers from that which would result from the use of a single methodology. Therefore, comparisons of subscriber numbers and churn rates between different telecommunications companies may be difficult to draw.

Risks Relating to Our Technology Business

Because some of our microelectronics products are not properly patented or licensed, we may not be able to protect our intellectual property rights adequately, resulting in a material adverse effect on our results of operations and our ability to develop our business.

In our Technology Segment, we manufacture certain microelectronic products that were developed more than a decade ago, at which time Russian intellectual property legislation lacked consistency and was uncertain as to the protection of intellectual property rights of foreign right holders. These products may infringe upon the rights of foreign intellectual property holders under current Russian and foreign law. It may be difficult to defend our intellectual property rights under the current legal framework from challenges in court or use by third parties, which could result in a material adverse effect on our results of operations and our ability to develop the business of our Technology Segment.

Risks Relating to Our Banking Business

If the Central Bank of Russia takes steps to enforce compliance with its requirements relating to maximum level of exposure to a single borrower or a group of related borrowers or other requirements, our business, financial condition and results of operations could be materially adversely affected.

Our banking subsidiary, MBRD, fulfills the treasury function for our group of companies. The Central Bank of Russia imposes a limit on a bank's exposure to a single borrower or group of related borrowers. This limit, as well as a number of other regulatory requirements, must be observed by MBRD on a daily basis. See "Regulation—Banking." Although the Central Bank of Russia has not imposed any sanctions on MBRD for non-compliance with these requirements, no assurance can be given that the Central Bank of Russia will not seek, in the future, to enforce compliance with these requirements. The sanctions for failure to comply with these requirements could include fines, temporary administration of MBRD by the Central Bank of Russia or revocation of its banking license. If the Central Bank of Russia takes such steps, our and MBRD's business, financial condition and results of operations could be materially adversely affected.

Instability in the Russian banking system could lead to market disruptions and large-scale withdrawals on deposits and have a material adverse effect on MBRD's ability to develop its retail banking division, and on our and MBRD's business, financial condition and results of operations.

In May 2004, the Central Bank of Russia announced that it would suspend the banking license of Sodbusinessbank, a medium-size institution that had been accused of serious breaches of money laundering laws. Fears that the Central Bank of Russia was set to adopt a tougher line of enforcement caused a dramatic loss of confidence within the banking system and the disruption of the inter-bank market. By the end of May, depositors began en masse to withdraw their money from the banks. Alfa Bank, Russia's leading private bank, lost an estimated $160 million in deposits over a three-day period. In response to these events, the Central Bank of Russia enacted regulations in July 2004 providing government assurance for private individuals' deposits of up to 100,000 rubles and lowering reserve requirements. Most analysts believe that the situation stabilized by July 2004. While MBRD was relatively unaffected by the foregoing events, similar large-scale market disruptions or drawdowns on deposits in the future could have a material adverse effect on MBRD's ability to develop its retail banking division, and on our and MBRD's business, financial condition and results of operations.

Risks Relating to Our Real Estate Business

Successful challenges to our ownership interests or lease rights in land or delays or cancellation of our construction projects could have a material adverse effect on our business and results of operations.

Our business includes the acquisition of ownership or lease interests in land plots and buildings in Moscow and other parts of Russia with a view to further development or re-development. In addition, we own or lease buildings in which our businesses are located. Russian land and property legislation is complicated and often ambiguous and/or contradictory at the federal and regional levels. In particular, it is not always clear which state bodies are authorized to enter into land leases with respect to particular land plots, construction approval procedures are complicated and prone to challenge or reversal, and construction and environmental rules often contain requirements that are impossible to comply with in practice. As a result, our ownership of and/or lease rights to land and buildings may be challenged by government authorities or third parties, and our construction projects may be delayed or cancelled.

Under Russian law, transactions involving real estate may be challenged on many grounds, including where the seller or assignor of rights to real estate did not have the right to dispose of such real estate, breach of internal corporate approval requirements by a counterparty and failure to register the transfer of title in the unified state register. As a result, defects in previous transactions with respect to real estate may lead to the invalidation of such transactions with respect to the particular real estate, which may affect our title or lease rights to such real estate.

Further, under Russian law, certain encumbrances over real estate (including leases of less than one year and free of charge use agreements) do not need to be registered in the unified state register in order to validly encumber the property. In addition, the law contains no time limits within which any registerable encumbrances have to be state registered. There is, therefore, a risk that third parties may successfully register or claim existence of encumbrances (of which we had no prior knowledge) over real estate owned or leased by us at any point in time.

We may be unable to successfully identify, acquire, develop, operate or dispose of real estate projects, which could have a material adverse effect on our business and results of operations.

We continue to evaluate real estate development opportunities and our projects are at various stages of development. Real estate development and acquisition activities are subject to significant risks of non-completion and loss due to:

- changing market conditions, which may result in diminished opportunities to acquire and develop desired properties, higher than expected vacancy rates, lower than expected rental rates and lower than expected sale prices;
- competition from others, which may diminish our opportunities for acquiring a desired property on favorable terms or at all. Even if we enter into agreements for the acquisition of properties, these agreements are subject to customary conditions to closing, including completion of due diligence investigations to our satisfaction;
- budget overruns and completion delays;
- our potential inability to obtain financing on favorable terms or at all for individual projects or in the context of multiple projects being developed at the same time;

- our potential inability to identify and participate in development projects with or obtain or renew land lease rights from governmental authorities;
- potential delays or refusals in obtaining all necessary land use, building, occupancy and other required governmental permits and authorizations, including investment contracts with the City of Moscow;
- potential defects in acquired and developed properties, including latent defects that may not reveal themselves until many years after we put a property in service; and
- potential liabilities relating to acquired land, properties or entities owning properties for which we may have limited or no recourse.

The realization of any of the above risks could have a material adverse effect on our business, financial condition and results of operations.

The lack of publicly available data on the real estate market in Russia makes it difficult to value our real estate properties.

There is a limited amount of publicly available data and research relating to the real estate market in Russia. Recently, a number of organizations have begun to publish statistical and other research data with respect to the Russian real estate markets. However, such data is generally narrower in scope and less consistent than data relating to real estate markets in other industrialized countries. This lack of data makes it difficult to assess market values and rental values of real estate in Russia. Although an independent appraiser has valued some of our key real estate properties, we cannot assure you that the values ascribed to those properties reflect their actual market values. Details of the valuation methodology and the assumptions used by the independent appraiser are set forth in its report included as Appendix A to this offering memorandum. In addition, the values ascribed to our properties by the independent appraiser may not represent the amounts that could be obtained upon disposal of such properties, and as many of these properties and development projects are not 100% owned by us, not all of such value can be attributed to our consolidated group. See also "Business—Real Estate—Business Overview" for a summary description of the valuation methodology and the assumptions used by the independent appraiser.

Risks Relating to Our Retail Business

The validity of the trademark "Detsky Mir" has been challenged by a third party in court. If any court awards a third party the right to use the name "Detsky Mir," our sales and marketing expenses may increase and our business may be materially adversely affected.

In June 2003, a third party filed a claim with the Moscow Arbitration Court challenging the validity of the registered trademark "Detsky Mir" of our subsidiary OJSC Detsky Mir, or Detsky Mir. The Moscow Arbitration Court rejected the claim and upheld our trademark. However, if, in the future, a court or the Russian Patent Authority grants third parties the right to use the Detsky Mir name, we would have limited ability under Russian law to defend this brand name from use by others, which would, in turn, significantly reduce the value of our Detsky Mir brand. This would also negatively affect our regional expansion plans for Detsky Mir and the products that utilize this brand name by potentially increasing our brand advertising and marketing expenses or requiring us to develop a new brand.

Russia and the other countries of the CIS in which we operate generally offer less intellectual property protection than countries in Europe and North America. We cannot be certain that the steps we have taken to protect our portfolio of intellectual property rights will be sufficient or that third parties will not infringe, misappropriate or challenge our proprietary rights. If we are unable to protect our proprietary rights against infringement or misappropriation, it could materially harm our future financial results and our ability to develop our business.

Risks Relating to Our Financial Condition

If we are unable to obtain adequate capital, we may have to limit our operations substantially, which could have a material adverse effect on our business, prospects and operating results.

We will need to make significant capital expenditures in many of our businesses. We spent approximately $1,063.3 million during the nine months ended September 30, 2004 and expect to spend approximately $2,500.0 million during the remainder of 2004 through the end of 2005 (including $2,200.0 million for MTS) for the fulfillment of our capital spending plans, excluding spending for acquisitions. In addition, the acquisition of UMTS licenses by our telecommunications subsidiaries and the buildout of UMTS networks will require substantial additional capital expenditures. However, we may not be able to meet our planned capital spending needs in the event of the following potential developments.

- a lack of external financing sources;
- changes in the terms of existing financing arrangements;
- construction of the wireless networks at a faster rate or higher capital cost than anticipated;
- pursuit of new business opportunities or investing in existing businesses that require significant investment;
- acquisitions or development of any additional wireless licenses;
- slower than anticipated subscriber growth;
- slower than anticipated revenue growth;
- regulatory developments;
- changes in existing interconnect arrangements; or
- a deterioration in the Russian economy.

To meet our financing requirements, we may need to attract additional equity or debt financing. Russian companies are limited in their ability to issue shares in the form of GDRs or other depositary receipts due to Russian securities regulations that came into force in 2003, which generally provide that no more than 40% of a Russian company's shares may be circulated abroad through sponsored depositary receipt programs. Moreover, currently we expect to have approval from the Federal Service for the Financial Markets for only 19% of our outstanding shares to be deposited in such facilities. We expect that our GDR program will account for 18.98% of our outstanding shares as a result of the offering (assuming exercise of the over-allotment option in full). The Russian securities regulatory authority may reduce the 40% limit in the future or refuse to increase the percentage of our outstanding shares which may be deposited in depositary receipt facilities. Moreover, any unused portion of such limits could become unavailable to us if our shareholders decide to sell their shares in the form of GDRs or other depositary receipts after this offering. Any of the foregoing factors may limit the amount of capital available to meet our operating requirements. If we cannot obtain adequate funds to satisfy our capital requirements, we may need to limit our operations significantly, which could have a material adverse effect on our business, prospects and results of operations.

From time to time, we may merge certain subsidiaries for operational reasons. Under Russian law, such mergers would be considered a reorganization and the merged subsidiaries would be required to notify their creditors of this reorganization. Russian law also provides that, for a period of 30 days after notice, these creditors would have a right to accelerate the merged subsidiaries' indebtedness and demand reimbursement for applicable losses. In the event that we elect to undertake any such merger and all or part of certain of our subsidiaries' indebtedness is accelerated, we and such subsidiaries may not have the ability to raise the funds necessary for repayment and our business and financial condition could be materially adversely affected. On November 9, 2004, MTS approved a merger of seven of its wholly-owned subsidiaries into itself. The term for notifying its creditors has not yet commenced. However, it is not expected that a substantial part of MTS' indebtedness will be accelerated.

Servicing and refinancing of our indebtedness will require a significant amount of cash. Our ability to generate cash or obtain financing depends on many factors beyond our control.

We have a substantial amount of outstanding indebtedness, primarily consisting of the obligations we entered into in connection with our notes and bank loans. At September 30, 2004, our consolidated total debt, including capital lease obligations, was approximately $2,540.0 million.

Our ability to service, repay and refinance our indebtedness and to fund planned capital expenditures and future investments will depend on our ability to generate cash in the future. This, to a certain extent, is subject to general economic, financial, competitive, legislative, regulatory and other factors that are beyond our control. If we are unable to generate sufficient cash flow or otherwise obtain funds necessary to make required payments, we may default under the terms of our indebtedness, and the holders of our indebtedness would be able to accelerate the maturity of such indebtedness, which could cause defaults under, and potential acceleration of, our other indebtedness.

We may not be able to generate sufficient cash flow or access international capital markets or incur additional indebtedness to enable us to service or repay our indebtedness or to fund our other liquidity needs. We may be required to refinance all or a portion of our indebtedness on or before maturity, sell assets, reduce or delay capital expenditures or seek additional capital. We cannot assure you that any refinancing or additional financing would be available on commercially reasonable terms or at all, or whether our assets could be sold, or if sold, whether the proceeds therefrom would be sufficient to meet our debt service obligations. Our inability to generate sufficient cash flow to satisfy our debt service obligations, or to refinance debt on commercially reasonable terms, would materially adversely affect our business, financial condition, results of operations and prospects. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources."

Devaluation of the ruble against the U.S. dollar could increase our costs and reduce our revenues.

Until recently, the ruble has fluctuated dramatically against the U.S. dollar, in the great majority of instances falling in value. A significant portion of our costs, expenditures and liabilities, including capital expenditures and borrowings (including our U.S. dollar-denominated notes), are either denominated in, or closely linked to, the U.S. dollar, while substantially all of our revenues are denominated in rubles. As a result, the devaluation of the ruble against the U.S. dollar can adversely affect us by increasing our costs in ruble terms. In order to hedge against this risk, we link the prices for certain of our products and services, which are payable in rubles, to the U.S. dollar. The effectiveness of this hedge is limited, however, as we may not be able to increase prices in line with ruble devaluation against the U.S. dollar due to competitive pressures or regulatory restrictions, leading to a loss of revenue in U.S. dollar terms. Additionally, if the ruble declines against the U.S. dollar and price increases cannot keep pace, we could have difficulty repaying or refinancing our U.S. dollar-denominated indebtedness, including our notes. The devaluation of the ruble also results in losses in the value of ruble-denominated assets, such as ruble deposits. In order to hedge against this risk, we invest a significant portion of our cash in U.S. dollar-denominated deposits.

The decline in the value of the ruble against the U.S. dollar also reduces the U.S. dollar value of tax savings arising from the depreciation of our property, plant and equipment, since their basis for tax purposes is denominated in rubles at the time of the investment. Increased tax liability would increase total expenses.

Inflation could increase our costs and decrease our operating margins.

The Russian economy has been characterized by high rates of inflation. In 2003, the inflation rate of 12%, combined with the nominal appreciation of the ruble, resulted in the appreciation of the ruble against the U.S. dollar in real terms. As we tend to experience inflation-driven increases in certain of our costs, including salaries and rents, which are sensitive to rises in the general price level in Russia, our costs in U.S. dollar terms will rise. In this situation, due to competitive pressures, we may not be able to raise the prices we charge for our products and services sufficiently to preserve operating margins. Accordingly, high rates of inflation in Russia could increase our costs and decrease our operating margins.

Russian currency control regulations hinder our ability to conduct our business.

The Central Bank of Russia has from time to time imposed various currency control regulations in attempts to support the ruble, and may take further actions in the future. For example, Central Bank of Russia regulations currently require us to convert into rubles 10% of our export proceeds. Furthermore, the government and the Central Bank of Russia may impose additional requirements on cash inflows and outflows into and out of Russia or on the use of foreign currency in Russia, which could prevent us from carrying on necessary business transactions, or from successfully implementing our business strategy.

A new framework law on exchange controls took effect on June 18, 2004. This law empowers the government and the Central Bank of Russia to further regulate and restrict currency control matters, including operations involving foreign securities and foreign currency borrowings by Russian companies. The new law also abolishes the need for companies to obtain transaction-specific licenses from the Central Bank of Russia (except for opening bank accounts outside Russia), envisaging instead the implementation of generally applicable restrictions on currency operations. See "Description of Share Capital and Certain Requirements of Russian Legislation—Exchange Controls" for a further description of Russia's currency control regulations. As the evolving regulatory regime is new and untested, it is unclear whether it will be more or less restrictive than the prior laws and regulations it has replaced.

Restrictions on investments outside Russia or in hard-currency-denominated instruments in Russia expose our cash holdings to devaluation.

Currency regulations established by the Central Bank of Russia restrict investments by Russian companies outside Russia and in most hard-currency-denominated instruments in Russia, and there are only a limited number of ruble-denominated instruments in which we may invest our excess cash. Additionally, subject to certain exceptions, Russian companies must repatriate 100% of offshore foreign currency earnings to Russia and convert 10% of those earnings into rubles within seven days of receipt, although Russian legislation allows the Central Bank of Russia to decrease this conversion requirement or increase it up to 30%. For example, MTS earned approximately $53 million, $83 million, $112 million and $72 million in foreign currency in 2001, 2002, 2003 and the first nine months of 2004, respectively, primarily from its roaming agreements. Any balances maintained in rubles will give rise to losses if the ruble devalues against the U.S. dollar.

Limitations on the conversion of rubles to hard currency in Russia could increase our costs when making payments in hard currency to suppliers and creditors and could cause us to default on our obligations to them.

Many of our major capital expenditures, in particular those of MTS, are denominated and payable in various foreign currencies, including the U.S. dollar and euro. For example, as of September 30, 2004, MTS had $331.0 million, principally denominated in U.S. dollars, committed under contracts with foreign suppliers for the purchase of network infrastructure. Russian legislation currently permits the conversion of ruble revenues into foreign currency. However, the market in Russia for the conversion of rubles into foreign currencies is limited. The scarcity of foreign currencies may tend to inflate their values relative to the ruble, and such a market may not continue to exist, which could increase our costs when making payments in foreign currencies to suppliers and creditors.

Additionally, any delay or other difficulty in converting rubles into a foreign currency to make a payment or delay or restriction in the transfer of foreign currency could limit our ability to meet our payment and debt obligations, which could result in the loss of suppliers, acceleration of debt obligations and cross-defaults and, consequently, have a material adverse effect on our business, financial condition and results of operations.

Indentures relating to our notes contain restrictive covenants, which limit our ability to incur debt and to engage in various activities.

The indentures relating to our notes maturing in 2008 and 2011 each contain covenants limiting our ability to incur debt, create liens on our properties and enter into sale and lease-back transactions. The indentures also contain covenants limiting our ability to merge or consolidate with another person or convey our properties and assets to another person. Failure to comply with these covenants could cause a default under the notes and result in the notes becoming immediately due and payable, which would materially adversely affect our business, financial condition and results of operations.

If a change in control occurs, our noteholders may require us to redeem notes not previously called for redemption, which could have a material adverse effect on our financial condition and results of operations.

Under the terms of our notes maturing in 2008 and 2011, if a change in control occurs, our noteholders will have the right to require us to redeem notes not previously called for redemption. The price we will be required to pay upon such event will be 101% of the principal amount of the notes, plus accrued interest to the redemption date. A change in control will be deemed to have occurred in any of the following circumstances:

- any person acquires beneficial ownership of 50% or more of the total voting power of all shares of our common stock;
- our shareholders adopt any plan or proposal for the liquidation and winding-up of Sistema; or
- we merge or consolidate with or into, or convey, sell, lease or otherwise dispose of all or substantially all of our assets to, another entity (other than an entity controlled by Mr. Evtushenkov and certain affiliates or related parties) or another entity (other than an entity controlled by Mr. Evtushenkov and certain affiliates or related parties) merges into us and, immediately following such transaction, and our shareholders do not beneficially own at least 50% of the total voting power of all shares of common stock of such entity.

If a change in control occurs, and our noteholders exercise their right to require us to redeem all of their notes not previously called for redemption, such event could have a material adverse effect on our financial condition and results of operations.

Risks Relating to the Russian Federation and Ukraine

Economic Risks

Economic instability in Russia and Ukraine could adversely affect our business.

Since the dissolution of the Soviet Union, the Russian and Ukrainian economies have experienced at various times:

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;
- high government debt relative to gross domestic product;
- a weak banking system providing limited liquidity to domestic enterprises;
- high levels of loss-making enterprises that continued to operate due to the lack of effective bankruptcy proceedings;
- significant use of barter transactions and illiquid promissory notes to settle commercial transactions;
- widespread tax evasion;
- growth of a black and gray market economy;
- pervasive capital flight;
- high levels of corruption and the penetration of organized crime into the economy;
- significant increases in unemployment and underemployment; and
- the impoverishment of a large portion of the population.

The Russian and Ukrainian economies have been subject to abrupt downturns. In particular, on August 17, 1998, in the face of a rapidly deteriorating economic situation, the Russian government defaulted on its ruble-denominated securities, the Central Bank of Russia stopped its support of the ruble and a temporary moratorium was imposed on certain hard currency payments. These actions resulted in an immediate and severe devaluation of the ruble and a sharp increase in the rate of inflation; a dramatic decline in the prices of Russian debt and equity securities; and an inability of Russian issuers to raise funds in the international capital markets. Certain other CIS countries, including Ukraine and Belarus, were similarly affected by these events.

These problems were aggravated by the near collapse of the Russian banking sector after the events of August 17, 1998, as evidenced by the termination of the banking licenses of a number of major Russian banks. This further impaired the ability of the banking sector to act as a consistent source of liquidity to Russian companies and resulted in the losses of bank deposits in some cases.

Recently, the Russian and Ukrainian economies have experienced positive trends, such as the increase in the gross domestic product, relatively stable national currencies, strong domestic demand, rising real wages and a reduced rate of inflation; however, these trends may not continue or may be abruptly reversed.

The Russian banking system remains underdeveloped, and another banking crisis could place severe liquidity constraints on our business.

Russia's banking and other financial systems are not well developed or regulated, and Russian legislation relating to banks and bank accounts is subject to varying interpretations and inconsistent applications. The August 1998 financial crisis resulted in the bankruptcy and liquidation of many Russian banks and almost entirely eliminated the developing market for commercial bank loans at that time. Although the Central Bank of Russia has the mandate and authority to suspend banking licenses of insolvent banks, many insolvent banks still operate. Most Russian banks also do not meet international banking standards, and the transparency of the Russian banking sector still lags far behind internationally accepted norms. Aided by inadequate supervision by the regulators, many banks do not follow existing Central Bank of Russia regulations with respect to lending criteria, credit quality, loan loss reserves or diversification of exposure.

Recently, there has been a rapid increase in lending by Russian banks, which many believe has been accompanied by a deterioration in the credit quality of the borrowers. In addition, a robust domestic corporate debt market is leading to Russian banks increasingly holding large amounts of Russian corporate ruble bonds in their portfolios, which is further deteriorating the risk profile of Russian bank assets. 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 market downturns or economic slowdowns, including due to Russian corporate defaults that may occur during any such market downturn or economic slowdown. In addition, the Central Bank of Russia has recently revoked the licenses of certain Russian banks, which resulted in market rumors about additional bank closures and many depositors withdrawing their savings. If a banking crisis were to occur, Russian companies would be subject to severe liquidity constraints due to the limited supply of domestic savings and the withdrawal of foreign funding sources that would occur during such a crisis.

There is currently a limited number of creditworthy Russian banks, most of which are located in Moscow. We have tried to reduce our risk by receiving and holding funds in a number of Russian banks, including subsidiaries of foreign banks. Nonetheless, we hold the bulk of our excess ruble and foreign currency cash in Russian banks, including subsidiaries of foreign banks, in part, because we are required to do so by Central Bank of Russia regulations and because the ruble is not transferable or convertible outside of Russia. There are few, if any, safe ruble-denominated instruments in which we may invest our excess ruble cash. Another banking crisis or the bankruptcy or insolvency of the banks from which we receive or with which we hold our funds could result in the loss of our deposits or affect our ability to complete banking transactions in Russia, which could have a material adverse effect on our business, financial conditions and results of operations.

The physical infrastructure in Russia and Ukraine is in very poor condition, which could disrupt normal business activity.

The physical infrastructure in Russia and Ukraine largely dates back to Soviet times and has not been adequately funded and maintained over the past decade. Particularly affected are the rail and road networks; power generation and transmission; communication systems; and building stock. In August 2000, a fire at the main communications tower in Moscow interrupted television and radio broadcasting and the operation of mobile phones for weeks. Road conditions throughout Russia and Ukraine are poor, with many roads not meeting minimum quality requirements. The Russian and Ukrainian governments are actively considering plans to reorganize the nations' rail, electricity and telephone systems. Any such reorganization may result in increased charges and tariffs while failing to generate the anticipated capital investment needed to repair, maintain and improve these systems.

The deterioration of physical infrastructure in Russia and Ukraine harms the national economies, disrupts the transportation of goods and supplies, adds costs to doing business in these countries and can interrupt business operations. These difficulties can impact us directly; for example, MTS has needed to keep portable electrical generators available to help us maintain base station operations in the event of power failures. Further deterioration in the physical infrastructure could have a material adverse effect on our business and the value of the GDRs.

Fluctuations in the global economy may materially adversely affect the Russian and Ukrainian economies and our business.

The Russian and Ukrainian economies are vulnerable to market downturns and economic slowdowns elsewhere in the world. 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 Russia and Ukraine and Russian and Ukrainian businesses could face severe liquidity constraints, further materially adversely affecting their economies. Additionally, because Russia produces and exports large amounts of oil, the Russian economy is especially vulnerable to the price of oil on the world market and a decline in the price of oil could slow or disrupt the Russian economy. Recent military conflicts and international terrorist activity have also significantly impacted oil and gas prices, and pose additional risks to the Russian economy. Russia and Ukraine are also major producers and exporters of metal products and their economies are vulnerable to world commodity prices and the imposition of tariffs and/or antidumping measures by the United States, the European Union or by other principal export markets.

Political and Social Risks

Political and governmental instability could materially adversely affect the value of the GDRs.

Since 1991, Russia has sought to transform itself from a one-party state with a centrally-planned economy to a democracy with a market economy. As a result of the sweeping nature of the reforms, and the failure of some of them, the Russian political system remains vulnerable to popular dissatisfaction, including dissatisfaction with the results of privatizations in the 1990s, as well as to demands for autonomy from particular regional and ethnic groups. Moreover, the composition of the Russian government, the prime minister and the other heads of federal ministries has, at times, been highly unstable. For example, six different prime ministers headed governments between March 1998 and May 2000. On December 31, 1999, President Yeltsin unexpectedly resigned. Vladimir Putin was subsequently elected president on March 26, 2000 and re-elected for a second term on March 14, 2004. Throughout his first term in office, President Putin has maintained governmental stability and even accelerated the reform process. In February 2004, President Putin dismissed his entire cabinet, including the prime minister. This was followed on March 12, 2004 by President Putin's announcement of a far-reaching restructuring of the Russian government, with the stated aim of making the government more transparent and efficient. The changes included, for example, reducing the number of ministries from 30 to 14 and dividing the government into three levels: ministries, services and agencies. In addition to the restructuring of the Russian federal government, President Putin has recently proposed that the executives of sub-federal political units be no longer directly elected by population but instead be nominated by the President of the Russian Federation and confirmed by the legislature of the sub-federal political unit. Further, President Putin has proposed to eliminate individual races in State Duma elections, so that voters would only cast ballots for political parties. These new structures are largely not yet finalized and implemented.

Future changes in government, major policy shifts or lack of consensus between various branches of the government and powerful economic groups could also disrupt or reverse economic and regulatory reforms.

Similarly to Russia, Ukraine has experienced political instability since its independence in 1991, having seen nine changes in prime minister since 1991. The various state authorities, and the relations between them, as well as the Ukrainian government's policies and the political leaders who formulate and implement them, are subject to rapid change. For example, following the presidential elections in November 2004, mass demonstrations and strikes took place throughout Ukraine to protest the election process and results. While tensions in Ukraine appear to have subsided following the invalidation of the

November election results and the new presidential election held on December 26, 2004, the long-term effects of these events and policy direction of the new government are not yet known.

Any disruption or reversal of the reform policies, recurrence of political or governmental instability or occurrence of conflicts with powerful economic groups could have a material adverse effect on our business and the value of investments in Russia and Ukraine, and the value of the GDRs could decline.

Conflict between central and regional authorities and other conflicts could create an uncertain operating environment hindering our long-term planning ability and could materially adversely affect the value of investments in Russia, including the value of the GDRs.

The Russian Federation is a federation of 88 sub-federal political units, consisting of republics, territories, regions, cities of federal importance and autonomous regions and districts. The delineation of authority and jurisdiction among the members of the Russian Federation and the federal government is, in many instances, unclear and remains contested. Lack of consensus between the federal government and local or regional authorities often results in the enactment of conflicting legislation at various levels and may lead to further political instability. In particular, conflicting laws have been enacted in the areas of privatization, land legislation and licensing. Some of these laws and governmental and administrative decisions implementing them, as well as certain transactions consummated pursuant to them, have in the past been challenged in the courts, and such challenges may occur in the future. This lack of consensus hinders our long-term planning efforts and creates uncertainties in our operating environment, both of which may prevent us from effectively and efficiently implementing our business strategy.

Additionally, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions and, in certain cases, military conflict, such as the continuing conflict in Chechnya, which has brought normal economic activity within Chechnya to a halt and disrupted the economies of neighboring regions. Various armed groups in Chechnya have regularly engaged in guerrilla attacks in that area and recently, other parts of Russia have experienced violence related to the Chechen conflict. Violence and attacks relating to this conflict have also spread to other parts of Russia, and several terrorist attacks have been carried out by Chechen terrorists throughout Russia, including in Moscow. The further intensification of violence, including terrorist attacks and suicide bombings, or its spread to other parts of Russia, could have significant political consequences, including the imposition of a state of emergency in some or all of Russia. Moreover, any terrorist attacks and the resulting heightened security measures are likely to cause disruptions to domestic commerce and exports from Russia, and could materially adversely affect our business and the value of investments in Russia, including the value of the GDRs.

In Ukraine, tensions between certain regional authorities and the central government were recently ignited following the November 2004 presidential elections. Amid the mass demonstrations and strikes that took place throughout Ukraine to protest the election process and results, the regional authorities in three regions in eastern Ukraine threatened to conduct referendums on creating a separate, autonomous region within Ukraine. Though the regional authorities backed down from these threats and tensions in Ukraine appear to have subsided following the invalidation of the November election results and the new presidential election held on December 26, 2004, the long-term effects of these events and their effect on relations among Ukrainians is not yet known.

Crime and corruption could disrupt our ability to conduct our business as we have in the past and could materially adversely affect our financial condition and results of operations.

The political and economic changes in Russia and Ukraine in recent years have resulted in significant dislocations of authority. The local and international press have reported that significant criminal activity, including organized crime, has arisen, particularly in large metropolitan centers.

Property crime in large cities has increased substantially. In addition, the local press and international press have reported high levels of official corruption in the locations where we conduct our business, including the bribing of officials for the purpose of initiating investigations by government agencies. Press reports have also described instances in which government officials engaged in selective investigations and prosecutions to further the commercial interests of the government officials or certain individuals. Additionally, published reports indicate that a significant number of Russian and Ukrainian media regularly publish slanted articles in return for payment. The depredations of organized or other crime, demands of corrupt officials or claims that we have been involved in official corruption may in the future bring negative publicity, could disrupt our ability to conduct our business effectively and could thus materially adversely affect our financial condition and results of operations.

Allegations about us or our directors or executive officers could adversely affect our reputation and the price of the GDRs.

Reports in the international and local press about criminal activity or corruption in Russia and Ukraine have, from time to time, made allegations of criminal activity or corruption involving companies, or individuals within companies, that otherwise conduct legitimate activities in the public or private sector. For example, press reports have included or reported on allegations of links between Evgeny Novitsky, the Chairman of our Board of Directors, to criminal activities in Russia. In February 2000, in response to one such press report, we and Mr. Novitsky brought a claim for defamation against the French newspaper, *Le Monde*. The French court ultimately dismissed our case and that of Mr. Novitsky, and in its decision the court referred to certain statements in the article as being defamatory and cited the good faith defense available to journalists under French law. Neither we nor any of our directors or executive officers have been prosecuted or convicted with respect to any criminal activity or corruption.

In addition, press reports routinely have linked Vladimir Evtushenkov, our President and a member of our Board of Directors, and our controlling shareholder, to the Moscow City Government. We believe the likely basis of such press reports is Mr. Evtushenkov's previous role as an advisor to the Moscow City Government and, in particular, to the Mayor of Moscow, Yuri Luzhkov. Although we do not believe that our business is affected by Mr. Luzhkov's status as the Mayor of Moscow, we cannot assure you that being perceived as being associated with any particular political group in Russia will not have adverse consequences for our business.

Future press speculation about these or similar matters which includes references to us or to our directors or executive officers, whether or not ultimately proven to be accurate, could adversely affect our reputation and the price of our GDRs.

Social instability could increase support for renewed centralized authority, nationalism or violence and thus materially adversely affect our operations.

The failure of the government and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living have led in the past, and could lead in the future, to labor and social unrest. For example, in 1998, miners in several regions of Russia, demanding payment of overdue wages, resorted to strikes which included blocking major railroads. More recently, mass protests and strikes erupted across Ukraine following the country's presidential election in November 2004, which was subsequently invalidated. Such labor and social unrest may have political, social and economic consequences, such as increased support for a renewal of centralized authority; increased nationalism, with restrictions on foreign involvement in the economies of Russia and Ukraine; and increased violence. An occurrence of any of the foregoing events could restrict our operations and lead to the loss of revenue, materially adversely affecting our operations.

Major changes in Ukraine-Russian relations could materially adversely affect our business.

The relationship between Ukraine and Russia has been historically strained due, among other things, to Ukraine's failure to pay arrears relating to the supply of energy resources, Russia's introduction of 20% VAT on Ukrainian imports, and border disputes. In addition, the impact of the recent political crisis in Ukraine and the results of the December 26, 2004 presidential election on Ukraine-Russia relations is not yet clear.

In recent years, bilateral relations between Ukraine and Russia have improved, in part, due to the conclusion in May 1997 of the Friendship and Cooperation Treaty, the conclusion, in December 2000, of two inter-governmental agreements on the transit and supply of Russian natural gas, the conclusion, in October 2002, of a framework agreement to ensure natural gas transit for the next 30 years and provide for the construction, modernization and operation of gas pipelines, and by Ukraine's ratification, in September 2003, of an agreement with Russia, Kazakhstan and Belarus to create a "free trade" economic zone.

However, any major changes in Ukraine-Russia relations, in particular any such changes adversely affecting energy supplies from Russia to Ukraine and/or Ukraine's export of services and goods to Russia, could materially adversely impact the Ukrainian economy and our Ukrainian operations.

Legal Risks and Uncertainties

Weaknesses relating to the legal system and legislation create an uncertain environment for investment and business activity, which could have a material adverse effect on the value of the GDRs.

Each of Russia and Ukraine is still developing the legal framework required to support a market economy. The following risk factors relating to the Russian and Ukrainian legal systems create uncertainty with respect to the legal and business decisions that we make, many of which uncertainties do not exist in countries with more developed market economies:

- inconsistencies between and among laws, the Constitution, Presidential decrees and governmental, ministerial and local orders, decisions, resolutions and other acts;
- conflicting local, regional and federal rules and regulations;
- the lack of judicial and administrative guidance on interpreting legislation;
- the relative inexperience of judges and courts in interpreting legislation;
- corruption within the judiciary;
- a high degree of discretion on the part of governmental authorities, which could result in arbitrary actions such as suspension or termination of our licenses; and
- poorly developed bankruptcy procedures that are subject to abuse.

Furthermore, several fundamental laws have only recently become effective. The recent nature of much of Russian and Ukrainian legislation, the lack of consensus about the scope, content and pace of economic and political reform and the rapid evolution of the Russian and Ukrainian legal systems in ways that may not always coincide with market developments place the enforceability and underlying constitutionality of laws in doubt and results in ambiguities, inconsistencies and anomalies. In addition, Russian and Ukrainian legislation often contemplates implementing regulations that have not yet been promulgated, leaving substantial gaps in the regulatory infrastructure. All of these weaknesses could affect our ability to enforce our rights under our licenses and under our contracts, or to defend ourselves against claims by others. We cannot assure you that regulators, judicial authorities or third parties will not challenge our internal procedures and by-laws or our compliance with applicable laws, decrees and regulations.

Additionally, as we expand our business and partnerships beyond Russia, seek international financing for our activities and source equipment and technologies from abroad, our directors and executive officers will need to be able to travel abroad regularly and often on short notice. Unlike the European Union, the United States and certain other countries, Russia has very few, if any, bi-lateral agreements with countries allowing for visa-free travel, other than certain countries of the CIS. Our directors and executive officers, therefore, may not be able to obtain visas on a timely basis or at all to travel to certain countries. For example, the relevant United States authorities have in the past declined to grant Evgeny Novitsky, the Chairman of our Board of Directors, a visa to enter the United States. In cases where the granting of a visa is denied by the relevant authorities, the denial often is not subject to appeal or any higher review and the reasons for the denial generally are not provided.

Failure to comply with existing laws and regulations or the findings of government inspections, or increased governmental regulation of our operations, could result in substantial additional compliance costs or various sanctions which could materially adversely affect our business, financial condition, results of operations and prospects.

Operations and properties of our group of companies are subject to regulation by various government entities and agencies, in connection with obtaining and renewing various licenses and permits, as well as with ongoing compliance with existing laws, regulations and standards. Regulatory authorities exercise considerable discretion in matters of enforcement and interpretation of applicable laws, regulations and standards, the issuance and renewal of licenses and permits and in monitoring licensees' compliance with the terms thereof. Russian authorities have the right to, and frequently do, conduct periodic inspections of operations and properties of our group of companies throughout the year. Any such future inspections may conclude that we or our subsidiaries have violated laws, decrees or regulations, and we may be unable to refute such conclusions or remedy the violations. See also "—The regulatory environment in Russia and other areas where we operate is uncertain and subject to political influence or manipulation, which may result in negative and arbitrary regulatory and other decisions against us on the basis of considerations other than legal considerations and may also result in preferential treatment for our competitors."

Our failure to comply with existing laws and regulations or the findings of government inspections may result in the imposition of fines or penalties or more severe sanctions including the suspension, amendment or termination of our licenses and permits, or in requirements that we cease certain of our business activities, or in criminal and administrative penalties applicable to our officers. Any such decisions, requirements or sanctions, or any increase in governmental regulation of our operations, could increase our costs and materially adversely affect our business, financial condition, results of operations and prospects.

The judiciary's lack of independence and overall inexperience, the difficulty of enforcing court decisions and governmental discretion in enforcing claims could prevent us or you from obtaining effective redress in a court proceeding, materially adversely affecting the value of the GDRs.

The independence of the judicial system and its immunity from economic, political and nationalistic influences in each of Russia and Ukraine remain largely untested. The court system in each of Russia and Ukraine is understaffed and underfunded. Judges and courts are generally inexperienced in the area of business and corporate law. Judicial precedents generally have no binding effect on subsequent decisions. Not all Russian and Ukrainian legislation and court decisions are readily available to the public or organized in a manner that facilitates understanding. The Russian and Ukrainian judicial systems can be slow or unjustifiably swift. Enforcement of court orders can, in practice, be very difficult in Russia and Ukraine. All of these factors make judicial decisions in Russia and Ukraine difficult to predict and effective redress uncertain. Additionally, court claims are often used in furtherance of political aims or infighting. We may be subject to such claims and may not be able to receive a fair hearing. Additionally, court orders are not always enforced or followed by law enforcement agencies, and the government may attempt to invalidate court decisions by backdating or retroactively applying relevant legislative changes.

These uncertainties also extend to property rights. During Russia and Ukraine's transformation from centrally planned economies to market economies, legislation has been enacted in both countries to protect private property against expropriation and nationalization. However, it is possible that due to the lack of experience in enforcing these provisions and due to potential political changes, these protections would not be enforced in the event of an attempted expropriation or nationalization. Expropriation or nationalization of any of our entities, their assets or portions thereof, including MTS' subsidiary UMC, potentially without adequate compensation, would have a material adverse effect on our business.

The regulatory environment in Russia and other areas where we operate is uncertain and subject to political influence or manipulation, which may result in negative and arbitrary regulatory and other decisions against us on the basis of considerations other than legal considerations and may also result in preferential treatment for our competitors.

We operate in an uncertain regulatory environment. There is no comprehensive legal framework with respect to several of the industries in which we operate in Russia and in other areas in which we currently operate or may operate in the future. However, a number of laws, decrees and regulations apply to our Telecommunications, Banking and Insurance Segments. In particular, the telecommunications industry is regulated by the Ministry of Information Technologies and Communications, the insurance industry is regulated by the Finance Ministry and the banking industry is regulated by the Central Bank of Russia, in each case, largely through the issuance of licenses, regulations and instructions. The regulatory officials in each of these industries and the tax authorities have a high degree of discretion. In this environment, political influence or manipulation could be used to affect regulatory, tax and other decisions against us on the basis of considerations other than legal considerations. For example, Russian governmental authorities investigated Vimpelcom in late 2003 alleging that it was illegally operating in Moscow pursuant to a license issued to its wholly-owned subsidiary rather than to Vimpelcom itself. In addition, some of our competitors may receive preferential treatment from the government, potentially giving them a substantial advantage over us. For example, according to press reports, MegaFon and Kyivstar, our competitors in Russia and Ukraine, respectively, received preferential treatment in regulatory matters in the past.

Unlawful or arbitrary government action may have a material adverse effect on our business and the value of the GDRs.

Governmental authorities have a high degree of discretion in Russia and Ukraine and, at times, act selectively or arbitrarily, without hearing or prior notice, and sometimes in a manner that is contrary to law or influenced by political or commercial considerations. Moreover, the government also has the power in certain circumstances, by regulation or government act, to interfere with the performance of, nullify or terminate contracts. Unlawful, selective or arbitrary governmental actions have reportedly included the denial or withdrawal of licenses, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local government entities have also used common defects in matters surrounding share issuances and registration as pretexts for court claims and other demands to invalidate such issuances and registrations or to void transactions, often for political purposes. S&P has expressed concerns that "Russian companies and their investors can be subjected to government pressure through selective implementation of regulations and legislation that is either politically motivated or triggered by competing business groups." In this environment, our competitors may receive preferential treatment from the government, potentially giving them a competitive advantage over us.

In addition, in 2003 and 2004, the Ministry for Taxes and Levies aggressively cracked down on certain Russian companies' use of tax-optimization schemes, and press reports have speculated that these enforcement actions have been selective and politically motivated. Unlawful or arbitrary government action, if directed at us, could have a material adverse effect on our business and on the value of the GDRs.

Developing corporate and securities laws and regulations in Russia may limit our ability to attract future investment.

The regulation and supervision of the securities market, financial intermediaries and issuers are considerably less developed in Russia than in the United States and Western Europe. Securities laws, including those relating to corporate governance, disclosure and reporting requirements, have only recently been adopted, whereas laws relating to anti-fraud safeguards, insider trading restrictions and fiduciary duties are rudimentary. In addition, the Russian securities market is regulated by several different authorities, which are often in competition with each other. These include

- the Federal Service for the Financial Markets;
- the Ministry of Finance;
- the Federal Antimonopoly Service;
- the Central Bank of Russia; and
- various professional self-regulatory organizations.

The regulations of these various authorities are not always coordinated and may be contradictory.

In addition, Russian corporate and securities rules and regulations can change rapidly, which may materially adversely affect our ability to conduct securities-related transactions. While some important areas are subject to virtually no oversight, the regulatory requirements imposed on Russian issuers in other areas result in delays in conducting securities offerings and in accessing the capital markets. It is often unclear whether or how regulations, decisions and letters issued by the various regulatory authorities apply to our company. As a result, we may be subject to fines or other enforcement measures despite our best efforts at compliance.

Because there is little minority shareholder protection in Russia, your ability to bring, or recover in, an action against us will be limited.

In general, minority shareholder protection under Russian law derives from supermajority shareholder approval requirements for certain corporate actions, as well as from the ability of a shareholder to demand that the company purchase the shares held by that shareholder if that shareholder voted against or did not participate in voting on certain types of actions. Companies are also required by Russian law to obtain the approval of disinterested shareholders for certain transactions with interested parties. See "Description of Share Capital and Certain Requirements of Russian Legislation—Description of Share Capital" for a more detailed description of some of these protections. While these protections are similar to the types of protections available to minority shareholders in U.S. corporations, in practice, corporate governance standards for many Russian companies have proven to be poor, and minority shareholders in Russian companies have suffered losses due to abusive share dilutions, asset transfers and transfer pricing practices. Shareholder meetings have been irregularly conducted, and shareholder resolutions have not always been respected by management. Shareholders of some companies also suffered as a result of fraudulent bankruptcies initiated by hostile creditors.

In addition, the supermajority shareholder approval requirement is met by a vote of 75% of all voting shares that are present at a shareholders' meeting. Thus, controlling shareholders owning slightly less than 75% of outstanding shares of a company may have a 75% or more voting power if certain minority shareholders are not present at the meeting. In situations where controlling shareholders effectively have 75% or more of the voting power at a shareholders' meeting, they are in a position to approve amendments to the charter of the company or significant transactions including asset transfers, which could be prejudicial to the interests of minority shareholders. It is possible that our majority shareholders and our management in the future may not run us and our subsidiaries for the benefit of minority shareholders, and this could materially and adversely affect the value of the GDRs.

Disclosure and reporting requirements, as well as anti-fraud legislation, have only recently been enacted in Russia. Most Russian companies and managers are not accustomed to restrictions on their activities arising from these requirements. The concept of fiduciary duties of management or directors to their companies and shareholders is also relatively new and is not well developed. Violations of disclosure and reporting requirements or breaches of fiduciary duties to us and our subsidiaries or to our shareholders could materially adversely affect the value of the GDRs.

While the Joint Stock Companies Law provides that shareholders owning not less than 1% of the company's stock may bring an action for damages on behalf of the company, Russian courts to date do not have much experience with respect to such lawsuits. Russian law does not contemplate class action litigation. Accordingly, your ability to pursue legal redress against us may be limited, reducing the protections available to you as a holder of our GDRs.

Shareholder liability under Russian legislation could cause us to become liable for the obligations of our subsidiaries.

The Civil Code of the Russian Federation and the Federal Law on Joint Stock Companies generally provide that shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one person is capable of determining decisions made by another person or entity. The person or entity capable of determining such decisions is deemed an "effective parent." The person whose decisions are capable of being so determined is deemed an "effective subsidiary." Under the Federal Law on Joint Stock Companies, effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if:

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between the companies; and
- the effective parent gives obligatory directions to the effective subsidiary.

In addition, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt resulting from the action or inaction of an effective parent. This is the case no matter how the effective parent's ability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent which caused the effective subsidiary to take action or fail to take action knowing that such action or failure to take action would result in losses. Accordingly, we could be liable in some cases for the debts of our consolidated subsidiaries. This liability could have a material adverse effect on our business, results of operations and financial condition.

Shareholder rights provisions under Russian law may impose additional costs on us, which could materially adversely affect our financial condition and results of operations.

Russian law provides that shareholders that vote against or abstain from voting on certain matters have the right to sell their shares to the company at market value in accordance with Russian law. The decisions that trigger this right to sell shares include:

- decisions with respect to a reorganization;
- the approval by shareholders of a "major transaction," which, in general terms, is a transaction involving property worth more than 50% of the gross book value of our assets calculated according to the Russian accounting standards, regardless of whether the transaction is actually consummated; and
- the amendment of our charter in a manner that limits shareholder rights.

Our (or, as the case may be, our subsidiaries') obligation to purchase shares in these circumstances, which is limited to 10% of the company's net assets calculated in accordance with Russian accounting standards at the time the matter at issue is voted upon could have a material adverse effect on our results of operations and financial condition.

The lack of a central and rigorously regulated share registration system in Russia may result in improper record ownership of our shares, including the Shares underlying your GDRs.

Ownership of Russian joint stock company shares (or, if the shares are held through a nominee or custodian, then the holding of such nominee or custodian) is determined by entries in a share register and is evidenced by extracts from that register. Currently, there is no central registration system in Russia. Share registers are maintained by the companies themselves or, if a company has more than 50 shareholders or so elects, by licensed registrars located throughout Russia. Regulations have been issued regarding the licensing conditions for such registrars, as well as the procedures to be followed by both companies maintaining their own registers and licensed registrars when performing the functions of registrar. In practice, however, these regulations have not been strictly enforced, and registrars generally have relatively low levels of capitalization and inadequate insurance coverage. Moreover, registrars are not necessarily subject to effective governmental supervision. Due to the lack of a central and rigorously regulated share registration system in Russia, transactions in respect of a company's shares could be improperly or inaccurately recorded, and share registration could be lost through fraud, negligence, official and unofficial governmental actions or oversight by registrars incapable of compensating shareholders for their misconduct. This creates risks of loss not normally associated with investments in other securities markets. Further, the Depositary, under the terms of the Deposit Agreements, will not be liable for the unavailability of shares or for the failure to make any distribution of cash or property with respect thereto due to the unavailability of the shares. See "Description of Share Capital and Certain Requirements of Russian Legislation—Description of Share Capital—Registration and Transfer of Shares" and "Description of the Global Depositary Receipts—Russian Share Register" for a further discussion of the share registration system and registrars in the Russian Federation.

Limitations on foreign investment could impair the value of your investment in our GDRs and could hinder our access to additional capital.

Russian and Ukrainian legislation governing foreign investment activities does not prohibit or restrict foreign investment in the telecommunications industry. However, a lack of consensus exists over the manner and scope of government control over the telecommunications industry. While draft legislation protecting the rights of foreign investors specifically in the telecommunications industry has been considered at various times, the Law on Foreign Investment in the Russian Federation does not provide any specific protections in this regard, nor are there specific protections in Ukraine. Because the telecommunications industry is widely viewed as strategically important to Russia and Ukraine, governmental control over the telecommunications industry may increase, and foreign investment in or control over the industry may be limited. Any such increase in governmental control or limitation on foreign investment could impair the value of your investment in our GDRs and could hinder our access to additional capital.

The implementation of the new Federal Law on Communications will impose an additional financial burden on us which may materially adversely affect our financial condition and results of operations.

The new Federal Law on Communications, or Law on Communications, came into force on January 1, 2004. Among other things, this law provides for the establishment of a "universal services reserve fund" for the purpose of supporting communications companies operating in less developed regions of Russia. This reserve fund will be funded by a levy imposed on all communication services providers, including us and our other Russian telecommunications subsidiaries, commencing on January 1, 2005. The amount of this levy, the procedure of its collection and procedures for distribution from this reserve fund will be determined in the future by the federal government. This additional levy will increase our costs and may materially adversely affect our financial condition and results of operations.

Generally, the new Law on Communications substantially modifies the existing regulatory framework governing telecommunications, and certain implementing legislation required by it is yet to be adopted. For example, the new Law on Communications has provided for the additional regulation of PSTN providers holding a substantial position (meaning PSTN providers which together with their affiliates have not less than 25% of installed capacity or territory coverage locally or in the Russian Federation generally or have capacity to carry out transmission of not less than 25% of traffic). In particular, such providers will be obliged to grant equal access to all other operators and connection and traffic transmission tariffs that such providers may charge such other operators will be regulated by the government. In the past, some of the alternative operators in our group have benefited from favorable connection and tariffs arrangements with MGTS, which may not be possible in the future with such regulated tariffs and connection rights, and as such the competitive advantages of these alternative operators may suffer. We believe that of our telecommunications subsidiaries currently only MGTS qualifies as a provider holding a substantial position. MGTS may also suffer additional operational costs under the new Law on Communications due to the requirement to account separately for revenues and expenses related to various types of its services.

Furthermore, under the new Law on Communications the regulation of the provision of services to residential subscribers will change. Under the changes, MGTS expects to benefit from the provisions (to take effect in 2005) that subscribers who enjoy statutory discounts will be required to pay for services in full and receive refunds in place of discounts from the state. However, residential subscribers will also receive the right to choose the type of fees (either per minute or by way of subscription) and also will enjoy rights to deferral of certain payments. In light of these and other changes to the telecommunication laws and regulations, it is difficult to assess at this time all the possible effects these changes might have on our telecommunications business and financial results, in general, and those of MGTS, in particular.

In addition, the new Ukrainian Law on Telecommunications came into force on January 1, 2004. However, regulations implementing the new law have not yet been promulgated and certain regulatory bodies established by the new law have not yet commenced their regulatory functions. For example, the regulatory body tasked with regulating the telecommunications industry and issuing telecommunications licenses has yet to be formed, and no other regulatory authority has been designated under the law to perform these functions. The new Ukrainian Law on Telecommunications, among other things, may require companies with a dominant position in the telecommunications market to develop public telecommunications services if directed to do so by the regulatory authorities. As UMC's estimated market share in wireless telecommunication services in Ukraine is over 50%, implementation of the new law may materially adversely affect MTS' financial condition and results of operations. See "Regulation—Telecommunications—Regulation in Ukraine."

Changes in the Russian tax system could materially adversely affect an investment in the GDRs.

Generally, taxes payable by Russian companies are substantial and numerous. These taxes include, among others:

- income taxes;
- value-added tax, or VAT;
- excise taxes and import duties;
- unified social tax; and
- property tax.

The tax environment in Russia historically has been complicated by the fact that various authorities have often issued contradictory pieces of tax legislation. For example, tax laws are unclear with respect to the deductibility of certain expenses and, at times, we have taken a position that may be considered aggressive by tax authorities, but that we consider to be in compliance with current law. Prior to 2003, MTS also refused to pay a certain levy imposed by government decree rather than established as prescribed under Russian law, though a recent Russian Supreme Court decision upheld the validity and enforceability of this levy, and MTS has begun paying this levy for periods commencing January 1, 2003. See "Regulation—Telecommunications—Regulation in the Russian Federation—Licensing of Telecommunications Services and Radio Frequency Allocation." This uncertainty potentially exposes us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could result in a greater than expected tax burden and the suspension or termination of our telecommunications licenses.

Because of the political changes, which have occurred in Russia over the past several years, there have recently been significant changes to the Russian taxation system. Global tax reforms commenced in 1999 with the introduction of Part One of the Tax Code of the Russian Federation, or the Tax Code, which sets general taxation guidelines. Since then, Russia has been in the process of replacing legislation regulating the application of major taxes such as corporate income tax, VAT and property tax with new chapters of the Tax Code.

In practice, the Russian tax authorities often interpret the tax laws in a way that rarely favors taxpayers, who often have to resort to court proceedings to defend their position against the tax authorities. Differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may impose fines, penalties and interest charges. Generally, taxpayers are subject to inspection for a period of three calendar years of their activities, which immediately preceded the year in which the audit is carried out. As previous audits do not exclude subsequent claims relating to the audited period, the statute of limitations is not entirely effective. In addition, in some instances, new tax regulations have been given retroactive effect. Recently, the Constitutional Court of the Russian Federation ruled that, in some instances, VAT paid on a commercial enterprise's purchases, or input VAT, cannot be offset against VAT collected from sales to the extent that the input VAT was incurred on items purchased with borrowed funds.

Moreover, financial results of Russian companies cannot be consolidated for tax purposes. Therefore, each of our Russian subsidiaries pays its own Russian taxes and may not offset its profit or loss against the loss or profit of any of our other subsidiaries. In addition, intercompany dividends are subject to a withholding tax of 9% to 15%, though this tax does not apply to dividends paid out higher up the ownership chain once they have already been taxed at the lower level. These tax requirements impose additional burdens and costs on our operations, including management resources.

The foregoing conditions create tax risks in Russia that are more significant than typically found in countries with more developed tax systems, imposing additional burdens and costs on our operations, including management resources. In addition to our substantial tax burden, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could materially adversely affect our business and the value of the GDRs. See also "—Legal Risks and Uncertainties—Unlawful or arbitrary government action may have a material adverse effect on our business and the value of the GDRs."

The implications of the tax system in Ukraine are uncertain and various tax laws are subject to different interpretations.

Ukraine currently has a number of laws related to various taxes imposed by both central and regional governmental authorities. Applicable taxes include value-added tax, corporate income tax (profits tax), customs duties, payroll (social) taxes and other taxes. These tax laws have not been in force for significant periods of time compared to more developed market economies and are constantly changed and amended. Accordingly, few precedents regarding tax issues are available. Differing opinions regarding the legal interpretation of tax laws often exist both among and within governmental ministries and organizations, including the tax administration, creating uncertainties and areas of conflict for taxpayers and investors.

Tax declarations/returns, together with other legal compliance areas (*e.g.,* customs and currency control matters), may be subject to review and investigation by various administrative divisions of the tax authorities, which are authorized by law to impose severe fines, penalties and interest charges. These circumstances create tax risks in Ukraine substantially more significant than typically found in countries with more developed tax systems. Generally, tax declarations/returns in Ukraine remain open and subject to inspection for a three-year period. However, this term may not be observed or may be extended under certain circumstances, including in the context of a criminal investigation. While we believe that we are currently in compliance with the tax laws affecting our operations in Ukraine, it is possible that relevant authorities may take differing positions with regard to interpretative issues, which may result in a material adverse effect on our results of operations and financial condition.

Vaguely drafted Russian transfer pricing rules and lack of reliable pricing information may impact our business results of operations.

Russian transfer pricing rules entered into force in 1999, giving Russian tax authorities the right to control prices for transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions or transactions with significant price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and arbitration courts and their use in politically motivated investigations and prosecutions. We believe that the prices used by our group are market prices and, therefore, comply with the requirements of Russian tax law on transfer pricing. However, due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge our prices and propose adjustments. If such price adjustments are upheld by the Russian arbitration courts and implemented, our results of operations could be materially adversely affected. In addition, we could face significant losses associated with the assessed amount of prior tax underpaid and related interest and penalties, which would have a material adverse effect on our financial condition and results of operations.

We face similar risks in other countries of the former Soviet Union and former Soviet-bloc countries in Eastern and Central Europe.

In addition to Russia and Ukraine, we currently have operations in other CIS countries, including Belarus and Uzbekistan, and in other former Soviet-bloc countries. We may acquire additional operations in these and other emerging markets. In many respects, the risks inherent in transacting business in these countries are similar to those in Russia and Ukraine, especially those risks set out above in "—Risks Relating to the Russian Federation and Ukraine."

Risks Relating to the GDRs and the Trading Market

Our controlling shareholder has the ability to exert significant influence over us, and his interests may conflict with those of other holders of our GDRs.

We are controlled by Vladimir Evtushenkov, our President and a member of our Board of Directors, who will beneficially own 65.45% of our outstanding shares following the offering (65.18% if the over-allotment option is exercised in full). As a result of his interest in Sistema, Mr. Evtushenkov has the ability to exert significant influence over certain actions requiring shareholder approval, including, but not limited to, the election of directors, declaration of dividends, the appointment of management and other policy decisions. Moreover, we have only two directors who are not otherwise affiliated with us. The interests of Mr. Evtushenkov could conflict with the interests of our shareholders and the holders of the GDRs, and he may make decisions that materially adversely affect your investment in the GDRs.

Because the Depositary may be considered the beneficial holder of the Shares underlying the GDRs, these Shares may be arrested or seized in legal proceedings in Russia against the Depositary.

Because Russian law may not recognize GDR holders as beneficial owners of the underlying Shares, it is possible that you could lose all your rights to those Shares if the Depositary's assets in Russia are seized or arrested. In that case, you would lose all the money you invested.

Russian law may treat the Depositary as the beneficial owner of the Shares underlying the GDRs. This is different from the way other jurisdictions treat GDRs. In the United States, although shares may be held in the Depositary's name or to its order, making it a "legal" owner of the shares, the GDR holders are the "beneficial," or real owners. In U.S. courts, an action against the Depositary, the legal owner of the shares, would not result in the beneficial owners losing their shares. Russian law may not make the same distinction between legal and beneficial ownership, and it may only recognize the rights of the Depositary in whose name the Shares are held, not the rights of GDR holders, to the underlying shares. Thus, in proceedings brought against a depositary, whether or not related to shares underlying GDRs, Russian courts may treat those underlying shares as the assets of the depositary, open to seizure or arrest. In the past, a lawsuit was filed against a depositary bank other than Deutsche Bank Trust Company Americas seeking the seizure of various Russian companies' shares represented by GDRs issued by that depositary. In the event that this type of suit were to be successful in the future against the Depositary, and the Shares underlying our GDRs were to be seized or arrested, the GDR holders involved would lose their rights to such underlying Shares.

You will not be able to withdraw the Shares underlying the GDRs prior to the registration of a placement report for the newly issued Shares, and the failure to register this placement report could result in the offering being withdrawn and newly issued Shares underlying the GDRs being cancelled.

Under the terms of the Deposit Agreements, all GDRs shall be deemed to be issued on a provisional basis until the placement report is registered by the Federal Service for the Financial Markets. Until the placement report is registered, you will not be able to withdraw the Shares underlying your GDRs or instruct the Depositary to exercise voting rights with respect to the Shares that underlie your GDRs, as you would ordinarily be able to do. The form of the placement report requires us to disclose information about the recipients of the newly issued Shares and the total number of Shares actually placed. For purposes of such disclosure requirements, we will name the Depositary as the recipient of the newly issued Shares. We may not file the placement report with the Federal Service for the Financial Markets until after the closing of the offering and we intend to file the placement report as soon as practicable following the closing of the offering. The Federal Service for the Financial Markets is statutorily required to make its decision within two weeks after we file the placement report, but the current practice is that registration of a placement report takes between 30 and 44 days after filing. Accordingly, registration of the placement report may occur later than one month after the closing date of the offering or may not occur at all.

The Federal Service for the Financial Markets may refuse to register the placement report if we violated Russian law in the issuance process and a Russian court may also hold the placement invalid for such violations. If the placement report is not registered, the newly issued Shares will be cancelled and we will then be required by Russian law to return the proceeds of the placement.

Pending the registration of the placement report, the proceeds of the offering will be held in U.S. dollars in escrow-type accounts and in escrow accounts. See "Escrow of Proceeds and Registration of Placement Report."

In the event that the placement report is not registered by the Federal Service for the Financial Markets within 60 days after the Closing Date (or such later date to which we and the Selling Shareholders agree with the Underwriters), we have agreed with the Underwriters to issue a press release and to notify the Depositary, the banks holding the escrow and escrow-type accounts, the Underwriters and the London Stock Exchange of the termination of the offering by the close of business on the termination date. Under Russian law, in the case of non-registration of the placement report, we are required to return the full amount of ruble proceeds that were initially deposited into our ruble-denominated account on the Closing Date. This will be effected by converting the U.S. dollar-denominated proceeds maintained in the escrow-type accounts into rubles, and such ruble amount will be converted into U.S. dollars for release to the Depositary for remittance to the holders of the GDRs. As these conversions are expected to be effected at the same rate of exchange, the U.S. dollar-denominated proceeds held in the escrow-type accounts should not suffer any diminution. We have agreed in the underwriting agreement that we will pay such additional amounts (if any) as may be necessary to ensure that the U.S. dollar funds released to the Depositary from the Russian escrow-type accounts will be equal to the original U.S. dollar proceeds deposited in the Russian escrow-type accounts plus interest, if any, received on such escrowed proceeds. All funds in the escrow accounts will also be released to the Depositary in U.S. dollars, without the need for such conversions. The Depositary will promptly distribute through DTC, Euroclear and Clearstream, as applicable, the funds it has received to the holders of the GDRs on the termination date. The amount returned to the holders of the GDRs as of the termination date is expected to be all of the escrowed proceeds plus interest, if any, received on the funds held in escrow and escrow-type accounts, regardless of the then-prevailing market prices for the GDRs, subject to applicable withholding taxes. However, the return of funds may be delayed due to Russian currency control, banking and securities regulations or practices and may be prevented if there is a change in such regulations or practices. Because of the legal and practical limitations on the enforceability of the escrow and escrow-type arrangements, the holders of the GDRs will be taking credit risk on us and on the Selling Shareholders for the return of funds in the event that the placement report is not registered.

Any attempt to claim damages from us in relation to the original issue price of the GDRs or the then-prevailing market prices for the GDRs would be subject to significant difficulties. See "Limitation on Enforcement of Civil Liabilities" for more information. Moreover, the return of the funds may be delayed due to Russian currency control regulations, and may be prevented if there is a change in such regulations. See "—Risks Relating to Our Financial Condition—Russian currency control regulations hinder our ability to conduct our business."

Your voting rights with respect to the Shares represented by the GDRs are limited by the terms of the Deposit Agreements for the GDRs and relevant requirements of Russian law.

As a GDR holder, you will have no direct voting rights with respect to the Shares represented by the GDRs. You will be able to exercise voting rights with respect to the Shares represented by GDRs only in accordance with the provisions of the Deposit Agreements relating to the GDRs and relevant requirements of Russian law. However, there are practical limitations upon your ability to exercise your voting rights due to the additional procedural steps involved in communicating with you. For example, the Federal Law on Joint Stock Companies and our charter require us to notify shareholders at least 20 days in advance of any meeting (though the RTS Stock Exchange and the Moscow Stock Exchange listing rules require us to provide at least 30 days' advance notice), at least 30 days in advance of a meeting relating to a reorganization and at least 50 days in advance of an extraordinary meeting relating to any election of directors. Our common shareholders will receive notice directly from us and will be able to exercise their voting rights by either attending the meeting in person or voting by power of attorney.

As a GDR holder, you, by comparison, will not receive notice directly from us. Rather, in accordance with the Deposit Agreements, we will provide the notice to the Depositary. The Depositary has undertaken, in turn, as soon as practicable thereafter, if requested by us in writing in a timely manner and at our expense, to mail to you notice of such meeting, copies of voting materials (if and as received by the Depositary from us) and a statement as to the manner in which instructions may be given by holders. To exercise your voting rights, you must then instruct the Depositary how to vote the Shares represented by the GDRs you hold. Because of this additional procedural step involving the Depositary, the process for exercising voting rights may take longer for you than for holders of the Shares and we cannot assure you that you will receive voting materials in time to enable you to return voting instructions to the Depositary in a timely manner. GDRs for which the Depositary does not receive timely voting instructions will not be voted.

In addition, although Russian securities regulations expressly permit the Depositary to split the votes with respect to the Shares underlying the GDRs in accordance with instructions from GDR holders, such regulations remain untested, and the Depositary may choose to refrain from voting at all unless it receives instructions from all GDR holders to vote the Shares in the same manner. You may thus have significant difficulty in exercising voting rights with respect to the Shares underlying the GDRs. There can be no assurance that holders and beneficial owners of GDRs will (i) receive notice of shareholder meetings to enable the timely return of voting instructions to the Depositary, (ii) receive notice to enable the timely cancellation of GDRs in respect of shareholder actions or (iii) be given the benefit of dissenting or minority shareholders' rights in respect of an event or action in which the holder or beneficial owner has voted against, abstained from voting or not given voting instructions. See "Description of the Global Depositary Receipts—Voting Rights" for a description of the voting rights of holders of GDRs and "Escrow of Proceeds and Registration of Placement Report" for a description of limitations on voting rights in respect of the newly issued Shares prior to registration of the placement report.

Holders of GDRs will not be able to instruct the Depositary to (i) vote the Shares represented by their GDRs on a cumulative basis, (ii) introduce proposals for the agenda of shareholders' meetings or request that a shareholders meeting be called or (iii) nominate candidates for our Board of Directors or our review commission. If you wish to take such actions, you must timely request that your GDRs be cancelled and take delivery of the Shares and thus become the owner of the Shares on our share register.

Because there has been no prior market for the GDRs or public trading in the Shares, the offering may not result in an active or liquid market for the GDRs, and their price may be highly volatile.

Before the offering, there has been no prior market for the GDRs or public trading in the Shares. Although application has been made to the UK Listing Authority for the GDRs to be admitted to the Official List and to the London Stock Exchange for such GDRs to be admitted to trading on the London Stock Exchange's market for listed securities, an active public market may not develop or be sustained after the offering. Active, liquid trading markets generally result in lower price volatility and more efficient execution of buy and sell orders for investors. If a liquid trading market for the GDRs does not develop, the price of the GDRs may become more volatile and it may be more difficult to complete a buy or sell order for such GDRs.

The liquidity of a securities market is often a function of the volume of the underlying shares that are publicly held by unrelated parties. Although GDR holders are entitled to withdraw the Shares underlying the GDRs from the Depositary (following the registration of the placement report with the Federal Service for the Financial Markets), there is currently no trading of our shares on the RTS Stock Exchange and the Moscow Stock Exchange where they are currently listed and there may only be a very limited public free float in the future. In addition, the Shares being sold by us in the offering cannot be sold on the RTS Stock Exchange or the Moscow Stock Exchange until three months from the date of the registration of the placement report. During the period from the registration of the placement report until such time as the Shares can be traded on the RTS Stock Exchange or the Moscow Stock Exchange (expected to be three months from the registration of the placement report), when you cancel your GDRs and deliver them to the Depositary, you will receive Shares being sold by the Selling Shareholders, and only if all such Shares have been withdrawn will you receive Shares being sold by us, irrespective of how you acquired your GDRs. Nevertheless, depending upon the demand for withdrawals, you may only be able to withdraw Shares that cannot be sold on the RTS Stock Exchange or the Moscow Stock Exchange during this period.

The trading prices of the GDRs may be subject to wide fluctuations in response to a number of factors, including:

- variations in our operating results and those of other Russian companies;
- variations in national and industry growth rates;
- actual or anticipated announcements of technical innovations or new products or services by us or our competitors;
- changes in governmental legislation or regulation;
- general economic conditions within our business sector or in Russia; or
- extreme price and volume fluctuations on the Russian or other emerging market stock exchanges.

In addition, the Russian stock market has experienced extreme price and volume fluctuations. These market fluctuations could adversely affect the value of the GDRs. Moreover, the market price of the GDRs may decline below the offering price, which will be determined by negotiation between us and representatives of the Underwriters.

You may be unable to repatriate your earnings from distributions made on the GDRs.

Russian legislation currently requires dividends on common shares to be paid in rubles and permits such ruble funds to be converted into U.S. dollars by the Depositary without restriction. Also, GDRs may be sold by non-residents of Russia for U.S. dollars outside Russia without regard to Russian currency control laws as long as the buyer is not a Russian resident for currency control purposes.

The ability to convert rubles into U.S. dollars is subject to the availability of U.S. dollars in Russia's currency markets. Although there is an existing market within Russia for the conversion of rubles into U.S. dollars, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is no market for the conversion of rubles into foreign currencies outside of Russia and no viable market in which to hedge ruble- and ruble-denominated investments.

You will experience immediate and substantial dilution.

The initial public offering price of the GDRs is substantially higher than the pro forma consolidated net tangible book value per GDR. That is, holders of GDRs will contribute 50.31% of our total book equity capitalization, but will own only 16.50% of our total equity outstanding, assuming no exercise of the over-allotment option.

Future sales of Shares or GDRs may affect the market price of the Shares and the GDRs.

Sales, or the possibility of sales, of substantial numbers of the Shares or the GDRs in the public markets, including the Russian stock market, following the offering could have an adverse effect on the market trading prices of the GDRs. Our subsequent equity offerings may reduce the percentage ownership of our shareholders. Moreover, newly issued preferred shares may have rights, preferences or privileges senior to those of the Shares.

You may not be able to benefit from double tax treaties.

In accordance with Russian legislation, dividends paid to a nonresident holder generally will be subject to Russian withholding at a rate of 15% for legal entities and organizations and at a rate of 30% for individuals. This tax may be reduced to 5% or 10% for legal entities and organizations and to 10% for individuals under the United States-Russia double tax treaty for U.S. holders and to 10% under the United Kingdom-Russia double tax treaty for U.K. holders. However, the Russian tax rules applicable to GDR holders are characterized by significant uncertainties and by an absence of interpretive guidance. The Russian tax or financial authorities have not provided any public guidance regarding the treatment of GDR arrangements, and it is unclear how the Russian tax authorities will ultimately treat those arrangements. Thus, we may be obliged to withhold tax at higher rates when paying out dividends to U.S. and U.K. holders, and U.S. and U.K. holders may be unable to benefit from these treaties. See "Taxation—Certain Russian Tax Law Considerations" for further details.

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

Under Russian tax legislation, gains arising from the disposition by legal entities or organizations of Russian shares and securities, such as the Shares, as well as financial instruments derived from such shares, such as the GDRs, may be subject to Russian profits tax or withholding income tax. However, no procedural mechanism currently exists to withhold and remit this tax with respect to sales made to persons other than Russian companies and foreign companies with a registered presence in Russia. Gains arising from the disposition of the foregoing types of securities listed on foreign stock exchanges by foreign holders who are legal entities or organizations listed on foreign stock exchanges are exempt from taxation in Russia.

Gains arising from the disposition of the foregoing types of securities and derivatives outside of Russia by U.S. or U.K. holders who are individuals not resident in Russia for tax purposes will not be considered Russian source income and will not be taxable in Russia. Gains arising from disposition of the foregoing types of securities and derivatives in Russia by U.S. or U.K. holders who are individuals not resident in Russia for tax purposes may be subject to tax either at the source in Russia or based on an annual tax return, which they may be required to submit with the Russian tax authorities. See “Taxation—Certain Russian Tax Law Considerations.”

You may have limited recourse against us and our directors and executive officers because we generally conduct our operations outside the United States and the United Kingdom and all of our directors and executive officers reside outside the United States and the United Kingdom.

Our presence outside the United States and the United Kingdom may limit your legal recourse against us. Sistema is incorporated under the laws of the Russian Federation. All of our directors and executive officers reside outside the United States and the United Kingdom, principally in the Russian Federation. All or a substantial portion of our assets and the assets of our directors and executive officers are located outside the United States and the United Kingdom, principally in the Russian Federation. As a result, you may not be able to effect service of process within the United States or the United Kingdom upon us or our directors and executive officers or to enforce U.S. or U.K. court judgments obtained against us or our directors and executive officers in jurisdictions outside the United States and the United Kingdom, including actions under the civil liability provisions of U.S. securities laws. In addition, it may be difficult for you to enforce, in original actions brought in courts in jurisdictions outside the United States and the United Kingdom, liabilities predicated upon U.S. or U.K. securities laws.

There is no treaty between the United States and the Russian Federation or the United Kingdom and the Russian Federation providing for reciprocal recognition and enforcement of foreign court judgments in civil and commercial matters. These limitations may deprive you of effective legal recourse for claims related to your investment in the GDRs. The Deposit Agreements provide for actions brought by any party thereto against us to be settled by arbitration in accordance with the rules of the London Court of International Arbitration. 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 the inexperience of Russian courts in international commercial transactions, official and unofficial political resistance to enforcement of awards against Russian companies in favor of foreign investors and Russian courts’ inability to enforce such orders and corruption.

Other Risks

We have not independently verified information regarding our competitors, nor have we independently verified official data from Russian government agencies.

We have derived substantially all of the information contained in this offering memorandum concerning our competitors from publicly available information, including press releases and filings under the U.S. securities laws, and we have relied on the accuracy of this information without independent verification.

In addition, some of the information contained in this offering memorandum has been derived from official data of Russian government agencies. The official data published by Russian federal, regional and local governments may be substantially less complete or researched than those of Western countries. Official statistics may also be produced on different bases than those used in Western countries. Any discussion of matters relating to Russia in this offering memorandum must, therefore, be subject to uncertainty due to concerns about the completeness or reliability of available official and public information.

The veracity of some official data released by the Russian government may be questionable. In the summer of 1998, the Director of the Russian State Committee on Statistics and a number of his subordinates were arrested and charged in connection with their misuse of economic data.

ESCROW OF PROCEEDS AND REGISTRATION OF PLACEMENT REPORT

Under Russian law, placement of the newly issued Shares we are offering pursuant to this offering memorandum is subject to our registration of a placement report with the Federal Service for the Financial Markets. We may not file the placement report with the Federal Service for the Financial Markets until after the closing of the offering and we intend to file the placement report as soon as practicable following the closing of the offering. Russian law requires that we file the placement report within 30 days following the Closing Date. The Federal Service for the Financial Markets is statutorily required to make its decision within two weeks after we file the placement report but the current practice is that registration of a placement report takes between 30 and 44 days after filing.

Accordingly, prior to the registration of the placement report by the Federal Service for the Financial Markets, all sums paid for the GDRs will be held in escrow and escrow-type accounts. The Underwriting Agreement and agreements governing these accounts will provide that, pending the registration of the placement report by the Federal Service for the Financial Markets, the proceeds of the offering will be deposited as follows:

- the net proceeds payable to us will be converted into rubles, paid into our ruble-denominated account at ZAO Bank Credit Suisse First Boston, converted back into U.S. dollars at the original conversion rate and then deposited in U.S. dollar-denominated accounts at Raiffeisenbank Austria ZAO, ZAO CB Citibank and ZAO Bank Credit Suisse First Boston; and
- the Underwriters' commission and the net proceeds to the Selling Shareholders will be deposited in a U.S. dollar-denominated escrow account at Credit Suisse Limited.

As Russian law does not allow for escrow accounts of the nature commonly seen in the United States or the United Kingdom, we have entered into a series of agreements with Raiffeisenbank Austria ZAO, ZAO CB Citibank and ZAO Bank Credit Suisse First Boston to replicate in substance, to the extent practicable, the functions of an escrow account. We refer to the accounts established under these agreements as "escrow-type" accounts.

In the event that the placement report is not registered by the Federal Service for the Financial Markets within 60 days after the Closing Date (or such later date to which we and the Selling Shareholders agree with the Underwriters), we have agreed with the Underwriters to issue a press release and to notify the Depositary, the banks holding the escrow and escrow-type accounts, the Underwriters and the London Stock Exchange of the termination of the offering by the close of business on the termination date. Under Russian law, in the case of non-registration of the placement report, we are required to return the full amount of ruble proceeds that were initially deposited into our ruble-denominated account on the Closing Date. This will be effected by converting the U.S. dollar-denominated proceeds maintained in the escrow-type accounts into rubles, and such ruble amount will be converted into U.S. dollars for release to the Depositary for remittance to the holders of the GDRs. As these conversions are expected to be effected at the same rate of exchange, the U.S. dollar-denominated proceeds held in the escrow-type accounts should not suffer any diminution. We have agreed in the underwriting agreement that we will pay such additional amounts (if any) as may be necessary to ensure that the U.S. dollar funds released to the Depositary from the Russian escrow-type accounts will be equal to the original U.S. dollar proceeds deposited in the Russian escrow-type accounts plus interest, if any, received on such escrowed proceeds. All funds in the escrow accounts will also be released to the Depositary in U.S. dollars, without the need for such conversions. The Depositary will promptly distribute through DTC, Euroclear and Clearstream, as applicable, the funds it has received to the holders of the GDRs on the termination date. The amount returned to the holders of the GDRs as of the termination date is expected to be all of the escrowed proceeds plus interest, if any, received on the funds held in escrow and escrow-type accounts, regardless of the then-prevailing market prices for the GDRs, subject to applicable withholding taxes. However, the return of funds may be delayed due to Russian currency control, banking and securities regulations or practices and may be prevented if there is a change in such regulations or practices. Because of the legal and practical limitations on the enforceability of the escrow and escrow-type arrangements, the holders of the GDRs will be taking credit risk on us and on the Selling Shareholders for the return of funds in the event that the placement report is not registered.

Until the registration of the placement report by the Federal Service for the Financial Markets, you will not be entitled to instruct the Depositary to exercise any voting rights on your behalf as our shareholder, and the Depositary and the Custodian will not exercise any voting rights as a shareholder. You may not withdraw the Shares or other property on deposit with the Depositary in respect of the GDRs sold in the offering prior to the registration of the placement report with the Federal Service for the Financial Markets. See "Risk Factors—Risks Relating to the GDRs and the Trading Market—You will not be able to withdraw the Shares underlying the GDRs prior to the registration of a placement report for the newly issued Shares, and the failure to register this placement report could result in the offering being withdrawn and newly issued Shares underlying the GDRs being cancelled." Such limitation on withdrawal and voting of the Shares will not prohibit trading in the GDRs.

USE OF PROCEEDS

The net proceeds we will receive from the offering, after deducting underwriting commissions and fees and expenses incurred in connection with the offering, will be approximately $1,284.4 million.

We currently expect approximately $550.0 million of the proceeds from the offering will be invested into our existing non-telecommunications businesses to accelerate their development. This amount reflects our current expectation of required equity investments by Sistema only. Our businesses are also expected to have access to additional potential sources of capital to finance capital investments and potential acquisitions, including cash flow from operations, debt financing, vendor financing and additional equity to be provided by our partners.

Many of our businesses are developing rapidly and operate in markets that are at an early stage of development and/or are subject to significant competitive or technological change. Our investment program for our existing businesses may change to respond to the evolution of the market for the services offered by our businesses, regulatory developments and competitor behavior, among other factors. For a detailed discussion of our investment principles, see "Business—Investment and Operating Principles." For a detailed discussion of the competitive positioning, strategy and growth objectives of our businesses, see "Business—Our Business."

Subject to meeting our investment criteria, we may instead use a portion or all of the net proceeds of the offering to pursue acquisitions in the telecommunications industry in Russia and the CIS. In particular, potential acquisitions might involve privatization transactions, such as the pending privatizations of Svyazinvest, Ukrtelecom and Kazakhtelecom. Given the anticipated competition for these and other assets, we do not expect to compete for or successfully complete all acquisition opportunities we evaluate. See "Risk Factors—Risks Relating to Our Business—General Risks—Our planned business combinations and restructurings may be delayed or fail to occur." In addition, while we may also assess opportunities to use the net proceeds of the offering to finance a significant new investment or acquisition by MTS, no such investment or acquisition is currently contemplated.

To the extent that the proceeds of the offering are not invested in our existing non-telecommunications businesses or used to pursue acquisitions, they will otherwise be used for general corporate purposes.

Prior to the use of these net proceeds, we intend to hold them in U.S. dollar-denominated, interest-bearing bank accounts in Russia. Subject to compliance with all Russian regulatory requirements, we will invest the net proceeds in short-term, interest-bearing, U.S. dollar-denominated instruments.

We will not receive any of the proceeds from the sale of the GDRs representing Shares offered by the Selling Shareholders.

Until the registration of the placement report by the Federal Service for the Financial Markets, the proceeds from the offering will be held in escrow and escrow-type accounts at ZAO CB Citibank, ZAO Bank Credit Suisse First Boston, Raiffeisenbank Austria ZAO and Credit Suisse Limited. The terms of the deposit of funds into these accounts will provide that the net proceeds will be released to us, and that the sums due to the Selling Shareholders and the Underwriters will be released to them, only upon the registration of the placement report. Although under Russian law the placement report should be registered within two weeks after the report is filed with the Federal Service for the Financial Markets, the registration may take longer or may not occur at all. See "Escrow of Proceeds and Registration of Placement Report" and "Risk Factors—Risks Relating to the GDRs and the Trading Market—You will not be able to withdraw the Shares underlying the GDRs prior to the registration of a placement report for the newly issued Shares, and the failure to register this placement report could result in the offering being withdrawn and newly issued Shares underlying the GDRs being cancelled" for more detail.

DIVIDEND POLICY

Following the offering, we expect to declare and pay a nominal annual dividend, subject to any applicable Russian legal restrictions. In accordance with our strategy, we expect to reinvest a substantial majority of our cash flow into our existing business and new investment opportunities for the foreseeable future. See "Business—Strategy."

Dividend payments, if any, must be recommended by our Board of Directors and approved by our shareholders. In particular, dividends may be declared only out of net profits calculated under Russian accounting standards and as long as the following conditions have been met:

- our charter capital has been paid in full;
- the value of our net assets, calculated under Russian accounting standards, is not less, and would not, as a result of the proposed dividend payment, become less than the sum of our charter capital, our reserve fund and the difference between the liquidation value and the par value of our issued and outstanding preferred shares;
- we have repurchased all shares from shareholders having the right to demand repurchase; and
- we are not, and would not become as the result of the proposed dividend payment, insolvent.

Dividends, if declared, are payable to our shareholders within 60 days of the declaration unless a shorter time period is set forth by the shareholders' decision declaring the dividends. Dividends not claimed within three years of the date of payment lapse and accrue to us. For a further description, please refer to "Description of Share Capital and Certain Requirements of Russian Legislation—Description of Share Capital—Dividends."

We did not pay dividends during the years ended December 31, 2001, 2002 and 2003. For the nine months ended September 30, 2004, we paid dividends of approximately $5.2 million, or $0.64 per share.

We anticipate that any dividends we may pay in the future in respect of the Shares represented by the GDRs will be declared and paid to the Depositary in rubles and will be converted into U.S. dollars by the Depositary and distributed to holders of the GDRs, net of the Depositary's fees and expenses. Accordingly, the value of dividends received by holders of the GDRs will be subject to fluctuations in the exchange rate between the ruble and the U.S. dollar.

MARKET INFORMATION

Our shares have been listed on the RTS Stock Exchange since October 28, 2004, but are not currently traded. Accordingly, no pricing or trading volume information is available in respect of the shares. Trading in the shares on the RTS Stock Exchange will commence within six months from the listing date, as indicated above.

Our shares have been listed on the Moscow Stock Exchange since November 4, 2004, but are not currently traded. Accordingly, no pricing or trading volume information is available in respect of the shares. Trading in the shares on the Moscow Stock Exchange will commence within six months from the listing date, as indicated above.

CAPITALIZATION

The following table sets forth our consolidated capitalization at September 30, 2004, on a historical basis and as adjusted to give effect to the offering. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Recent Financing Activities" and our consolidated financial statements included elsewhere in this offering memorandum.

	As of September 30, 2004	
	Historical	As adjusted
	(Amounts in thousands)	
Short-term debt[(1)]		
Loans from related parties	$ 15,985	$ 15,985
Other short-term debt	44,571	44,571
Current portion of long-term debt	497,654	497,654
Current portion of capital lease obligation	4,789	4,789
Total short-term debt	562,999	562,999
Long-term debt		
Capital lease obligations	2,138	2,138
Bonds issued	73,223	73,223
Vendor financing	13,905	13,905
Loans from related parties	14,853	14,853
Other long-term debt	375,168	375,168
MTS notes due 2008	398,883	398,883
MTS notes due 2004	400,000	400,000
$350,000,000 10¼% guaranteed senior secured notes due 2008	348,808	348,808
$350,000,000 8.875% senior notes due 2011	350,000	350,000
Total long-term debt	1,976,978	1,976,978
Total debt[(1)(2)(3)(4)]	$2,539,977	$2,539,977
Shareholders' equity		
Share capital (8,100,000 and 9,650,000 issued and outstanding historical and as adjusted, respectively, with a nominal value of 90 rubles)[(5)]	$ 25,090	$ 30,039
Additional paid-in capital	198,882	1,478,333
Retained earnings	1,089,898	1,089,898
Accumulated other comprehensive income	20,725	20,725
Total shareholders' equity[(4)]	$1,334,595	$2,618,995
Total capitalization	$3,874,572	$5,158,972

(1) Excludes bank deposits and notes issued. As of September 30, 2004, bank deposits and notes issued included deposits repayable on demand of $89.9 million, term deposits of $116.5 million and promissory notes issued of $33.4 million.

(2) Since September 30, 2004, we have engaged in various financing activities, all as further described under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations—Liquidity and Capital Resources—Recent Financing Activities."

(3) As at September 30, 2004, we had contingent liabilities of nil and had granted guarantees not reflected on our balance sheet in a total amount of $49.9 million. Of our total indebtedness at September 30, 2004, $431.7 million was secured, $2,108.3 million was unsecured, $14.4 million was guaranteed and $2,525.6 million was unguaranteed.

(4) Save as described above, there has been no material change in our share capital, indebtedness, contingent liabilities or guarantees since September 30, 2004.

(5) Sistema has 68,325,000 authorized shares, all of which are common shares.

SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA

The table below shows our historical financial information as of and for the years ended December 31, 2001, 2002 and 2003 and as of and for the nine months ended September 30, 2003 and 2004. This information has been extracted without material adjustment from our audited annual financial statements and unaudited interim financial statements included elsewhere in this offering memorandum, except as provided in the footnotes below. Our unaudited interim financial statements include all normal and recurring adjustments, which are, in our opinion, necessary for a fair presentation of our financial position at such dates and results of operations for such periods. The results of operations for the nine months ended September 30, 2004 are not necessarily indicative of the results for the full year.

The selected financial data should be read in conjunction with "Management's Discussion and Analysis of Financial Condition and Results of Operations" and our consolidated financial statements included elsewhere in this offering memorandum.

Our financial statements have been prepared in accordance with U.S. GAAP since 1998. Although our results are presented in U.S. dollars, you should not construe those translations as a representation that those amounts could be converted from one currency to another at any particular rate or at all. The ruble generally is not convertible outside Russia. A market exists within Russia for the conversion of rubles into other currencies, but the limited availability of other currencies may tend to inflate their values relative to the ruble.

	Years ended December 31,			Nine months ended September 30,	
	2001[1]	2002[1]	2003[1]	2003[1]	2004[1]
	(Amounts in thousands, except per share amounts)				
Total revenues	$ 720,536	$ 889,506	$ 3,759,915	$ 2,608,597	$ 4,135,920
Total cost of sales, exclusive of depreciation and amortization shown separately below	(424,783)	(521,467)	(1,388,027)	(945,409)	(1,589,533)
Selling, general and administrative expenses	(95,272)	(141,401)	(689,057)	(489,282)	(679,629)
Depreciation and amortization	(59,978)	(72,042)	(520,976)	(354,330)	(540,679)
Goodwill impairment	—	—	(19,251)	(19,251)	—
Other operating (expenses)/income, net	(704)	12,762	(37,326)	(39,296)	(30,614)
Equity in net income of investees	96,635	124,625	465	1,295	12,942
Net gain on disposal of subsidiaries	4,452	3,787	—	(941)	(1,862)
Operating income	240,886	295,770	1,105,743	761,383	1,306,545
Interest income	1,812	1,622	19,341	14,743	17,370
Interest expense	(39,737)	(53,111)	(198,346)	(132,057)	(163,316)
Currency exchange and translation gain/(loss)	2,482	5,113	(3,015)	3,671	9,496
Income from continuing operations before income tax, minority interests and cumulative effect of a change in accounting principle	205,443	249,394	923,723	647,740	1,170,095
Income tax expense	(29,170)	(43,398)	(290,933)	(200,343)	(326,141)
Minority interest	(28,953)	(35,109)	(402,120)	(303,454)	(471,761)
Gain/(loss) from discontinued operations[2]	(5,886)	(3,156)	12,810	9,952	—
Gain on disposal of discontinued operations[3]	—	19,725	143,567	22,500	—
Cumulative effect of a change in accounting principle[4]	(6,179)	(21,480)	—	—	(35,472)
Net income	$ 135,255	$ 165,976	$ 387,047	$ 176,935	$ 336,721

	Years ended December 31,			Nine months ended September 30,	
	2001[1]	2002[1]	2003[1]	2003[1]	2004[1]
	(Amounts in thousands, except per share amounts)				
Consolidated cash flow data					
Net cash provided by operating activities	$ 27,006	$ 188,616	$ 986,402	$ 687,798	$ 1,496,130
Net cash used in investing activities	(248,143)	(151,505)	(2,365,236)	(1,895,872)	(1,287,156)
of which capital expenditures[5]	(145,245)	(150,759)	(1,159,294)	(766,924)	(1,063,326)
Net cash provided by financing activities	252,343	28,194	1,504,732	1,224,550	(183,592)
Consolidated balance sheet data (end of period)[6]					
Cash and cash equivalents[7]	$ 91,962	$ 157,267	$ 283,165	$ 173,743	$ 308,547
Short-term investments	86,187	164,315	278,850	240,939	178,964
Total assets	1,958,384	2,328,331	6,792,230	6,108,294	7,678,929
Total debt (long-term and short-term)[8]	525,174	607,984	2,685,440	2,403,197	2,539,977
of which capital lease obligations	18,995	36,664	16,330	18,389	6,927
Total liabilities	1,179,637	1,345,496	4,446,389	4,099,480	4,640,700
Total shareholders' equity	414,336	594,780	989,284	747,806	1,334,595
Earnings per share, basic and diluted					
Income from continuing operations before cumulative effect of a change in accounting principle	18.2	21.1	28.5	17.8	45.9
Gain/(loss) from discontinued operations	(0.7)	2.0	19.3	4.0	—
Cumulative effect of a change in accounting principle	(0.8)	(2.7)	—	—	(4.4)
Net income	16.7	20.5	47.8	21.8	41.6
Non-U.S. GAAP measure					
OIBDA[9]	$ 300,864	$ 367,812	$ 1,626,719	$ 1,115,713	$ 1,847,224

(1) For 2001 and 2002, we accounted for our investment in MTS under the equity method. Effective January 1, 2003, MTS' accounts have been consolidated in our financial statements, with pre-acquisition earnings on the additional 10% interest purchased in April 2003 included in minority interest in the statement of operations.

(2) Gain/(loss) from discontinued operations is shown net of the income tax effect of $0.5 million, $1.5 million, $3.6 million and $3.2 million for the years ended December 31, 2001, 2002 and 2003 and the nine months ended September 30, 2003, respectively.

(3) Gain on disposal of discontinued operations is shown net of the income tax effect of nil, $18.3 million and nil for the years ended December 31, 2002 and 2003 and the nine months ended September 30, 2003, respectively.

(4) Cumulative effect of a change in accounting principle is shown net of the income tax effect of $1.1 million, nil and nil for the years ended December 31, 2001 and 2002 and the nine months ended September 30, 2004, respectively.

(5) Represents the aggregate of purchases of property, plant and equipment and of intangible assets.

(6) Our consolidated balance sheet at September 30, 2003 is not included in this offering memorandum.

(7) Includes cash representing MBRD's minimum reserve deposit requirements with the Central Bank of Russia. Minimum reserve deposits with the Central Bank of Russia were $12.5 million and $45.7 million as of September 30, 2004 and December 31, 2003, respectively.

(8) Includes short-term notes payable, long-term debt, including current portion, and capital lease obligations, including current portion, but does not include bank deposits and notes issued and certain other liabilities. As of September 30, 2004 and December 31, 2003, bank deposits and notes issued included deposits repayable on demand of $89.9 million and $58.0 million, respectively, term deposits of $116.5 million and $67.4 million, respectively, and promissory notes issued of $33.4 million and $48.3 million, respectively.

(9) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including or ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and service debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

Segment Information

Segment information is presented after elimination of intra-segment transactions, but prior to the elimination of transactions between segments.

Revenue by Segment

	Years ended December 31,						Nine months ended September 30,			
	2001	% of revenues	2002	% of revenues	2003	% of revenues	2003	% of revenues	2004	% of revenues
	(Amounts in thousands, except percentages)									
Telecommunications	$421,156	58.5%	$482,723	54.3%	$3,247,568	86.4%	$2,272,764	87.1%	$3,350,379	81.0%
Technology	29,879	4.1	76,170	8.6	85,942	2.3	63,682	2.4	319,816	7.7
Insurance	89,960	12.5	140,735	15.8	187,929	5.0	133,178	5.1	201,160	4.9
Banking	19,072	2.6	36,660	4.1	57,513	1.5	40,063	1.5	49,220	1.2
Other Businesses	171,076	23.7	181,094	20.4	249,658	6.6	153,139	5.9	283,096	6.8
Aggregated revenues	731,143		917,382		3,828,610		2,662,826		4,203,671	
Eliminations	(10,607)	(1.5)	(27,876)	(3.1)	(68,695)	(1.8)	(54,229)	(2.1)	(67,751)	(1.6)
Total	$720,536	100%	$889,506	100%	$3,759,915	100%	$2,608,597	100%	$4,135,920	100%

Assets by Segment

	Years ended December 31,						Nine months ended September 30,			
	2001	% of assets	2002	% of assets	2003	% of assets	2003	% of assets	2004	% of assets
	(Amounts in thousands, except percentages)									
Telecommunications	$1,284,568	65.6%	$1,478,924	63.5%	$5,204,668	76.6%	$4,923,164	80.6%	$6,134,456	79.9%
Technology	41,642	2.1	63,446	2.7	103,568	1.5	91,419	1.5	251,829	3.3
Insurance	119,786	6.1	165,150	7.1	239,273	3.5	208,232	3.4	308,737	4.0
Banking	325,237	16.6	283,045	12.2	595,516	8.8	401,224	6.6	376,960	4.9
Other Businesses	187,151	9.6	338,393	14.5	651,718	9.6	493,372	8.1	625,856	8.2
Aggregated assets	1,958,384		2,328,958		6,794,743		6,117,411		7,697,838	
Eliminations	—	—	(627)	—	(2,513)	—	(9,117)	(0.1)	(18,909)	(0.2)
Total	$1,958,384	100%	$2,328,331	100%	$6,792,230	100%	$6,108,294	100%	$7,678,929	100%

Operating Income by Segment

	Years ended December 31,						Nine months ended September 30,			
	2001	% of operating income	2002	% of operating income	2003	% of operating income	2003	% of operating income	2004	% of operating income
	(Amounts in thousands, except percentages)									
Telecommunications	$236,002	98.0%	$279,837	94.6%	$1,103,282	99.8%	$769,408	101.1%	$1,291,462	98.8%
Technology	(639)	(0.3)	5,533	1.9	(3,348)	(0.3)	(351)	(0.0)	13,913	1.1
Insurance	(13,959)	(5.8)	2,583	0.9	17,111	1.5	10,479	1.4	14,372	1.1
Banking	5.979	2.5	8,804	3.0	2,567	0.2	6,174	0.8	14,687	1.1
Other Businesses	15,179	6.3	(1.507)	(0.5)	(16,131)	(1.5)	(19,767)	(2.6)	(11,263)	(0.9)
Aggregated operating income	242,562		295,250		1,103,481		765,943		1,323,171	
Eliminations	(1,676)	(0.7)	520	0.2	2,262	0.2	(4,560)	(0.6)	(16,626)	(1.3)
Total	$240,886	100%	$295,770	100%	$1,105,743	100%	$761,383	100%	$1,306,545	100%

OIBDA[1] by Segment

	Years ended December 31,						Nine months ended September 30,			
	2001	% of OIBDA	2002	% of OIBDA	2003	% of OIBDA	2003	% of OIBDA	2004	% of OIBDA
	(Amounts in thousands, except percentages)									
Telecommunications	$289,648	96.3%	$342,194	93.0%	$1,609,926	99.0%	$1,115,269	100.0%	1,821,172	98.6%
Technology	1,270	0.4	8,452	2.3	(486)	0.0	1,733	0.2	16,162	0.9
Insurance	(13,336)	(4.4)	4,383	1.2	20,226	1.2	12,627	1.1	17,275	0.9
Banking	6,358	2.1	9,091	2.5	3,187	0.2	6,639	0.6	15,526	0.8
Other Businesses	18,600	6.1	3,172	0.9	(8,396)	(0.5)	(15,995)	(1.4)	(6,285)	(0.3)
Aggregated OIBDA	302,540		367,292		1,624,457		1,120,273		1,863,850	
Eliminations	(1,676)	(0.6)	520	0.1	2,262	0.1	(4,560)	(0.4)	(16,626)	(0.9)
Total	$300,864	100%	$367,812	100%	$1,626,719	100%	$1,115,713	100%	$1,847,224	100%

(1) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including or ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and service debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

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

The following is a discussion of our financial condition and results of operations as of and for the years ended December 31, 2001, 2002 and 2003 and as of and for the nine months ended September 30, 2003 and 2004, and of the material factors that we believe are likely to affect our consolidated financial condition. You should read this section together with our audited consolidated financial statements for the years ended December 31, 2001, 2002 and 2003, including the notes to those financial statements, and our unaudited interim consolidated financial statements for the nine months ended September 30, 2003 and 2004, including the notes to those financial statements. Our consolidated financial statements have been prepared in accordance with U.S. GAAP.

Overview

We are the largest private sector consumer services company in Russia and the CIS. We have over 35 million customers. Our business is developing, managing and realizing the value of market-leading businesses in the markets in which we have a presence. We operate in a select number of service-based industries offering the potential for rapid growth of our businesses. In our consolidated financial statements, we report our results in five segments: Telecommunications; Technology; Insurance; Banking; and Other Businesses (which comprises our real estate, retail, media, travel services and miscellaneous businesses together with our other operations and central corporate functions). Our consolidated revenues were $4,135.9 million for the nine months ended September 30, 2004 and $3,759.9 million for the year ended December 31, 2003. Net income from continuing operations before cumulative effect of accounting changes was $372.2 million for the nine months ended September 30, 2004 and $230.7 million for the year ended December 31, 2003.

Our revenues for the nine months ended September 30, 2004 increased by 58.5% to $4,135.9 million, compared with $2,608.6 million in the nine months ended September 30, 2003. We have increased our revenues through organic growth, as well as through acquisitions. Net income from continuing operations before cumulative effect of accounting changes in the nine months ended September 30, 2004 increased by 158.6% to $372.2 million, compared with $143.9 million in the nine months ended September 30, 2003. For additional information and description of the most relevant factors affecting our business, see "Business—Overview."

The following table illustrates our ownership interests in our principal consolidated subsidiaries and equity holdings as of December 31, 2004.

Segment	Company	Beneficial ownership[1]	Voting interest[2]
Telecommunications	MTS	51%	51%
	MGTS	46%	56%
	Comstar UTS[3]		
	MTU-Inform	76%	99%
	Comstar	77%	100%
	Telmos	62%	80%
	MTU-Intel	87%	100%
	Golden Line	87%	100%
	Sky-Link	42%	50%
	MTT	36%	45%
	Sistema Telecom	100%	100%
Technology	CSC	78%	78%
	Kvazar-Micro	50%	51%
	Mikron	60%	77%
	STROM telecom	52%	67%
	Sitronics	78%	100%
Insurance	ROSNO	49%	51%
Banking	MBRD[4]	95%	99%
	East-West United Bank	49%	49%
Other Businesses			
Real Estate	Sistema-Hals	100%	100%
	Landshaft	100%	100%
Retail	Detsky Mir	75%	75%
	Detsky Mir Center	100%	100%
Mass Media	Sistema Mass Media	90%	90%
Travel Services	Intourist	91%	91%
International Operations	ECU GEST	99%	99%
Radio and Space Technology	RTI Systems	100%	100%
Pharmaceuticals and Biotechnology	Medical Technological Holding Company	74%	74%

(1) "Beneficial ownership" represents the percentage of ownership interests of the relevant entity that are beneficially owned by Sistema, directly or indirectly, based on Sistema's proportionate ownership of the relevant entity through its consolidated subsidiaries. Our ownership interests in the subsidiaries presented above are calculated based on shares owned by us as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP (FIN 46R). Excluding the ownership interests of these affiliated companies, our beneficial ownership interests in certain subsidiaries listed above would have been lower by the following amounts: CSC (2.0%), Mikron (1.5%), STROM telecom (1.4%), Sitronics (2.0%), ROSNO (1.8%), MBRD (28.8%), Detsky Mir (4.5%), Sistema-Hals (1.1%) and Landshaft (1.1%).

(2) "Voting interest" represents the percentage of ownership interests of the relevant entity that Sistema or any of its consolidated subsidiaries has the power to vote.

(3) The entities comprising the businesses of Comstar UTS are currently being restructured and combined into a single legal entity. After the completion of the restructuring, we expect that Sistema will own at least 51% of Comstar UTS directly with an additional stake owned indirectly through MGTS. References herein to "Comstar" are to our alternative fixed line subsidiary Comstar only.

(4) Our beneficial ownership and voting interest in MBRD are presented as of January 31, 2005 to reflect our acquisition of an additional 13.7% stake in MBRD in January 2005. See "Business—Banking" for additional information.

Macroeconomic Factors Affecting Our Results of Operations

Most of our operations are based in Russia. As a result, Russian macroeconomic trends and country-specific risks significantly influence our performance. In recent years, Russia has been able to overcome the consequences of the 1998 financial crisis. Below is a summary of several key macroeconomic factors that may have a substantial impact on our business:

	Year ended December 31,			Nine months ended September 30,
	2001	2002	2003	2004
GDP growth	5.0%	4.3%	7.3%	6.9%
Consumer price index	18.6%	15.1%	12.0%	8.0%
Unemployment rate	8.7%	7.1%	8.9%	7.4%
Nominal exchange rate (rubles per U.S. dollar)[1]	29.2	31.4	30.6	28.9
Real ruble appreciation against U.S. dollar[2]	10.8%	9.2%	20.9%	8.9%

Sources: Central Bank of Russia, Goskomstat, EIU, Russian Ministry of Economic Development.

(1) The average of the exchange rates on the last business day of each full month during the relevant period.

(2) Real ruble appreciation against U.S. dollar is a consumer price index adjusted for nominal exchange rate changes over the same period.

GDP growth rates in Russia remain relatively high compared to North America and Europe. The Russian economy has not been significantly affected by the current global economic slowdown due to the high proportion of oil and oil products in its export revenues and the high oil prices on the international markets. Real incomes have increased significantly since the financial crisis in August 1998. The higher disposable income of the Russian population has stimulated demand for the services provided by our main businesses, such as telecommunications, insurance, banking and retail. The continuation of growth in Russian GDP and real and disposable income in Russia is subject to the influences of various political groups whose interests may not be aligned with those of the current government and to the ability of the government to continue to progress economic and regulatory reforms currently underway.

Acquisitions and Divestitures

During the periods under review, we have completed a number of acquisitions and divestitures, several of which have had a significant impact on our results of operations and financial condition. We consolidate revenues and expenses of newly acquired entities from the beginning of the year in which we obtain a controlling interest. Earnings attributable to these entities for the portion of the year prior to the date upon which we obtained a controlling interest are included in minority interests.

Due to the number of significant transactions completed during the periods under review, period-to-period comparisons of our results of operations need to be considered in the light of the impact of such transactions. For example, due to the acquisition of a controlling stake in MTS during 2003 and the subsequent consolidation of the results of operations of MTS for the year ended December 31, 2003, our results of operations for 2003 are not directly comparable to our results of operations for the year ended December 31, 2002. See also Note 3 to our audited consolidated financial statements.

Below is a list of our major acquisitions during the last full fiscal year and the interim period.

Company	Principal activity	Date of acquisition	Stake acquired	Acquiring entity	Purchase price(1)
					(in millions)
Year ended December 31, 2003					
MTS	Mobile operator in Russia and Ukraine	April 2003	10.0%	Sistema	$ 370.0
UMC	Mobile operator in Ukraine	March 2003	57.7%	MTS	199.0
UMC	Mobile operator in Ukraine	June 2003	26.0%	MTS	87.6
UMC	Mobile operator in Ukraine	July 2003	16.3%	MTS	91.7
TAIF Telcom	Mobile operator in the Tatarstan Republic and Volga region	April 2003	51.0%	MTS	61.0
TAIF Telcom	Mobile operator in the Tatarstan Republic and Volga region	May 2003	1.7%	MTS	2.3
Sibchallenge	Mobile operator in the Krasnoyarsk region	August 2003	100.0%	MTS	45.5
TSS	Mobile operator in Eastern Siberia	September 2003	100.0%	MTS	47.0
Kuban-GSM	Mobile operator in Krasnodar region	September 2003	47.3%	MTS	107.0
Comstar	Fixed line operator in Moscow	December 2003	50.0%	ECU GEST	20.8
					$1,031.9
Nine months ended September 30, 2004					
SCS-900	Mobile operator in Siberian region	March 2004	11.0%	MTS	$ 8.5
FECS-900	Mobile operator in Far East region	April 2004	40.0%	MTS	8.3
Primtelefon	Mobile operator in Far East region	June 2004	50.0%	MTS	31.0
Kvazar-Micro	Distributor of computer components and system integrator in Ukraine	July 2004	51.0%	ECU GEST	28.0
Uzdunrobita	Mobile operator in Uzbekistan	August 2004	74.0%	MTS	121.0
UDN-900	Mobile operator in Udmurtia Republic	August 2004	49.0%	MTS	6.4
MTT	Nationwide transit network operator	September 2004	29.8%	ECU GEST, Hurdsfield	39.8
					$ 243.0

(1) Excluding acquisition-related costs.

Recent Acquisitions

In October 2004, MTS completed its exercise of a call option in respect of 47.3% of the common shares and 50% of the preferred shares of TAIF Telcom, increasing MTS' voting power in TAIF Telcom to 100%. The value of consideration equaled $63.0 million. TAIF Telcom provides GSM 900/1800 services under the MTS brand in the Republic of Tatarstan (population 3.8 million), located in the Volga region of Russia. As of September 30, 2004, the prepayment for TAIF Telcom's shares in the amount of $63.0 million is recorded within advance payments for non-current assets.

In October 2004, ROSNO acquired from RAO UES a 100% stake in Leader. The value of consideration equaled $3.0 million. Leader is an insurance company, selling primarily property insurance to energy companies. During 2002-2004, ROSNO assumed reinsurance from Leader and performed operational management of this company.

In November 2004, we acquired from Vneshtorgbank a 14% stake in East-West United Bank, increasing our ownership to 49%. The value of consideration equaled $5.3 million.

In November 2004, MTS won a government tender to acquire a 76% stake in Gorizont RT, a cellular operator in the Republic of Saha (Yakutia) in the Far-East region of Russia, for cash consideration of $52.2 million. Gorizont RT is the sole mobile services provider in the region, which has a population of 949,300.

In November 2004, MTS signed an agreement to acquire 100% of US-based MCT Sibi Corp., which owns a 93.5% stake in Sibintertelecom, a wireless operator in the Chita region and in the

Aginsk-Buryatsk Autonomous District in the Far-East region of Russia, for cash consideration of $37.3 million. Sibintertelecom is the sole mobile services provider in the two regions, which together have a total population of 1.23 million.

In December 2004, MTS acquired a 52.5% stake in Telesot-Alania. The value of consideration equaled $6.2 million. Telesot-Alania is a GSM 900/1800 mobile phone operator in the Republic of North Ossetia, which has a population of 710,000.

In January 2005, we acquired a 13.7% stake in MBRD for approximately $10.0 million from Alrosa, a state-controlled diamond producer.

Consolidation of MTS

In April 2003, we exercised our rights under a call option agreement with T-Mobile to acquire from T-Mobile 199,322,614 shares of common stock of MTS, amounting to an additional 10% of MTS' outstanding common stock, for the total consideration of $370.0 million. As a consequence, since April 2003 we have had a controlling interest of 50.6% of MTS' shares, and we have consolidated the results of operations of MTS in our financial statements for the year commencing January 1, 2003 and subsequent periods.

For the nine months ended September 30, 2004 and the year ended December 31, 2003, MTS accounted for approximately $2,865.1 million and $2,638.2 million, or 69.3% and 70.2% of our net revenues, respectively, while in periods prior to 2003 the results of MTS' operations were recorded under income from equity investees.

Other Acquisitions

In December 2002, as a part of our corporate reorganization process, we established CSC, a new holding company for our Technology Segment and contributed our shares of Mikron, Elion, Elaks, NIITM and several other subsidiaries and affiliates in the Technology Segment in exchange for 76% of the voting shares of CSC. Additionally, certain employees of Mikron exchanged their collective 15% interest in Mikron for 14% of CSC, and NED Electronics, our affiliate, exchanged all of the shares of STROM telecom, a supplier of telecommunications equipment and software located in the Czech Republic, for 10% of CSC. As a result of this transaction, we obtained control over STROM telecom's operations beginning in December 2002. The consolidation of STROM telecom, with effect from January 1, 2002, added $27.7 million to the Technology Segment revenues, including $17.6 million in revenues from sales to our Telecommunications Segment. Prior to 2002, our investment in STROM telecom was accounted for under the equity method.

During the nine months ended September 30, 2004, ROSNO repurchased 3,302,400 shares, or 3.44%, from a director of our consolidated group for the total cash consideration of $5.6 million. Later in the same period, we acquired from ROSNO 1,682,193 of such shares, or 1.75%, for $2.8 million in cash. The remaining shares were sold by ROSNO to Allianz.

In June 2004, we purchased an additional 5% stake in East-West United Bank for the total cash consideration of $1.7 million, which increased our beneficial ownership and voting interest in East-West United Bank to 35% as of September 30, 2004.

In addition, during the periods under review we acquired controlling and non-controlling stakes in several small regional companies. Moreover, we increased our shareholdings in several subsidiaries by acquiring stakes from minority shareholders and related parties. See also Note 4 to our consolidated financial statements. For information on other acquisitions after September 30, 2004, see Note 29 to our interim consolidated financial statements.

Divestitures

During 2002 and 2003, we disposed of our interests in our oil business. The gain on the disposal of our oil business was classified as gain on disposal of discontinued operations in our consolidated statements of operations for the years ended December 31, 2003 and 2002 and amounted to $143.6 million and $19.7 million, respectively.

In December 2002 and February 2003, we sold 100% of our voting shares in FPK Kedr-M, a network of 30 gasoline stations located in Moscow, to a third party for the total consideration of $45.0 million.

During 2003, we acquired 33.0% of common shares of Belkamneft, 100.0% of Consortium-12, 100.0% of Baikal Oil and 24.0% of Sistema-Neft, the holding company for our oil business line, for total cash consideration of $186.8 million. In December 2003, we sold our interests in these companies to a third party for total cash consideration of $292.5 million and a promissory note with a fair value of $15.9 million collected in 2004.

In July 2004, we sold 33.0% of the common shares of our subsidiary STROM telecom to a third party for cash consideration of $2.0 million. The transaction resulted in the recognition of a loss on disposal of interest in subsidiary of $1.2 million.

In August 2004, we sold 83.5% of the common shares of our subsidiary P-Com to Sky-Link, our affiliate, for promissory notes in the amount of $16.0 million. The transaction resulted in the recognition of a loss on disposal of interest of subsidiary of $1.9 million. The revenues of P-Com were excluded from our consolidated revenues from January 1, 2004, and our share in the earnings of P-Com for the nine months ended September 30, 2004 was accounted for under the equity method of accounting.

During 2003 and the nine months ended September 30, 2004, we sold our interests in Mikron-Energo, a manufacturer of electronic devices, Sofora, a subsidiary operating in the media business, and in certain other subsidiaries. The proceeds from these sales and the results of operations of these subsidiaries were not material.

Consolidated Financial Results Overview

The following table sets forth a summary of our financial results for the years ended December 31, 2001, 2002 and 2003 and for the nine months ended September 30, 2003 and 2004. This financial information should be read in conjunction with our consolidated financial statements.

	Years ended December 31,						Nine months ended September 30,			
	2001	% of revenues	2002	% of revenues	2003	% of revenues	2003	% of revenues	2004	% of revenues
	(Amounts in thousands, except percentages)									
Revenues	$ 720,536	100.0%	$ 889,506	100.0%	$ 3,759,915	100.0%	$2,608,597	100.0%	$ 4,135,920	100.0%
Cost of sales, exclusive of depreciation and amortization shown separately below	(424,783)	(59.0)	(521,467)	(58.6)	(1,388,027)	(36.9)	(945,409)	(36.2)	(1,589,533)	(38.4)
Selling, general and administrative expenses	(95,272)	(13.2)	(141,401)	(15.9)	(689,057)	(18.3)	(489,282)	(18.8)	(679,629)	(16.4)
Depreciation and amortization	(59,978)	(8.3)	(72,042)	(8.1)	(520,976)	(13.9)	(354,330)	(13.6)	(540,679)	(13.1)
Goodwill impairment	—	—	—	—	(19,251)	(0.5)	(19,251)	(0.7)	—	—
Net other operating income/(expenses)	(704)	(0.1)	12,762	1.4	(37,326)	(1.0)	(39,296)	(1.5)	(30,614)	(0.7)
Income from equity investees	96,635	13.4	124,625	14.0	465	0.0	1,295	0.0	12,942	0.3
Net gain/(loss) on disposal of subsidiaries	4,452	0.6	3,787	0.4	—	—	(941)	(0.0)	(1,862)	(0.0)
Operating income[(1)]	$ 240,886	33.4%	$ 295,770	33.3%	$ 1,105,743	29.4%	$ 761,383	29.2%	$ 1,306,545	31.6%
Interest income	1,812	0.3	1,622	0.2	19,341	0.5	14,743	0.6	17,370	0.4
Interest expense	(39,737)	(5.5)	(53,111)	(6.0)	(198,346)	(5.3)	(132,057)	(5.1)	(163,316)	(3.9)
Income tax	(29,170)	(4.0)	(43,398)	(4.9)	(290,933)	(7.7)	(200,343)	(7.7)	(326,141)	(7.9)
Foreign exchange gain/(loss)	2,482	0.3	5,113	0.6	(3,015)	(0.1)	3,671	0.1	9,496	0.2
Income from continuing operations before minority interest and cumulative effect of accounting changes	$ 176,273	24.5%	$ 205,996	23.2%	$ 632,790	16.8%	$ 447,397	17.2%	$ 843,954	20.4%
Minority interests	(28,953)	(4.0)	(35,109)	(3.9)	(402,120)	(10.7)	(303,454)	(11.6)	(471,761)	(11.4)
Gain/(loss) from discontinued operations	(5,886)	(0.8)	16,569	1.9	156,377	4.2	32,452	1.2	—	—
Cumulative effect of a change in accounting principle	(6,179)	(0.9)	(21,480)	(2.4)	—	—	—	—	(35,472)	(0.9)
Net income	$ 135,255	18.8%	$ 165,976	18.7%	$ 387,047	10.3%	176,395	6.8%	336,721	8.1%
OIBDA[(2)]	$ 300,864	41.8%	$ 367,812	41.4%	$ 1,626,719	43.3%	$1,115,713	42.8%	$ 1,847,224	44.7%

(1) Operating income is calculated as revenues less operating costs, plus income from equity investees and net gain or loss on sale of subsidiaries. Operating costs include costs of sales, selling, general and administrative expenses and depreciation and amortization, as well as other operating expenses (net of other operating income).

(2) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and services debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following tables set forth a summary of revenues and operating income by reporting segment for the years ended December 31, 2001, 2002 and 2003 and for the nine months ended September 30, 2003 and 2004. In our comparison of period-to-period results of operations, in order to analyze changes, developments and trends in revenues by reference to individual segment revenues, we present our revenues on an aggregated basis, which is revenues after elimination of intra-segment (between entities in the same segment) transactions, but before inter-segment (between entities in different segments) eliminations. Amounts attributable to individual companies, where appropriate, are shown prior to both intra-segment and inter-segment eliminations.

Revenues by segment:

	Year ended December 31,						Nine months ended September 30,			
	2001	% of revenues	2002	% of revenues	2003	% of revenues	2003	% of revenues	2004	% of revenues
	(Amounts in thousands, except percentages)									
Telecommunications	$421,156	58.5%	$482,723	54.3%	$3,247,568	86.4%	$2,272,764	87.1%	$3,350,379	81.0%
Technology	29,879	4.1	76,170	8.6	85,942	2.3	63,682	2.4	319,816	7.7
Insurance	89,960	12.5	140,735	15.8	187,929	5.0	133,178	5.1	201,160	4.9
Banking	19,072	2.6	36,660	4.1	57,513	1.5	40,063	1.5	49,220	1.2
Other Businesses[(1)]	171,076	23.7	181,094	20.4	249,658	6.6	153,139	5.9	283,096	6.8
Aggregated revenue	$731,143		$917,382		$3,828,610		$2,662,826		$4,203,671	
Eliminations[(2)]	(10,607)	(1.5)%	(27,876)	(3.1)%	(68,695)	(1.8)%	(54,229)	(2.1)%	(67,751)	(1.6)%
Total	$720,536	100.0%	$889,506	100.0%	$3,759,915	100.0%	$2,608,597	100.0%	$4,135,920	100.0%

(1) Other Businesses includes our real estate, retail and media businesses together with our other operations and central corporate functions.

(2) Eliminations of inter-segment revenue.

Operating income by segment:

	Year ended December 31,						Nine months ended September 30,			
	2001	% of operating income	2002	% of operating income	2003	% of operating income	2003	% of operating income	2004	% of operating income
	(Amounts in thousands, except percentages)									
Telecommunications	$236,002	98.0%	$279,837	94.6%	$1,103,282	99.8%	$769,408	101.1%	$1,291,462	98.8%
Technology	(639)	(0.3)	5,533	1.9	(3,348)	(0.3)	(351)	(0.0)	13,913	1.1
Insurance	(13,959)	(5.8)	2,583	0.9	17,111	1.5	10,479	1.4	14,372	1.1
Banking	5,979	2.5	8,804	3.0	2,567	0.2	6,174	0.8	14,687	1.1
Other Businesses[(1)]	15,179	6.3	(1,507)	(0.5)	(16,131)	(1.5)	(19,767)	(2.6)	(11,263)	(0.9)
Aggregated operating income	$242,562		$295,250		$1,103,481		$765,943		$1,323,171	
Eliminations[(2)]	(1,676)	(0.7)%	520	0.2%	2,262	0.2%	(4,560)	(0.6)%	(16,626)	(1.3)%
Total	$240,886	100.0%	$295,770	100.0%	$1,105,743	100.0%	$761,383	100.0%	$1,306,545	100.0%

(1) Other Businesses includes our real estate, retail and media businesses together with our other operations and central corporate functions.

(2) Eliminations of inter-segment operating income.

Nine months ended September 30, 2004 compared to nine months ended September 30, 2003

Revenues

Our aggregated revenue increased by 58.5% to $4,135.9 million for the nine months ended September 30, 2004 from $2,608.6 million for the nine months ended September 30, 2003.

The growth in our revenues was attributable to the growth in our Telecommunications Segment of $1,077.6 million, in our Technology Segment of $256.1 million, in our Insurance Segment of $68.0 million, in our Banking Segment of $9.2 million and in our Other Businesses Segment of $130.0 million.

Growth in revenues for the nine months ended September 30, 2004 compared with the nine months ended September 30, 2003 was primarily due to organic growth, as well as to acquisitions made subsequent to September 30, 2003, including Comstar, Primtelefon, Kvazar-Micro and Uzdunrobita, the results of which are only reflected in the current period. The consolidation of Comstar, Primtelefon, Kvazar-Micro and Uzdunrobita contributed $56.2 million, $45.3 million, $206.4 million and $41.4 million, respectively, to the increase in aggregated revenues for the nine months ended September 30, 2004. P-Com had revenues of $38.0 million in the nine months ended September 30, 2003, which is not included in aggregated revenues as of January 1, 2004. Organic growth in our aggregated revenues for the nine months ended September 30, 2003 was $1,216.0 million, or 79.6% of the overall growth.

The Telecommunications Segment continued to be the largest revenue contributor for the nine months ended September 30, 2004, though its share of the aggregated revenues decreased to 81.0% from 87.1% for the nine months ended September 30, 2003 due to accelerated growth and significant acquisitions in our other segments. In the nine months ended September 30, 2004, MTS and MGTS were the largest contributors to the growth of the Telecommunications Segment revenue. Revenues of MTS and MGTS grew by $910.7 million (exclusive of the effects of the acquisitions of Primtelefon and Uzdunrobita), and $64.4 million, or by 48.8% and 23.1%, respectively, over the nine months ended September 30, 2003. This increase was primarily due to the significant growth in MTS' subscriber base from 13.9 million as of September 30, 2003 to 26.6 million as of September 30, 2004. The increase in MGTS' revenues was primarily due to increases in subscription fees for residential and government subscribers that took effect in June and August 2003.

The increase in the revenues of our Technology Segment was primarily attributable to the organic growth of STROM telecom and Sitronics, as well as to the acquisition of Kvazar-Micro in July 2004. Revenues of STROM telecom and Sitronics for the nine months ended September 30, 2004 increased by $18.6 million and $11.9 million, or by 64.5% and 596.2%, respectively, compared with the nine months ended September 30, 2003. Revenues of STROM telecom increased mainly due to its sale of new billing systems to MTS and MGTS. Revenues of Sitronics increased as a result of increased production of consumer electronics under the Sitronics umbrella brand. The consolidation of Kvazar-Micro contributed $206.4 million to the increase in the aggregate revenues of our Technology Segment for the nine months ended September 30, 2004.

Revenues from our Insurance Segment grew by 51.0% for the nine months ended September 30, 2004, compared with the nine months ended September 30, 2003 due to ROSNO's promotion of new insurance products and the expansion of its client base in line with the overall growth of the insurance market in Russia.

Our real estate, tourism and retail businesses were the largest contributors to the organic growth in our Other Businesses Segment, with increases in revenue of $76.8 million, $23.9 million and $15.7 million, respectively, for the nine months ended September 30, 2004, compared with the same period in 2003. Our real estate business revenues increased as a result of the sale of completed office buildings and residential property in Moscow. The revenues of our tourism business increased primarily due to an increase in the number of Intourist's customers during the period.

Operating costs

Operating costs include costs of sales, selling, general and administrative expenses and depreciation and amortization, as well as other operating expenses (net of other operating income).

For the nine months ended September 30, 2004, our cost of sales increased as a percentage of revenues to 38.4% from 36.2% for the nine months ended September 30, 2003, primarily as a result of the consolidation of the low-margin Kvazar-Micro business, partially offset by a decrease in the cost of sales, as percentage of revenues, in MTS.

Our selling, general and administrative expenses decreased to 16.4% of revenue for the nine months ended September 30, 2004 from 18.8% of revenue for the nine months ended September 30, 2003 primarily due to the slower growth of general and administrative expenses of MTS compared with the growth of its revenues for the same period, resulting from economies of scale. Depreciation and amortization expenses remained stable and decreased slightly to 13.1% of revenues for the nine months ended September 30, 2004 from 13.6% of revenue for the nine months ended September 30, 2003.

An impairment provision of $19.3 million was recorded for the nine months ended September 30, 2003 as a result of the impairment of goodwill attributable to P-Com.

Operating income

Operating income is revenues less operating costs, plus income from equity investees and net gain or loss on disposal of subsidiaries.

Our consolidated operating income margin increased to 31.6% of revenues for the nine months ended September 30, 2004, compared with 29.2% of revenue for the nine months ended September 30, 2003. The increase in operating income margin was primarily attributable to MTS. MTS' operating income margin increased to 41.1% for the nine months ended September 30, 2004 from 36.0% for the nine months ended September 30, 2003 primarily due to lower interconnection and line rental charges payable to other operators for access to their networks compared to MTS' increasing revenues. MTS contributed $1,176.6 million, or 90.1% of aggregated operating income, for the nine months ended September 30, 2004.

Interest

Our consolidated interest expense for the nine months ended September 30, 2004 increased by 23.7% to $163.3 million from $132.1 million for the nine months ended September 30, 2003, primarily as a result of an increase in our debt related to MTS' issuance of $300.0 million notes in August 2003 and $400.0 million notes in October 2003, and Sistema Capital's issuance of $350.0 million notes in January 2004, partially offset by the repayment of MTS' Floating Rate Notes in May 2004.

Income tax

Our consolidated provision for income taxes for the nine months ended September 30, 2004 increased by 62.8% to $326.1 million from $200.3 million for the nine months ended September 30, 2003. Our effective tax rate for the nine months ended September 30, 2004 decreased to 27.9%, compared to 30.9% for the nine months ended September 30, 2003 mainly as a result of the relatively lower amount of non tax deductible expenses as a percentage of pre-tax income incurred during the nine months ended September 30, 2004 as compared with the nine months ended September 30, 2003.

Net income from continuing operations before minority interest and cumulative effect of accounting changes

Consolidated net income from continuing operations prior to minority interest and cumulative effect of accounting changes increased by 88.6% to $844.0 million for the nine months ended September 30, 2004 from $447.4 million for the nine months ended September 30, 2004. To arrive at this measure, we add interest income and foreign exchange gain to, and deduct interest expense and income taxes from, operating income. Net income margin was 20.4% for the nine months ended September 30, 2004, compared with 17.2% for the nine months ended September 30, 2003. MTS was the most significant contributor to the increase in the net income margin for the nine months ended September 30, 2004.

Minority interests

Minority interests in net income of our subsidiaries for the nine months ended September 30, 2004 increased to $471.8 million from $303.5 million for the nine months ended September 30, 2003 primarily due to the increase of net income attributable to MTS.

Year ended December 31, 2003 compared to year ended December 31, 2002

Revenues

Our aggregated revenue increased by 317.3%, to $3,828.6 million, in 2003 from $917.4 million in 2002.

The consolidation of MTS, combined with the acquisitions by MTS of UMC, TAIF Telcom, Sibchallenge and Tomsk Cellular Communications, effective January 1, 2003, contributed $2,638.2 million, before intra-segment eliminations of $37.5 million, to the increase of our consolidated revenues for the year ended December 31, 2003. We consolidate revenues and expenses of newly acquired subsidiaries starting from the beginning of the year when control was acquired (with pre-acquisition earnings included in minority interest in the statement of operations), while MTS consolidates them from the date of their acquisition. This difference in accounting policies results in MTS' standalone reporting revenues being lower by $92.0 million and operating income being lower by $31.4 million than the respective amounts included in our consolidated financial statements for MTS for the year ended December 31, 2003.

The acquisition of Comstar, completed in the fourth quarter of 2003, contributed $66.5 million to the revenues of our Telecommunications Segment for the year ended December 31, 2003.

Prior to 2003, most of our radio and space technology business entities operated under governmentally imposed restrictions. Such restrictions precluded consolidation of these entities in our financial statements. In those periods, we accounted for investments in radio and space technology business entities at the cost of acquisition, net of impairment charges. In 2003, most of these restrictions were waived (except as relates to NIIDAR, a Research and Development Institute of Long-Distance Radio Communications), and we began consolidating operations of the radio and space technology business with effect from January 1, 2003 (except for operations of NIIDAR, which continues to be accounted for at cost, net of impairment charges). Revenues and net income of the radio and space technology business for the year ended December 31, 2003 amounted to $29.2 million and $1.0 million, respectively.

The organic growth in our aggregated revenues was $244.3 million, or 26.6%, compared to 2002 aggregated revenues. The increase was attributable to increases in the revenues of our Telecommunications Segment (excluding MTS and Comstar) of $122.3 million, in our Insurance Segment of $47.2 million, in our Technology Segment (excluding Mikron-Energo) of $14.6 million, in our Banking Segment of $20.9 million and in our Other Businesses Segment (excluding the radio and space technology business) of $39.4 million.

The Telecommunications Segment continued to be the largest revenue contributor during the year ended December 31, 2003. The segment's share of revenues was 86.4% in the year ended December 31, 2003, increasing from 54.3% for the year ended December 31, 2002 primarily due to the consolidation of MTS. In the year ended December 31, 2003, MGTS was the largest contributor to the organic growth of the Telecommunications Segment revenue. Revenues of MGTS grew by $80.0 million, or 26.6%, over the same period in 2002, primarily due to increases in subscription fees for residential and government subscribers that took effect in November 2002 and in June 2003.

Insurance Segment revenues grew by $47.2 million, or 33.5%, as we continued to develop and promote new insurance products and to expand our client base.

The increase in operational volumes in our Banking Segment resulted in revenues of $57.5 million in 2003, an increase of $20.9 million, or 57.1%, compared to revenues of $36.6 million in 2002.

Operating costs

For the year ended December 31, 2003, cost of sales decreased as a percentage of revenues to 36.9% from 58.6% for the year ended December 31, 2002 primarily as a result of the consolidation of MTS.

MTS' and Comstar's cost of sales for the year ended December 31, 2003 were $781.5 million and $31.1 million, respectively, representing 29.6% and 46.7% of their revenues. Cost of sales, exclusive of the effects of the acquisitions of MTS and Comstar, for the year ended December 31, 2003 amounted to 54.5% and 58.6% of their revenues, respectively. In dollar terms, operating costs, exclusive of the effects of the acquisitions of MTS and Comstar, increased due to increased selling, general and administrative expenses, primarily attributable to salary growth, increased depreciation and amortization due to our increased capital expenditure program over the past several years and an impairment provision of $19.3 million, recorded as a result of the impairment of goodwill attributable to P-Com.

Income from equity investees

Income from equity investees totaled $0.5 million for the year ended December 31, 2003, compared to income attributable to our investment in MTS and Comstar in 2002 of $123.0 million and $2.0 million, respectively. As a result of our acquisitions of controlling interests in these entities during 2003, we changed the accounting treatment for our interests in MTS and Comstar from the equity method to consolidation.

Operating income

As a result of the change in the accounting treatment of our investment in MTS from the equity method in 2002 to consolidation in 2003, our operating income margin decreased to 29.4% of revenues in 2003, compared with 33.3% in 2002. Primarily due to the consolidation of MTS, operating income increased to $1,105.7 million for the year ended December 31, 2003, compared to $295.8 million for 2002.

MTS and Comstar contributed $954.0 million and $4.8 million, respectively, to our operating income for the year ended December 31, 2003. Operating income, exclusive of the effects of the acquisitions of MTS and Comstar, decreased by 14.0% to $146.9 million for the year ended December 31, 2003, compared to $170.8 million for the year ended December 31, 2002, and operating income margin, exclusive of the effects of the acquisitions of MTS and Comstar, decreased from 19.2% for the year ended December 31, 2002 to 13.9% for the same period of 2003. This decrease was attributable primarily to an impairment provision of $19.3 million, recorded as a result of the impairment of goodwill attributable to P-Com, and to losses of $8.6 million from damage to Telmos' and MGTS' equipment resulting from a fire at one of MGTS' switching stations, which were charged to operating expenses.

Interest

For the year ended December 31, 2003, total interest expense was $198.3 million, an increase of 273.5% over $53.1 million in the same period in 2002. The consolidation of MTS contributed $109.0 million to the increase of the interest expense. The increase of the interest expense in our other businesses was attributable primarily to the higher debt levels required to finance acquisitions and our capital expenditure programs for the year ended December 31, 2003. Interest income for the year ended December 31, 2003 increased to $19.3 million compared with $1.6 million for the year ended December 31, 2002. The increase was primarily attributable to the consolidation of MTS and the increase in income from short-term investments in promissory notes.

Income tax

Our effective tax rate for the year ended December 31, 2003 was 31.5%, compared to 17.4% in the year ended December 31, 2002. Our effective current tax rate (exclusive of the effects of deferred taxes) for these periods was 36.1% and 12.5%, respectively. The primary reason for the increase was the change in the accounting method for our investment in MTS, as income attributable to MTS for periods prior to 2003 was treated as dividend income and taxed at the rate of 6%. The effective tax rate and effective current tax rate for MTS for the year ended December 31, 2003 were 29.2% and 34.3%, respectively. Our other businesses contributed to higher consolidated effective tax rates in this period primarily due to an increase in non-deductible expenses, including goodwill impairment charges.

Net income from continuing operations before minority interest and cumulative effect of accounting changes

We recorded net income from continuing operations prior to minority interest and cumulative effect of accounting changes of $632.8 million in the year ended December 31, 2003, compared to $206.0 million in the year ended December 31, 2002. The net income margin was 16.8% in the year ended December 31, 2003, compared with 23.2% in the year ended December 31, 2002. Both the increase in net income and the decrease of the net income margin are primarily explained by the change in the accounting treatment for our investment in MTS.

Minority interests

Minority interests for the year ended December 31, 2003 increased to $402.1 million from $35.1 million for the year ended December 31, 2002, due to the consolidation of MTS' and Comstar's operations in our financial statements starting January 1, 2003. As a result of our acquisitions of controlling interests in these entities during 2003, we changed the accounting treatment for our interests in MTS and Comstar from the equity method to consolidation.

Year ended December 31, 2002 compared to year ended December 31, 2001

Revenues

Our aggregated revenue increased by 25.4%, to $917.4 million, in 2002 from $731.1 million in 2001. The growth in our revenues was attributable to increases in our Telecommunications Segment of $61.6 million, in our Insurance Segment of $50.8 million, in our Technology Segment of $46.3 million, in our Banking Segment of $17.6 million and in our Other Businesses Segment of $10.0 million.

Growth in revenues during 2002 was primarily due to organic growth, other than revenue attributable to the acquisitions of Golden Line and STROM telecom, which contributed \$11.8 million and \$10.1 million, respectively, to aggregated revenues in our Telecommunications Segment and Technology Segment, respectively, for the year ended December 31, 2002. Organic growth in aggregated revenues in 2002 was \$164.4 million, representing growth of 22.5%.

The Telecommunications Segment continued to be our largest revenue contributor during the year ended December 31, 2002. The segment's share of revenues was 54.3% in 2002, which is slightly lower than 58.5% in 2001 due to accelerated growth in our other segments. In 2002, MGTS was the largest contributor to the Telecommunications Segment revenue growth. Revenues of MGTS grew by \$26.7 million, or 9.7%, over the 2001 results, primarily due to increases in subscription fees for residential and government subscribers that took place in January and November 2002. In addition, 41.7% revenue growth at P-Com (our subsidiary during 2001-2003 and currently a subsidiary of Sky-Link) contributed \$13.1 million, or 21.3%, to the increase in the Telecommunications Segment revenues. Our fastest-growing telecommunications company was MTU-Intel, whose revenues grew by \$15.6 million, a growth of 113% in 2002 over 2001.

Insurance Segment revenues grew by \$50.8 million, or 56.4%, as we continued to develop and promote new insurance products and to expand our client base.

In our Banking Segment, we increased the capital of MBRD in December 2001 by purchasing its newly issued shares for \$66.1 million. The increase in operational volumes in our Banking Segment resulted in revenue growth of \$17.6 million, or 92.2%, to \$36.7 million in 2002.

Our Technology Segment also grew at a rapid rate over 2002, primarily due to revenue attributable to the acquisition of STROM telecom and to the introduction of new products in the semiconductor design and manufacturing division such as integrated circuits for radios. As a result, Technology Segment revenues grew by \$46.3 million, or 154.9%, to \$76.2 million in 2002.

The strongest growth in our Other Businesses Segment was in our retail business, which increased revenues by \$9.2 million in 2002.

Operating costs

For the year ended December 31, 2002, cost of sales decreased as a percentage of revenues to 58.6% from 59.0% for the year ended December 31, 2001. Operating costs increased due to increased selling, general and administrative expenses, primarily attributable to salary growth, and increased depreciation and amortization due to our increased capital expenditure program during 2001 and 2002.

Income from equity investees

Income from equity investees totaled \$124.6 million for the year ended December 31, 2002, an increase of 29.0% over 2001. This increase is primarily due to the increase in income attributable to our investment in MTS, which was \$123.0 million for 2002, compared to \$94.0 million for 2001.

Net gain/loss on disposal of subsidiaries

During 2002 and 2001, we disposed of certain non-core assets. These transactions resulted in a gain on disposal of \$3.8 million in 2002 and \$4.5 million in 2001.

Operating income

Operating income increased by 22.8%, to \$295.8 million, for 2002, compared to \$240.9 million for 2001. Our operating income margin decreased slightly to 33.3% of revenues in 2002, compared with

33.4% for 2001. The increases in income from equity investees offset increases in selling, general and administrative expenses and depreciation and amortization in the same period.

Interest

In 2002, total interest expense was $53.1 million, an increase of 33.7% over $39.7 million in 2001. This increase was attributable primarily to the higher debt levels required to finance acquisitions and our capital expenditure programs for 2002 and 2001.

Income tax

Our effective tax rate for the year ended December 31, 2002 was 17.4%, compared to 14.2% in the year ended December 31, 2001. Our effective current tax rate for these periods was 12.5% and 18.1%, respectively. The income tax chapter of the new tax code came into effect January 1, 2002. In accordance with the new legislation, the nominal tax rate decreased from 35% (43% for insurance companies and banks) to 24%. Income tax on dividends paid within Russia decreased from 15% to 6%, investment tax credits were disallowed and the tax loss carry-forward period was extended to ten years. The effect of the changes in the tax legislation was reflected in the statement of operations for the year ended December 31, 2002. The reduction in our effective current tax rate for the year ended December 31, 2002 was due to a decrease in non-deductible expenses, partially offset by the abolition of the investment tax credits.

The income from equity investees was 50.0% and 47.0% of our income before taxes for the year ended December 31, 2002 and 2001, respectively. The tax rate of 6% applies to this portion of our taxable income, as we receive this income through dividends.

Net income from continuing operations before minority interest and cumulative effect of accounting changes

We recorded net income from continuing operations prior to minority interest and cumulative effect of changes in accounting principles of $206.0 million in 2002, compared to $176.3 million in 2001. Net income margin was 23.2% for the year ended December 31, 2002, compared with 24.5% in the year ended December 31, 2001.

Minority interests

Minority interests for the year ended December 31, 2002 increased to $35.1 million from $29.0 million for the year ended December 31, 2001, primarily due to an increase in net income attributable to our subsidiaries MGTS and MTU-Inform.

Segment Financial Results Overview

The following analysis concentrates on our five reporting segments: Telecommunications, Technology, Insurance, Banking and Other Businesses. We include the discussion of our real estate, retail, media business and other operations as well as corporate functions, under the Other Businesses Segment.

Segment results are presented after elimination of intra-segment transactions, but prior to elimination of transactions between segments.

Telecommunications

We divide our Telecommunications Segment into two divisions: wireless services (MTS and our affiliate Sky-Link) and fixed line communications (MGTS and Comstar UTS).

The following table presents the results of operations for our Telecommunications Segment for the periods under review:

	Year ended December 31,						Nine months ended September 30,			
	2001	% of revenues	2002	% of revenues	2003	% of revenues	2003	% of revenues	2004	% of revenues
	(Amounts in thousands, except percentages)									
Revenues	$ 421,156	100.0%	$ 482,723	100.0%	$3,247,568	100.0%	$2,272,764	100.0%	$ 3,350,379	100.0%
Costs of sales, exclusive of depreciation and amortization shown separately below	(205,217)	(48.7)	(244,324)	(50.6)	(1,059,315)	(32.6)	(724,234)	(31.9)	(1,001,465)	(29.9)
Selling, general and administrative expenses	(17,412)	(4.1)	(26,443)	(5.5)	(539,010)	(16.6)	(389,496)	(17.1)	(532,971)	(15.9)
Depreciation and amortization	(53,646)	(12.7)	(62,357)	(12.9)	(506,644)	(15.6)	(345,861)	(15.2)	(529,710)	(15.8)
Goodwill impairment	—	—	—	—	(19,251)	(0.6)	(19,251)	(0.8)	—	—
Net other operating income/(expenses)	(4,755)	(1.1)	5,617	1.2	(20,505)	(0.6)	(25,718)	(1.1)	(4,910)	(0.1)
Income from equity investees	96,328	22.9	122,638	25.4	439	0.0	1,204	0.1	12,129	0.4
Net (loss)/gain on disposal of subsidiaries	(452)	(0.1)	1,983	0.4	—	—	—	—	(1,990)	(0.1)
Operating income	$ 236,002	56.0%	$ 279,837	58.0%	$1,103,282	34.0%	$ 769,408	33.9%	$ 1,291,462	38.5%
OIBDA[1]	$ 289,648	68.8%	$ 342,194	70.9%	$1,609,926	49.6%	$1,115,269	49.1%	$ 1,821,172	54.4%

(1) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and services debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

Nine months ended September 30, 2004 compared to nine months ended September 30, 2003

Revenues

Telecommunications Segment revenues increased by 47.4% for the nine months ended September 30, 2004 to $3,350.4 million compared to $2,272.8 million for the nine months ended September 30, 2003. MTS and MGTS were the principal contributors to the growth, with an increase in revenues of $997.4 million and $64.4 million, respectively.

In August 2004, we sold our 83.5% interest in P-Com to Sky-Link. Revenues of P-Com were excluded from our consolidated revenues from January 1, 2004, and our share in the earnings of P-Com for the nine months ended September 30, 2004 was recorded using the equity method of accounting. P-Com's revenues for the nine months ended September 30, 2003 were $38.0 million.

Wireless services

Revenues of MTS for the nine months ended September 30, 2004 were $2,865.1 million, an increase of 53.4% compared to $1,867.7 million for the nine months ended September 30, 2003. This increase was primarily due to the significant growth in MTS' subscriber base from 13.9 million as of

September 30, 2003 to 26.6 million as of September 30, 2004, including 20.8 million in Russia, 5.5 million in Ukraine and 0.3 million in Uzbekistan. A portion of the growth in the subscriber base was due to acquisitions during the nine months ended September 30, 2004, including Primtelefon and Uzdunrobita with subscriber bases of 0.2 million and 0.3 million, respectively. The growth was also attributable to MTS' sales and marketing efforts and the expansion of its network, as well as improving general economic conditions and income levels in Russia and Ukraine. The increase in revenues from subscriber growth was partially offset by a decrease in tariffs in the Moscow license area and other highly competitive license areas, an increase of mass-market subscribers in MTS' subscriber mix and its continuing expansion into the regions of Russia outside the Moscow license area where tariffs are lower. As a result, average monthly service revenue per subscriber in Russia decreased by 22.2% from $18 per subscriber for the nine months ended September 30, 2003 to $14 per subscriber for the nine months ended September 30, 2004.

For the nine months ended September 30, 2004, MTS' service revenues and connection fees increased by $992.2 million, or by 54.9%, to $2,797.7 million from $1,805.5 million for the nine months ended September 30, 2003 due to growth in the number of its subscribers, as explained above. Revenues from sales of handsets and accessories increased by $5.3 million, or 8.5%, for the nine months ended September 30, 2004, compared to the nine months ended September 30, 2003, due to growth of handset sales activity. This growth was partially offset by a decline in the average selling price for handsets.

During the nine months ended September 30, 2004, Sky-Link acquired our interest in P-Com, as well as a number of Svyazinvest's NMT-450 companies, and started providing services under the Sky-Link brand name. As of September 30, 2004, Sky-Link had 175,631 subscribers (including subscribers of MCC and Delta Telecom). Our share in Sky-Link earnings for the nine months ended September 30, 2004 was insignificant.

Fixed line communications

MGTS' revenues grew by 23.1% in the nine months ended September 30, 2004 to $343.8 million, compared to $279.4 million for the nine months ended September 30, 2003. Revenues from monthly subscription fees increased by 15.6% in nine months ended September 30, 2004, compared to the same period in 2003, and reached $170.1 million. This increase was primarily due to an increase in monthly subscription fees for residential and government subscribers effective June 2003 and August 2003, respectively, while the number of active subscribers increased by 1.3%, to 4.2 million. Revenues from local traffic fees, service activation fees and line rentals increased by 42.1% compared to the nine months ended September 30, 2003, to $107.8 million.

MGTS is not licensed to provide domestic long distance, international long distance or DLD/ILD telecommunications services directly to its subscribers, but must route such traffic through a DLD/ILD licensed operator. As a result, DLD/ILD traffic originated by MGTS subscribers is carried by Rostelecom, which bills MGTS subscribers directly. MGTS has a revenue sharing agreement with Rostelecom pursuant to which Rostelecom pays MGTS a portion of the DLD/ILD revenues generated by MGTS customers. This amount is periodically revised. MGTS' revenues from Rostelecom amounted to $21.3 million for the nine months ended September 30, 2004, compared to $17.7 million for the nine months ended September 30, 2003.

Revenues of MTU-Inform decreased in the nine months ended September 30, 2004 to $73.6 million, compared to $75.8 million during the same period in 2003 as a result of the decrease in tariffs on services provided to mobile operators.

Telmos' revenues grew by 32.7%, to $34.6 million, for the nine months ended September 30, 2004, compared with $26.1 million for the nine months ended September 30, 2003, primarily due to the negative effect of a temporary disruption in Telmos' services in February through April 2003 due to damage to its equipment caused by a fire. The increased traffic from fixed line operators also contributed to revenue growth. The number of active lines in service grew to 68,819 as of September 30, 2004, from 54,971 as of September 30, 2003.

MTU-Intel's revenues increased for the nine months ended September 30, 2004 due to growth in the number of active subscribers of ADSL Internet services. In February 2004, MTU-Intel introduced a new residential focused brand, STREAM, and reduced ADSL tariffs by 50%, which increased the number of subscribers as of September 30, 2004 by 581.1% to 99,441, compared to September 30, 2003. As a result, MTU-Intel's revenues grew by 34.7% from $33.3 million for the nine months ended September 30, 2003 to $44.8 million for the same period in 2004.

In addition, our consolidated results for the nine months ended September 30, 2004 included the results of Comstar. Comstar's results were not included in our consolidated results for the nine months ended September 30, 2003, as we acquired a controlling stake in Comstar in December 2003. Comstar contributed $56.2 million to our telecommunication revenues for the nine months ended September 30, 2004.

Operating income

The operating income margin of the Telecommunications Segment was 38.5% in the nine months ended September 30, 2004, compared to 33.9% in the nine months ended September 30, 2003. This growth was primarily attributable to the increase in the operating income margins of MTS and MGTS.

Wireless services

MTS' operations contributed $1,176.6 million to our operating income from wireless services for the nine months ended September 30, 2004.

MTS' operating income margin was 41.1% for the nine months ended September 30, 2004, compared to 36.0% for the nine months ended September 30, 2003. The increase in MTS' operating income margin is due to lower interconnection and line rental charges payable to other operators for access to their networks relative to increasing revenues. With the expansion of MTS' network, more calls are placed and completed solely within its network, thereby avoiding the need to pay such charges to other operators while still fully earning the related revenues from such calls. The increase in MTS' operating income margin was also affected by the lower costs of leasing telecommunication lines compared with MTS' increasing revenues as it builds out its own fiber-optic network in its license areas.

P-Com contributed $6.9 million to our operating income for the nine months ended September 30, 2003.

Fixed line communications

MGTS' operating income margin for the nine months ended September 30, 2004 was 19.9%, compared with 22.8% for the nine months ended September 30, 2003, primarily due to a new property tax payable on its cable network as a result of changes in Russian tax legislation effective January 1, 2004. Operating costs increased by $59.7 million, or 27.7%, for the nine months ended September 30, 2004.

MTU-Inform's operating income margin decreased to 41.7% for the nine months ended September 30, 2004, compared with 50.4% in the same period in 2003. The lower operating income margin in the nine months ended September 30, 2004 was attributable primarily to the decreased tariffs charged to mobile operators to maintain competitive prices.

Comstar contributed $4.1 million to our operating income from traditional telephone services for the nine months ended September 30, 2004. Its operating income margin was 7.3% for this period.

Costs of goods and services sold by Telmos reached $17.1 million, or 49.4% of revenues, for the nine months ended September 30, 2004, compared to $15.2 million, or 58.1% of revenues, for the same period in 2003. Telmos' operating income increased to $5.4 million for the nine months ended September 30, 2004, compared to an operating loss of $3.5 million in the same period of 2003 attributable to damage to its equipment and temporary disruption of services caused by a fire in 2003. Telmos' operating margin was 15.7% in the nine months ended September 30, 2004.

The increase in the number of MTU-Intel subscribers was partially offset by a continued reduction in tariffs in 2004 for corporate and residential subscribers. Operating costs were $44.4 million in the nine months ended September 30, 2004, or 99.1% of revenues, compared with $35.3 million, or 105.9% of revenues, in the same period in 2003. The operating margin improved as the cost of data transmission services provided by MGTS increased at a lower rate than revenues.

Income from equity investees

Income from equity investees accounted for $12.1 million and $1.2 million for the nine months ended September 30, 2004 and 2003, respectively. The increase in income from equity investees is primarily attributable to the increase in the net income of MTS Belarus.

Year ended December 31, 2003 compared to year ended December 31, 2002

Revenues

The acquisition of a controlling stake in, and consolidation of MTS and Comstar effective January 1, 2003, contributed $2,704.7 million, before intra-segment eliminations of $51.8 million, to the increase in our Telecommunications Segment revenues for the year ended December 31, 2003.

Segment revenues grew by $2,764.8 million in 2003, to $3,247.6 million, compared with $482.7 million in 2002. Apart from the effect of the consolidation of MTS and Comstar, MGTS was the principal contributor to the growth with increased revenues of $80.0 million in 2003. Organic growth of our Comstar UTS subsidiaries (excluding Comstar) contributed $29.1 million to the overall increase in revenues. Without the contribution resulting from the consolidation of MTS and Comstar, revenues of our Telecommunications Segment grew by $111.9 million, or 23.2%, compared to 2002.

Wireless services

The consolidation of MTS, combined with the acquisitions by MTS of additional mobile operators in Ukraine and in the Russian regions, effective January 1, 2003, contributed $2,638.2 million to the increase in our consolidated revenues from wireless services for the year ended December 31, 2003.

P-Com (our subsidiary during 2001-2003, currently a subsidiary of Sky-Link) increased its revenues by 15.3% to $51.3 million for the year ended December 31, 2003 from $44.5 million in 2002. This increase was mostly attributable to a larger client base, which grew by 10.2% to 86,800 subscribers as of December 31, 2003. The growth in subscribers was attributable to an aggressive marketing campaign, network investments and enhanced service quality.

Fixed line communications

MGTS' revenues grew by 26.6% in the year ended December 31, 2003, to $380.4 million, compared to $300.3 million for the year ended December 31, 2002. Revenues from monthly subscription fees increased by 32.6% in 2003 compared to 2002, and reached $198.8 million. This increase was primarily due to an increase in monthly subscription fees for residential and government subscribers effective November 2002 and June 2003, respectively, while the number of active subscribers increased by 1.1%, to 4.1 million. Revenues from local traffic fees, service activation fees and line rentals increased by 20.7% compared to 2002, to $103.5 million.

MGTS' revenues from Rostelecom amounted to $24.7 million for the year ended December 31, 2003, compared to $21.2 million for the year ended December 31, 2002.

Revenues of MTU-Inform increased in the year ended December 31, 2003 to $101.3 million, compared to $92.3 million during the year ended December 31, 2002 due to an increased number of active lines in service.

Despite the temporary disruption in Telmos' services in February to April 2003 as a result of damage to equipment caused by a fire, its revenues grew by 2.2%, to $37.5 million, in 2003, compared with $36.7 million in 2002. The revenue growth was due to increased traffic from fixed line operators. The number of active lines in service grew to 57,609 at December 31, 2003, from 51,690 at December 31, 2002.

MTU-Intel's revenues increased in 2003 due to strong growth in the number of subscribers of ADSL Internet services, which increased by 449.0%, compared to 2002. This increase was partially offset by tariff reductions. As a result, MTU-Intel revenues grew by 57.0%, from $29.4 million in 2002 to $46.1 million in 2003.

Income from equity investees

Income from equity investees amounted to $0.4 million and $122.6 million (including $123.0 million from our equity investment in MTS) for the years ended December 31, 2003 and 2002, respectively. The decrease in 2003 was due to the consolidation of MTS with effect from January 1, 2003.

Operating income

The operating income margin of the Telecommunications Segment was 34.0% in the year ended December 31, 2003, compared to 58.0% in 2002, primarily as a result of the consolidation of MTS.

MTS, with an operating income margin of 36.2%, contributed $954.0 million to our Telecommunications Segment operating income in 2003. In addition, the Comstar acquisition contributed $4.8 million to our operating income for this period. Operating income for our other telecommunication businesses was $144.5 million for the year ended December 31, 2003, compared to $157.6 million in 2002. A decrease in the operating income of our other telecommunications businesses was primary attributable to an impairment provision of $19.3 million, recorded as a result of the impairment of goodwill attributable to P-Com, and to losses of $8.6 million from damage to Telmos' and MGTS' equipment resulting from a fire in one of MGTS' switching stations, which were charged to operating expenses. An increase in selling, general and administrative expenses of $40.0 million, or 151.5%, was mostly driven by an increase in salaries, advertising and insurance costs. An increase in depreciation and amortization of $20.3 million, or 32.5%, resulted from increased capital expenditures during the 2003.

Wireless services

MTS' operations contributed $954.0 million to our operating income from wireless services for the year ended December 31, 2003.

In May 2003, we decided to curtail further investments in P-Com. Concurrently, we recorded an impairment charge of $19.3 million related to the impairment of goodwill attributable to P-Com as a part of operating expenses. Excluding the impairment provision, P-Com contributed $7.6 million to our Telecommunications Segment operating income in the year ended December 31, 2003, compared to $9.6 million in 2002. P-Com's operating income margin decreased to 14.8% in the year ended December 31, 2003 from 21.6% in 2002 due to an increase in advertising expenses and tariff reductions.

Fixed line communications

MGTS' operating income margin in 2003 was 22.9%, compared with 23.3% in 2002. Operating costs and expenses increased by $63.6 million, or 27.5%, in 2003. Increase in personnel costs, repair and maintenance expenses, insurance expenses and depreciation and amortization contributed to the increase in operating costs and expenses and to the decline of MGTS' standalone operating income margin.

MTU-Inform's operating income margin increased to 48.3% for the year ended December 31, 2003, compared with 41.1% in 2002. The higher operating income margin in 2003 resulted from an 8.3% increase in the number of active lines in service and a concurrent 9.6% increase in revenues.

In February 2003, a fire occurred in one of MGTS' switching stations, damaging approximately 40,000 telephone lines. In addition to disrupting part of MGTS' network, equipment of certain alternative fixed line communications providers was also affected, including that of Telmos, MTU-Inform and MTU-Intel. In particular, 40,000 out of Telmos' 50,000 telephone lines were damaged. Damage from the fire was recorded in other operating expenses in the amount of $8.6 million.

Comstar contributed $4.8 million to our operating income from traditional telephone services for the year ended December 31, 2003. Costs of sales by Comstar reached $31.1 million, or 46.7%, of revenues in 2003. Operating income margin was 7.3% for the year ended December 31, 2003.

Costs of sales by Telmos reached $23.6 million, or 62.7% of revenues, for the year ended December 31, 2003, compared to $15.6 million, or 42.5% of revenues, for the year ended December 31, 2002 as a result of an increased proportion of revenues from other operations. Telmos experienced operating losses of $2.4 million as a result of changes in its business mix and damage to its equipment and temporary disruption of services caused by a fire. Telmos' operating margin was 16.8% in the year ended December 31, 2002.

The growth in revenues of MTU-Intel was partially offset by a reduction in tariffs for corporate and residential subscribers. Costs of sales were $34.4 million in 2003, or 74.7% of revenues, compared with $22.8 million, or 77.6% of revenues, in 2002.

Year ended December 31, 2002 compared to year ended December 31, 2001

Revenues

Overall, the segment achieved 14.6% revenue growth for the year ended December 31, 2002, with an increase of $61.6 million, to $482.7 million, compared with $421.2 million in 2001. MGTS was the principal contributor to the growth with an increase in revenues of $26.7 million. Telecommunications Segment revenues from existing operations (excluding Golden Line) grew by 11.8% compared to 2001.

Wireless services

P-Com increased its revenues by 41.7% to $44.5 million for the year ended December 31, 2002 from $31.4 million in 2001. This increase was attributable to a larger client base, which grew by 40.2% to 78,800 subscribers as of December 31, 2002, though this increase was partially offset by tariff reductions. The growth in subscribers was attributable to an aggressive marketing campaign, network investments and enhanced service quality.

Fixed line communications

MGTS' revenues grew by 9.5%, to $300.3 million in the year ended December 31, 2002 compared to $274.4 million in the year ended December 31, 2001. Revenues from monthly subscription fees increased by 17.2% in 2002 compared to 2001, and reached $150.0 million. This increase was primarily due to an increase in monthly subscription fees for residential and government subscribers effective January and November 1, 2002, respectively, while the number of active subscribers increased by 2.2% during 2002. Revenues from local traffic fees, service activation fees and rent of lines increased by 16.1% compared to 2001, to $85.7 million.

MGTS' revenues from Rostelecom amounted to $21.2 million for the year ended December 31, 2002, compared to $32.5 million for the year ended December 31, 2001, when the terms of the revenue sharing agreement between MGTS and Rostelecom were more favorable to MGTS.

Revenues of MTU-Inform increased in the year ended December 31, 2002 to $92.3 million, compared to $91.4 million during the year ended December 31, 2001, due to an increased number of active lines in service.

Telmos' revenues grew 8.4%, to $36.7 million in 2002, compared with $33.9 million in 2001. The revenue growth resulted from increased traffic from existing clients, increased subscription and connection fees and a growing number of corporate subscribers, partially offset by decreased tariffs in order to maintain competitive prices. The number of active lines in service grew to 51,690 at December 31, 2002, from 43,586 at December 31, 2001.

MTU-Intel's revenues increased in 2002 due to strong growth in the number of active subscribers to both dial-up and ADSL Internet services, which increased to 356,407 and 8,430 subscribers, respectively, compared to 258,082 and 3,269, respectively, in 2001. We started to provide ADSL Internet services to residential subscribers in 2002. The increase in our revenues was mainly attributable to this service, partially offset by tariff reductions. As a result, MTU-Intel revenues grew by 113.0% from $13.8 million in 2001 to $29.4 million in 2002.

In addition, starting from January 1, 2002, Golden Line's results have been consolidated in our financial statements. For the year ended December 31, 2002, Golden Line contributed $11.8 million to our Telecommunications Segment revenues.

Income from equity investees

Income from equity investees, primarily attributable to MTS, amounted to $122.6 million for the year ended December 31, 2002. Income from MTS increased by 30.9%, from $94.0 million in 2001 to $123.0 million in 2002.

Operating income

The operating income margin of the Telecommunications Segment was 58.0% for the year ended December 31, 2002, compared to 56.0% in 2001. Income from our investment in MTS contributed $123.0 million, or 44.0%, to operating income in 2002, compared to $94.0 million, or 39.8%, in 2001, representing a 30.9% increase over 2001. Operating income margin without the effect of income from the investment in MTS would have decreased to 32.5% in 2002 from 33.7% in 2001. An increase in costs of sales by $39.1 million, or 19.1%, was mostly driven by an increase in MGTS' costs. An increase in depreciation and amortization of $8.7 million, or 16.2%, resulted from increased capital expenditures in 2002 and the fourth quarter of 2001, as well as from the Golden Line acquisition.

Wireless services

P-Com's operations contributed $9.6 million, or 3.4%, to our Telecommunications Segment operating income in 2002, compared to $3.7 million, or 1.6%, in 2001. P-Com's operating income margin grew to 21.6% in 2002 from 11.9% in 2001 due to a 40.2% increase in the number of subscribers.

Fixed line communications

MGTS' operating income margin in 2002 was 23.3%, compared with 24.6% in 2001. Operating costs and expenses increased by $23.9 million, or 11.5%, in 2002. Increases in personnel costs, repair and maintenance expenses, insurance expenses and depreciation and amortization contributed to the decline of MGTS' standalone operating income margin.

MTU-Inform's operating income decreased to $27.5 million, or 29.8% of revenues, in 2002, from $50.7 million, or 55.5% of revenues, in 2001. Lower operating income margins in 2002 were due to a reduction of tariffs charged by MTU-Inform to mobile operators, and an increase of tariffs charged to MTU-Inform for line rental (primarily by MGTS), partially offset by a concurrent increase in traffic.

Costs of sales at Telmos reached $15.6 million, or 42.5% of revenues, for the year ended December 31, 2002, compared to $13.3 million, or 39.1% of revenues, for the year ended December 31, 2001. Telmos' operating margin slightly decreased due to the reduction of its tariffs, partially offset by an increase in traffic. Telmos' operating margin was 16.8% and 17.8% in 2002 and 2001, respectively.

MTU-Intel experienced a substantial increase in the number of dial-up subscribers, by 98,325, and of ADSL subscribers, by 5,161, during the year ended December 31, 2002. The resulting revenue growth was partially offset by a reduction in tariffs for corporate subscribers. Costs of sales were $22.7 million in 2002, or 77.2% of revenues, compared with $10.4 million, or 74.9% of revenues, in 2001.

Technology

As of September 30, 2004, our subsidiaries in the Technology Segment operated along four main divisions: telecommunications equipment manufacturing and software (STROM telecom and its subsidiaries), semiconductor design and manufacturing (Mikron, VZPP-Mikron, NIITM and ICM), electronic devices and consumer electronics (Sitronics, Elion and Elaks) and IT and systems integration (Kvazar-Micro). We added the fourth business division, IT and systems integration, in July 2004 through our acquisition of Kvazar-Micro, a company based in Ukraine with a presence throughout Eastern Europe. Kvazar-Micro, STROM telecom and Micron were the largest sources of revenue in the Technology Segment for the nine months ended September 30, 2004.

The following table presents the operating results of our Technology Segment for the periods under review:

	Year ended December 31,						Nine months ended September 30,			
	2001	% of revenues	2002	% of revenues	2003	% of revenues	2003	% of revenues	2004	% of revenues
	(Amounts in thousands, except percentages)									
Revenues	$ 29,879	100.0%	$ 76,170	100.0%	$ 85,942	100.0%	$ 63,682	100.0%	$ 319,816	100.0%
Costs of sales, exclusive of depreciation and amortization shown separately below	(19,542)	(65.4)	(50,009)	(65.7)	(64,162)	(74.7)	(47,228)	(74.2)	(275,306)	(86.1)
Selling, general and administrative expenses	(6,988)	(23.4)	(23,511)	(30.9)	(20,269)	(23.6)	(12,930)	(20.3)	(25,335)	(7.9)
Depreciation and amortization	(1,909)	(6.4)	(2,919)	(3.8)	(2,862)	(3.3)	(2,084)	(3.3)	(2,249)	(0.7)
Net other operating income/(expenses)	(2,079)	(7.0)	3,699	4.9	(1,997)	(2.3)	(1,791)	(2.8)	(1,827)	(0.6)
Net gain/(loss) on disposals of subsidiaries	—	—	2,103	2.8	—	—	—	—	(1,186)	(0.4)
Operating income/(loss)	$ (639)	(2.1)%	$ 5,533	7.3%	$ (3,348)	(3.9)%	$ (351)	(0.6)%	$ 13,913	4.4%
OIBDA[(1)]	$ 1,270	4.3%	$ 8,452	11.1%	$ (486)	(0.6)%	$ 1,733	2.7%	$ 16,162	5.1%

(1) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and therefore comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur and services debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

Nine months ended September 30, 2004 compared to nine months ended September 30, 2003

Revenues

The revenues of our Technology Segment increased by $256.1 million, or by 402.2%, to $319.8 million during the nine months ended September 30, 2004. The acquisition of a controlling stake and consolidation of Kvazar-Micro revenues effective January 1, 2004 contributed $206.4 million to the increase of our Technology Segment revenues. Exclusive of the effects of the Kvazar-Micro acquisition, segment revenues would have increased by $49.7 million, or 78.0%, for the nine months ended September 30, 2004. Revenues of the telecommunications equipment manufacturing and software division grew by 64.5% to $47.6 million (including $33.3 million in sales to our Telecommunication Segment), or 41.9% of the total segment revenues, net of the effects of the Kvazar-Micro acquisition, in the nine months ended September 30, 2004, compared to $28.9 million (including $24.7 million in sales to our Telecommunication Segment), or 45.4% of the segment revenues in the nine months ended September 30, 2003. Revenues of the semiconductor design and manufacturing division grew by 23.4% to $36.8 million, or 32.5% of segment revenues, net of the effects of the Kvazar-Micro acquisition and intra-segment sales, in the nine months ended September 30, 2004 compared to $29.9 million, or 46.9% of the segment revenues in the nine months ended September 30, 2003. The electronic devices and consumer electronics division showed significant growth in the nine months ended September 30, 2004, with revenues increasing to $27.2 million, or 24.0% of the segment revenues, net of the effects of the Kvazar-Micro acquisition, from $4.4 million, or 6.9% of the segment revenues, for the same period in 2003. The increase of revenues in the electronic devices and consumer electronics division was primarily attributable to the increased production of consumer electronics under the Sitronics umbrella brand during the first nine months of 2004.

Operating income

Operating income increased to $13.9 million, or 4.4% of segment revenues, for the nine months ended September 30, 2004 from an operating loss of $0.4 million in the same period of 2003. The consolidation of the low-margin Kvazar-Micro business contributed $0.2 million to the operating income for the nine months ended September 30, 2004. The increase in operating income was primarily attributable to the sales of telecommunications equipment to our Telecommunication Segment, which contributed $11.7 million to the operating income of the Technology Segment for the nine months ended September 30, 2004. Net of the effects of the Kvazar-Micro acquisition, cost of sales increased by 58.2%, to $74.7 million, for the nine months ended September 30, 2004 compared to $47.2 million for the same period in 2003. Selling, general and administrative expenses decreased as a percentage of sales, net of the effects of the Kvazar-Micro acquisition, to 17.7% for the nine months ended September 30, 2004 from 20.3% for the same period in 2003 mainly due to the increased volume of production and sales.

Year ended December 31, 2003 compared to year ended December 31, 2002

Revenues

The revenues of our Technology Segment increased by $9.8 million, or 12.8%, to $85.9 million during the year ended December 31, 2003, compared to 2002. Exclusive of the effects of the Mikron-Energo disposition, segment revenues would have increased by $14.6 million, or 20.4%, compared to the same period in 2002. The semiconductor design and manufacturing division's revenues increased by 3.7% from $39.7 million, or 55.6% of the segment revenues (excluding Mikron-Energo), to $41.2 million, or 48.0% of the segment revenues, in 2003. The revenues of the telecommunications equipment manufacturing and software division increased by 34.1% to $37.3 million, or 43.5% of the segment revenues, in 2003 compared to $27.8 million, or 39.0% of the segment revenues (excluding Mikron-Energo), in 2002. The revenues from the electronic devices and consumer electronics division (primarily from sales of products under the Sitronics brand) increased to $7.4 million, or 8.6% of the segment revenues, in 2003, compared to $4.9 million, or 6.9% of the segment revenues, in 2002.

Operating income

Operating income decreased from $5.5 million in 2002 to an operating loss of $3.3 million in 2003. Costs of sales increased by 36.4% to $64.2 million in 2003, due to increased volumes of production in all divisions of the segment. Selling, general and administrative expenses decreased from $21.8 million, or 30.5% of sales, in 2002 to $20.3 million, or 23.6% of sales, in the year ended December 31, 2003.

Year ended December 31, 2002 compared to year ended December 31, 2001

Revenues

The revenues of our Technology Segment increased by $46.3 million, or 154.9%, to $76.2 million during the year ended December 31, 2002, compared to 2001. The consolidation of STROM telecom, with effect from January 1, 2002, added $27.7 million to segment revenues, including $17.6 million in revenues from sales to our Telecommunications Segment. Exclusive of the effects of the STROM telecom acquisition, segment revenues increased by $18.5 million, or 61.8%, compared with 2001. The semiconductor design and manufacturing division's standalone revenues grew by 45.5% to $39.7 million in 2002, compared to $27.3 million in 2001. The revenues from the electronic devices and consumer electronics division were $9.7 million, or 12.7% of the segment revenues, in 2002, compared to $2.1 million, or 7.0% of the segment revenues, in 2001. In 2002, we launched Sitronics, our umbrella brand in consumer electronics. Sitronics' contribution to revenues was marginal due to its startup stage status.

Operating income/(loss)

Operating income improved from an operating loss of $0.6 million in 2001 to operating income of $5.5 million in 2002. Costs of sales, exclusive of the effects of the STROM telecom acquisition, increased by 52.4%, to $29.8 million, in 2002, due to increased production volumes, both in the semiconductor design and manufacturing division and the electronic devices and consumer electronics division. Selling, general and administrative expenses, exclusive of the effects of the STROM telecom acquisition, increased from $7.0 million, or 23.4% of sales, in 2001 to $18.8 million, or 38.9% of sales, in 2002 due to our decision to increase allowances for doubtful receivables, including the allowance for the reimbursable VAT on export sales.

In 2002, Mikron completed negotiations with Hua Ko, a 50% shareholder of Corona Semiconductors, to resolve a dispute related to prior supplies of equipment and finished goods between the parties. These negotiations resulted in a reduction of Mikron's debt to Hua Ko and recognition of a gain of $2.0 million, recorded in other operating income.

Insurance

Our Insurance Segment is represented by ROSNO. ROSNO's principal activities are non-life and life insurance, as well as insurance-related services, such as obligatory insurance. ROSNO's corporate clients are primarily in the telecommunications, oil and gas, banking, retail and manufacturing sectors.

The following table presents the results of operations of our Insurance Segment for the periods under review:

	Year ended December 31,						Nine months ended September 30,			
	2001	% of revenues	2002	% of revenues	2003	% of revenues	2003	% of revenues	2004	% of revenues
	(Amounts in thousands, except percentages)									
Revenues from financial services	$ 89,960	100%	$ 140,735	100.0%	$ 187,929	100.0%	$133,178	100%	$ 201,160	100%
Financial services related costs, exclusive of depreciation and amortization shown separately below	(73,777)	(82.0)	(103,086)	(73.2)	(118,805)	(63.2)	(86,451)	(64.9)	(137,875)	(68.5)
Selling, general and administrative expenses	(23,315)	(25.9)	(32,928)	(23.4)	(48,280)	(25.7)	(33,612)	(25.2)	(46,505)	(23.1)
Depreciation and amortization	(623)	(0.7)	(1,800)	(1.3)	(3,115)	(1.7)	(2,148)	(1.6)	(2,903)	(1.4)
Other operating (expenses)/income	—	—	(338)	(0.2)	(109)	(0.1)	(252)	(0.2)	292	0.1
Net loss on disposal of subsidiaries	(6,195)	(6.9)	—	—	—	—	—	—	—	—
(Loss)/gain from equity investees	(9)	—	—	—	(509)	(0.3)	(235)	(0.2)	203	0.1
Operating (loss)/income	$(13,959)	(15.5)%	$ 2,583	1.8%	$ 17,111	9.1%	$ 10,479	7.9%	$ 14,372	7.1%

Voluntary medical insurance, motor own damage insurance and property insurance historically have been the largest contributors to our gross written premiums, or GWP. In 2003, ROSNO also commenced writing premiums on obligatory motor third-party liability insurance. GWP for non-life insurance products is equal to the total gross premiums to be paid over the term of the insurance policies issued by ROSNO during the period, while GWP for life insurance is equal to premiums due under the policies during the period. Premiums for non-life insurance are recorded as revenue primarily on a pro-rata basis over the terms of the related policies whereas life insurance premiums are recognized as revenue when due from the policyholder.

The adjustments necessary to reconcile GWP to revenue derived from the relevant policies are set forth in change in provision in unearned premiums, net of reinsurance, in the table below.

The table below provides a breakdown of our Insurance Segment revenues by business line.

	Year ended December 31,			Nine months ended September 30,	
	2001	2002	2003	2003	2004
	(Amounts in thousands)				
Voluntary medical insurance	$ 47,336	$ 53,537	$ 62,223	$ 51,026	$ 77,145
Motor third-party liability	4,493	5,231	3,168	2,573	1,424
Motor own damage insurance	20,902	24,029	33,503	22,905	42,149
Property	39,424	18,388	25,462	18,945	29,057
General third-party liability	2,293	2,823	3,201	2,139	6,592
Marine, aviation and transport	6,604	7,968	7,838	4,336	10,814
Personal accident	3,922	4,140	7,044	3,599	4,359
Other non-life liability	507	1,867	2,988	2,287	5,030
Life insurance	1,511	1,968	1,710	1,124	977
Obligatory motor third-party liability	—	—	14,993	5,058	27,818
Reinsurance inward	4,098	38,062	56,117	42,600	54,277
Total gross premiums written	131,090	158,013	218,247	156,592	259,642
Reinsurance outwards	(13,970)	(18,973)	(46,580)	(27,918)	(23,492)
Change in provision in unearned premiums, net of reinsurance	(37,277)	(13,081)	(8,355)	(12,717)	(54,800)
Net premiums earned	79,843	125,959	163,312	115,957	181,350
Commission income	6,205	4,912	8,225	4,760	6,556
Medical services income	—	3,291	5,278	3,875	3,624
Net gains on operations with securities	1,501	1,299	1,867	307	929
Interest income	1,318	4,362	6,143	5,210	5,508
Other income	1,093	912	3,104	3,069	3,193
Total revenue	$ 89,960	$140,735	$187,929	$133,178	$201,160

Nine months ended September 30, 2004 compared to nine months ended September 30, 2003

Revenues

In the nine months ended September 30, 2004, our Insurance Segment revenues grew by $68.0 million, or 51.0%, compared to the nine months ended September 30, 2003, as we continued to expand our client base. Voluntary medical insurance, MOD and property insurance together accounted for $148.4 million, or 57.1%, of GWP for the nine months ended September 30, 2004. GWP on obligatory motor third-party liability insurance, which we commenced writing in July 2003, accounted for $27.8 million, or 10.7%, of our GWP for the nine months ended September 30, 2004.

An increase in reinsurance inward for the nine months ended September 30, 2004 resulted from our operations with Leader, our former subsidiary, which we disposed of to RAO UES in 2001. During the nine months ended September 30, 2004, ROSNO conducted the management functions of Leader and undertook inward insurance from it. Leader insures RAO UES' extensive property assets which ROSNO, in turn, reinsures. Overall, GWP increased by 65.8%, to $259.6 million, in the nine months ended September 30, 2004, in comparison to $156.6 million in the nine months ended September 30, 2003.

Operating income

As a result of ROSNO's expansion of its operations, the operating income of our Insurance Segment increased to $14.4 million in the nine months ended September 30, 2004 from $10.5 million in the nine months ended September 30, 2003. The operating income margin decreased to 7.1% in the nine months ended September 30, 2004 from 7.9% for the same period in 2003 due to growth in claims ratios in the voluntary medical insurance and property insurance lines caused by increasing market competition. General and administrative expenses of the segment increased to $46.5 million in the nine months ended September 30, 2004 from $33.6 million in the nine months ended September 30, 2003 primarily due to an increase in payroll costs and advertising and marketing expenses.

Total assets

The total assets of our Insurance Segment increased to $308.7 million as of September 30, 2004 from $239.3 million as of December 31, 2003, or by 29.0%. This increase is primarily due to an increase in trading securities and bank deposits of $32.1 million, in receivables from insurance operations of $26.0 million and in deferred acquisition costs of $14.6 million.

Year ended December 31, 2003 compared to year ended December 31, 2002

Revenues

In 2003, our Insurance Segment revenues grew by $47.2 million, or 33.5%, compared to 2002, as we continued to develop and promote new insurance products and increased our client base. GWP increased by 38.1% to $218.2 million in 2003, compared to $158.0 million in 2002. Voluntary medical insurance, MOD and property insurance together accounted for $121.2 million, or 55.5%, of GWP. An increase in reinsurance inward during the year ended December 31, 2003 resulted from our operations with Leader.

Operating income

Our operating income increased to $17.1 million in the year ended December 31, 2003 from $2.6 million in the year ended December 31, 2002, while our operating income margin grew to 9.1% in the year ended December 31, 2003 from 1.8% in 2002. Improvement in operating margin was due to the accelerated growth of business lines with relatively lower loss ratios (primarily inward reinsurance).

Total assets

The total assets of our Insurance Segment increased to $239.3 million as of December 31, 2003 from $165.2 million as of December 31, 2002, or by 44.9%. Cash and cash equivalents and investments in securities increased by $21.4 million and $19.1 million, respectively. Receivables arising out of insurance operations and premiums assumed increased by $19.7 million.

Year ended December 31, 2002 compared to year ended December 31, 2001

Revenues

In 2002, our Insurance Segment revenues grew by $50.8 million, or 56.4%, compared to 2001, as we continued to expand our operations. GWP increased by 20.5% to $158.0 million in 2002, compared to $131.1 million in 2001. Voluntary medical insurance, MOD and property insurance together accounted for $96.0 million, or 60.7%, of GWP. An increase in inward reinsurance and a decrease in property insurance GWP for the year ended December 31, 2002 were due to the sale of Leader to RAO UES in December 2001.

Operating income

Operating income increased from an operating loss of $14.0 million in the year ended December 31, 2001 to operating income of $2.6 million in 2002. In 2001, ROSNO's estimate of loss provision increased by $11.3 million due to an increase in GWP and a higher loss history. Additionally, we extended the period of risk due to claims history.

Total assets

Total assets of our Insurance Segment increased to $165.2 million as of December 31, 2002 from $119.8 million as of December 31, 2001, or by 37.9%, mainly due to an increase in receivables arising out of insurance operations and premiums assumed of $19.3 million and an increase in investments in securities of $23.8 million.

Banking

Our Banking Segment is represented by MBRD, which provides a broad range of services. Historically, MBRD has primarily performed treasury functions for companies in or related to our consolidated group. Accordingly, MBRD's revenues are primarily derived from our subsidiaries and related parties. As of September 30, 2004, MBRD operated in Moscow and in four additional regions.

The following table summarizes MBRD's financial performance for the periods indicated:

	Year ended December 31,						Nine months ended September 30,			
	2001	% of revenues	2002	% of revenues	2003	% of revenues	2003	% of revenues	2004	% of revenues
	(Amounts in thousands, except percentages)									
Revenues from financial services	$19,072	100%	$ 36,660	100.0%	$ 57,513	100.0%	$ 40,063	100.0%	$ 49,220	100.0%
including:										
Revenues from consolidated companies	1,882	9.9	5,416	14.8	10,321	17.9	6,311	15.8	14,272	29.0
Revenues from related parties	6,211	32.6	7,154	19.5	11,730	20.4	8,474	21.2	6,632	13.5
Financial services related costs, exclusive of depreciation and amortization shown separately below[(1)]	(9,101)	(47.7)	(17,654)	(48.2)	(27,635)	(48.1)	(19,525)	(48.7)	(25,041)	(50.9)
Selling, general and administrative expenses	(3,613)	(18.9)	(11,500)	(31.4)	(27,180)	(47.3)	(14,327)	(35.8)	(9,681)	(19.7)
Depreciation and amortization	(379)	(2.0)	(287)	(0.8)	(620)	(1.1)	(465)	(1.2)	(839)	(1.7)
Income from equity investees	—	—	1,585	4.3	490	0.9	428	1.1	1,028	2.1
Operating income	$ 5,979	31.3%	$ 8,804	24.0%	$ 2,567	4.5%	$ 6,174	15.4%	$ 14,687	29.8%

(1) Includes interest expense on deposits.

Nine months ended September 30, 2004 compared to nine months ended September 30, 2003

Revenues

For the nine months ended September 30, 2004, compared with the same period in 2003, MBRD's revenues increased by 22.9%, to $49.2 million. Interest income grew by $7.0 million in the nine months ended September 30, 2004 and amounted to $42.1 million. This growth was mostly attributable to interest on loans to customers. As of September 30, 2004, loans to customers, net of allowances for loan losses, increased by 75.8% to $460.5 million, including $276.2 million, or 60.0%, of inter-company loans and $38.6 million, or 8.4%, of loans to our related parties. As of September 30, 2004, the weighted average interest on inter-company loans was 9.0% on U.S. dollar-denominated loans (which totaled $118.6 million), 11.0% for ruble-denominated loans (which totaled $157.5 million) and 15.0% for euro-denominated loans (which totaled $0.1 million). The weighted average interest rate on loans to related parties was 11.0% on U.S. dollar-denominated loans (which totaled $25.2 million) and 7.5% for ruble-denominated loans (which totaled $13.4 million). Loans to third parties, net of allowance for loan losses, increased by $74.1 million to $145.7 million in the first nine months of 2004 compared with the first nine months of 2003. The weighted average interest rate on loans to third parties was 9.6% for ruble-denominated loans and 7.5% for U.S. dollar-denominated loans as of September 30, 2004.

Non-interest income increased to $7.1 million in the first nine months of 2004 from $5.0 million in the first nine months of 2003, due to an increase in fee and commission income by $1.1 million and an increase of net profit on dealing securities by $0.9 million in the nine months ended September 30, 2004 in comparison with the same period in 2003.

Operating income

Banking Segment's operating income amounted to $14.7 million in the first nine months of 2004, compared to $6.2 million for the same period in 2003, mostly due to an increase in the volume of MBRD's lending operations in the nine months ended September 30, 2004.

Selling, general and administrative expenses as a percent of revenues decreased to 19.7% in the first nine months of 2004 from 35.8% in the same period in 2003 as a result of a decrease in allowances for loan losses.

Income from equity investees

Income from equity investees of $1.0 million recorded in the operating income of the segment in the first nine months of 2004 represents our share of the net income of East-West United Bank, in which we owned 35% as of September 30, 2004.

Total assets

Total assets of the Banking Segment decreased to $377.0 million as of September 30, 2004 from $595.5 million as of December 31, 2003, mainly due to a decrease in loans to banks and trading securities. The decrease resulted primarily from a decrease in cash deposits of MTS.

Year ended December 31, 2003 compared to year ended December 31, 2002

Revenues

For the year ended December 31, 2003, compared with 2002, MBRD's revenues were $57.5 million, an increase of 56.9%, compared with revenues of $36.7 million in 2002. Interest income grew by 59.2%, amounting to $46.5 million for the year ended December 31, 2003. This growth was primarily attributable to interest on loans to customers. As of December 31, 2003, loans to customers, net of allowances for loan losses, had increased by 70.0%, to $308.5 million, including $89.3 million, or

28.9%, of inter-company loans and $151.6 million, or 49.1%, of loans to related parties. As of December 31, 2003, the weighted average interest rate on inter-company loans was 12.8% for U.S. dollar-denominated loans (total of $51.8 million), 12.7% for EURO-denominated loans (total of $2.3 million), and 11.9% for ruble-denominated loans (total of $35.2 million), and the weighted average interest rate on loans to related parties was 13.2% on U.S. dollar-denominated loans (total of $49.2 million) and 13.1% on ruble-denominated loans (total of $102.4 million). For this purpose, related parties include equity investees and parties directly or indirectly controlled by or affiliated with our directors or executive officers but that are not part of our consolidated group. Loans to third parties, net of allowances for loan losses, grew by 59.8% to $67.6 million in 2003. The weighted average interest rate on loans to third parties was 16.3% for ruble-denominated loans and 13.3% for U.S. dollar-denominated loans as of December 31, 2003. The growth in interest income in the year ended December 31, 2003 compared to 2002 reflected a significant increase in MBRD's loan portfolio.

Non-interest income amounted to approximately $11.0 million in 2003, an increase of $3.5 million compared to $7.5 million in 2002. The proportion of non-interest income to segment revenue decreased to 19.2% in 2003, compared to 20.4% in 2002. The growth in non-interest income of $3.5 million in 2003 was derived primarily from dealing in securities, resulting from an increase in MBRD's securities portfolio and the positive trends in the Russian securities market.

Income from equity investees

Income from equity investees of $0.5 million recorded in 2003 represented our 30% share in the net income of East-West United Bank.

Operating income

In 2003, the Banking Segment operating income decreased to $2.6 million, or 4.5% of revenues, from $8.8 million, or 24.0% of revenues in 2002, as the volume of MBRD's lending operations increased and the cost of financing grew as a result of an increase in the share of higher interest rate term deposits and MBRD's own debt securities in its borrowings. Selling, general and administrative expenses as a percent of revenues increased to 47.3% in 2003 from 31.4% in 2002 as a result of an increase in allowance for loan losses.

Total assets

Total assets of our Banking Segment increased to $595.5 million as of December 31, 2003 from $283.0 million as of December 31, 2002, primarily due to an increase in loans to customers, resulting from an increase in cash deposited by MTS.

Year ended December 31, 2002 compared to year ended December 31, 2001

Revenues

For the year ended December 31, 2002, compared with 2001, MBRD's revenues increased by 92.2%, to $36.7 million. Interest income grew by 91.8%, amounting to $29.2 million for the period ended December 31, 2002. This growth was primarily attributable to interest on loans to customers. As of December 31, 2002, loans to customers, net of allowances for loan losses, increased by 1.7%, to $181.4 million, including $48.0 million, or 26.5%, of inter-company loans and $93.7 million, or 51.7%, of loans to related parties. As of December 31, 2002, the weighted average interest rate on inter-company loans was 12.0% for U.S. dollar-denominated loans (total of $41.9 million) and 10.0% for ruble-denominated loans (total of $6.1 million) and the weighted average interest rate on loans to related parties was 13.8% on U.S. dollar-denominated loans (total of $23.0 million) and 14.3% on ruble-denominated loans (total of $70.7 million). Loans to third parties, net of allowances for loan losses, grew by 296.6%, to $39.7 million, in 2002. The weighted average interest rate on loans to third parties was 20.2% for ruble-denominated loans and 13.0% for U.S. dollar-denominated loans as of December 31, 2002. The strong growth in interest income in the year ended December 31, 2002 compared to 2001 reflected a significant increase in MBRD's loan portfolio.

Non-interest income amounted to approximately $7.5 million in 2002, an increase of $3.6 million compared to $3.9 million in 2001. The proportion of non-interest income to segment revenue remained stable at 20.4% in 2001 and 2002. The growth in non-interest income of $3.6 million in 2002 was derived from dealing in securities, resulting from an increase in MBRD's securities portfolio and positive trends in the Russian securities market.

Income from equity investees

Income from equity investees of $1.6 million recorded in the operating income of the segment in 2002 represents our 25% share in the net income of East-West United Bank. In December 2002, we bought an additional 5% stake in the bank for $1.3 million, thus increasing our shareholding to 30%.

Operating income

In 2002, the Banking Segment operating income increased to $8.8 million, or 24.0% of revenues, from $6.0 million, or 31.3% of revenues, in 2001. Operating income for 2002 decreased, as a percentage of revenue, compared to 2001, as the volume of MBRD's operations increased and the cost of financing grew as a result of an increase of the share of higher interest rate term deposits and MBRD's own debt securities in its borrowings. In August 2002, MBRD, for the first time in its history, issued public debt in the form of one-year 300 million ruble ($9.5 million) 18.8% bonds traded on the Moscow Interbank Currency Exchange. Selling, general and administrative expenses as a percent of revenues fell in 2002, as the growth in MBRD's activities did not require a proportionate increase in administrative costs.

Total assets

Total assets of our Banking Segment decreased to $283.0 million as of December 31, 2002 from $325.2 million as of December 31, 2001, mainly due to a decrease in cash deposited by our affiliates.

Other Businesses

In this segment we include our real estate, retail, media, travel services and miscellaneous businesses, as well as operations of our parent company, Sistema. Thus, costs of our corporate function (other than Sistema Telecom) are included in the operating costs of this segment. These costs amounted to $15.9 million in the nine months ended September 30, 2004, compared to $16.5 million in the same period in 2003.

	Year ended December 31,						Nine months ended September 30,			
	2001	% of revenues	2002	% of revenues	2003	% of revenues	2003	% of revenues	2004	% of revenues
	(Amounts in thousands, except percentages)									
Revenues	$ 171,076	100%	$ 181,094	100.0%	$ 249,658	100.0%	$ 153,139	100.0%	$ 283,096	100.0%
Costs of sales, exclusive of depreciation and amortization shown separately below	(127,296)	(74.4)	(131,292)	(72.5)	(170,789)	(68.4)	(108,730)	(71.0)	(188,213)	(66.5)
Selling, general and administrative expenses	(42,725)	(25.0)	(49,588)	(27.4)	(75,564)	(30.3)	(49,812)	(32.5)	(76,538)	(27.0)
Depreciation and amortization	(3,421)	(2.0)	(4,679)	(2.6)	(7,735)	(3.1)	(3,772)	(2.5)	(4,978)	(1.8)
Net other operating income/(expenses)	6,130	3.6	2,855	1.6	(11,746)	(4.7)	(9,549)	(6.2)	(25,508)	(9.0)
Income/(loss) from equity investees	316	0.2	402	0.2	45	0.0	(102)	(0.1)	(418)	(0.1)
Net gain/(loss) on disposal of subsidiaries	11,099	6.5	(299)	(0.2)	—	—	(941)	(0.6)	1,296	0.5
Operating income/ (loss)	$ 15,179	8.9%	$ (1,507)	(0.8)%	$ (16,131)	(6.5)%	$ (19,767)	(12.9)%	$ (11,263)	(4.0)%

In our real estate businesses, we are a leading real estate owner, developer and manager predominantly focused on the Moscow market in the segments of Class A and B offices, elite housing, cottages and land development. We have been in the real estate business since the early 1990s, making real estate one of our first businesses. Since 1994, we have successfully completed more than 20 projects totaling over 150,000 sq.m. of space.

We operate our retail business through Detsky Mir, the largest retailer of children's goods in Russia. Detsky Mir is among the most recognized brands in Russia. As of September 30, 2004, we operated seven stores in Moscow, including the flagship Detsky Mir store in central Moscow, and three stores outside of Moscow with a total retail space of 42,705 sq.m. We plan to expand Detsky Mir by opening new stores in Moscow and other Russian cities and to undertake a significant refurbishment of our flagship store.

We operate our media businesses mainly through Sistema Mass Media, a holding company that is active in three main areas: advertising, print distribution and other media, which includes a number of secondary companies that operate in other segments such as publishing, film production and news services. Following a strategic review of our media assets in 2003, we are primarily focused on developing distribution platforms and content for pay-TV and multi-media services initially in Moscow and subsequently in other parts of Russia.

Our travel services business consists of Intourist, a Moscow-based tour operator. Intourist is one of the leading Russian providers of travel and leisure services and operates its business through 40 Russian and five foreign subsidiaries.

Our miscellaneous businesses consist of radio and space technology, pharmaceuticals and biotechnology and international operations.

Nine months ended September 30, 2004 compared to nine months ended September 30, 2003

Revenues

Total operating revenues of the Other Businesses Segment increased to $283.1 million in the nine months ended September 30, 2004, compared to $153.1 million in the nine months ended September 30, 2003.

Real estate revenues increased by $69.8 million, to $81.9 million, in the nine months ended September 30, 2004 over the nine months ended September 30, 2003. The increase is primarily attributable to the completion and sale of real estate projects in the nine months ended September 30, 2004, including two residential properties and two office buildings in Moscow.

In our retail business, revenues increased by 44.7%, to $51.0 million, in the nine months ended September 30, 2004 from $35.2 million in the nine months ended September 30, 2003. The increase was mostly generated by revenues of our new retail outlets.

Mass media revenues increased to $28.9 million, or by 31.1%, in the nine months ended September 30, 2004 compared to $22.1 million in the same period of 2003, primarily due to an increase in print distribution revenues.

The total operating revenues of our travel services business for the nine months ended September 30, 2004 was $75.4 million compared with $51.5 million for the same period in 2003, representing growth of 46.4%. In the nine months ended September 30, 2004, the number of inbound tourists served increased to 142,003, or by 23.4% compared to the nine months ended September 30, 2003, while the number of outbound tourists increased to 65,704, or by 62.0%, compared to the nine months ended September 30, 2003.

Operating loss

For the Other Businesses Segment, operating loss decreased during the nine months ended September 30, 2004 to $11.3 million from $19.8 million for the same period of 2003, mostly due to the improved financial results in our real estate business, which was partially offset by charity expenses of $16.4 million paid by our corporate office in the nine months ended September 30, 2004.

In the real estate business, operating income for the first nine months of 2004 increased to $26.9 million, from an operating loss of $0.9 million for the nine months ended September 30, 2003. The increase resulted from the completion and sale of four real estate projects in the first nine months of 2004.

In our retail business, operating income in the nine months ended September 30, 2004 increased to $4.7 million, compared with $4.3 million in the same period of 2003, as a result of an increase in the number of retail outlets.

In the media business, we reduced operating losses in the first nine months of 2004 to 3.7% of total revenue, or $1.1 million, from an operating loss of $4.6 million in the same period in 2003.

In our travel services business, operating income, as a percentage of revenues, increased to 1.2% in the nine months ended September 30, 2004, compared to an operating loss of 2.4% in the same period of 2003. The increase was due to our focus on the sale of travel packages, including quality transportation and accommodation which, in turn, resulted in an increase in the gross margin for the tour packages sold.

Year ended December 31, 2003 compared to year ended December 31, 2002

Revenues

Total operating revenues for the segment increased by 37.9%, to $249.7 million, in 2003, compared to $181.1 million in 2002. Our retail, travel services and real estate businesses, as well as consolidation of our radio and space technology business effective January 1, 2003, were responsible for most of the revenue growth in the year ended December 31, 2003.

Real estate revenues increased by $17.6 million to $39.1 million during the year ended December 31, 2003, compared to 2002. The increase in revenues was primarily due to proceeds from the sale of three completed office buildings, including a building sold to Telecom XXI, a subsidiary of MTS.

In our retail business, revenues increased by 15.3%, to $55.5 million, for the year ended December 31, 2003, from $48.2 million in 2002. The increase was primarily due to the opening of new retail stores and expansion of retail space.

Media revenues increased by 15.5%, to $35.2 million, in 2003, compared with 2002. The restructuring of our media assets in 2003 resulted in the closing of unprofitable branches of our print distribution business.

Total operating revenues of our travel services business for the years ended December 31, 2003 and 2002 were $62.1 million and $52.0 million, respectively, representing growth at 19.6%. In 2003, the number of inbound tourists served increased by 3.7%, to 141,626, while the number of outbound tourists increased by 109.0%, to 53,977.

Operating loss

The operating loss of the Other Businesses Segment increased to $16.1 million in 2003, primarily due to an increase in selling, general and administrative expenses of $26.0 million, which was mostly attributable to an increase in the salary expenses of our central corporate functions and other businesses.

In our retail business, operating income in 2003 was at $6.8 million, compared to $4.8 million in 2002, as a result of increased sales volumes.

In the media business, we continued to experience operating losses in 2003. In the year ended December 31, 2003, such losses amounted to $4.4 million, representing a 29.5% decrease from the operating loss of $6.3 million in 2002. The improvement was a result of a restructuring and cost cutting program.

In the travel services business, operating loss as a percentage of revenues increased to 3.1% in 2003, compared to 2.4% in 2002, which resulted primarily from an increase in salary expense.

Year ended December 31, 2002 compared to year ended December 31, 2001

Revenues

Total operating revenues for the segment increased 5.9%, to $181.1 million, in 2002, compared to $171.1 million in 2001.

Revenues of our real estate business fell 23.2% for the year ended December 31, 2002 to $21.5 million, compared to $28.0 million in 2001. This decrease was due to the long business cycle in the construction business (our policy is to recognize construction revenues upon project completion). During 2001, Sistema-Hals completed Hals-Tower and sold it to Sistema. Revenues in 2002 were primarily a result of the completion of a sports complex in Moscow occupied by our "Olympic Star" fitness center.

In our retail business, revenues increased by 23.6%, to $48.2 million, in 2002 from $39.0 million in 2001. We were able to benefit from robust retail growth in Moscow fueled by the increasing purchasing power of the population, as well as certain improvements in the merchandise mix and retail space allocation.

During 2002, we continued the expansion of our retail network by launching a new Detsky Mir store in Tambov, Russia. Additionally, we resolved our disputes with minority shareholders of Dom Igrushki, a children's toy store located in downtown Moscow, and obtained control over its operations from January 1, 2002. Dom Igrushki contributed $3.2 million to our retail revenues for the year ended December 31, 2002.

Media business revenues decreased to $30.5 million, or 14.0%, in 2002, compared with 2001 due to the disposal of several non-core subsidiaries. The revenues of Nasha Pressa, our print distribution house, decreased by 5.8%, from $25.3 million in 2001 to $23.8 million in 2002. This decrease was due to the disposal of certain unprofitable branches.

Total operating revenues of our travel services business for the years ended December 31, 2002 and 2001 were $52.0 million and $49.6 million, respectively, representing an increase of 4.8%. In 2002, the number of inbound tourists served increased by 5.3% to 136,638, while the number of outbound tourists increased by 12.9% to 59,720.

Operating income/(loss)

For the Other Businesses Segment, operating margins declined and our operating income of $15.2 million in 2001 decreased to a loss of $1.5 million in 2002, mostly due to an increase in selling, general and administrative expenses of $6.9 million in 2002, offset by a one-time gain of $11.1 million on the disposal of certain smaller subsidiaries which contributed to higher operating income in 2001. The increases in selling, general and administrative expenses were mostly attributable to the operations of our corporate headquarters, which accounted for $15.0 million of the selling, general and administrative expenses in 2002.

In our retail business, operating income in 2002 was at $4.8 million, compared to an operating loss of $3.8 million in 2001, as a result of increased sales volumes.

In the media business, we continued to experience operating losses, which amounted to $5.8 million for 2002, representing a 16.0% increase from operating losses of $5.0 million in 2001.

In the travel services business, operating loss, as a percentage of revenues, decreased to 2.4% for the year ended December 31, 2002, compared to 4.3% in 2001. The major factor in improving the operating income margin was the continuation of our cost reduction programs, including closing some of the loss making branches.

Telecommunications Operating Data

Our revenues and operating income for the nine months ended September 30, 2004 and for the years ended December 31, 2003, 2002 and 2001 were influenced by trends in the principal businesses included in our Telecommunications Segment: MTS, MGTS and Comstar UTS. The following discussion contains certain operating data relating to each of the principal businesses in our Telecommunications Segment.

MTS

The following tables show the number of MTS' subscribers and average monthly service revenue per subscriber as of the dates indicated.

	At December 31,			At September 30,	
	2001	2002	2003	2003	2004
	(Amounts in thousands, except average monthly service revenue per subscriber)				
Subscribers[1]					
Russia	2,650	6,644	13,370	11,344	20,842
MTS OJSC	2,275	3,746	6,529	6,036	11,146
Moscow license area	2,035	3,082	4,936	4,488	6,697
Telecom XXI	n/a	854	1,666	1,438	2,320
Russian regions	375	2,044	5,175	3,870	7,377
UMC	n/a	n/a	3,350	2,550	5,528
Uzbekistan (Uzdunrobita)	n/a	n/a	n/a	n/a	263
Total	2,650	6,644	16,720	13,894	26,633
Average monthly service revenue per subscriber					
Russia	$ 36	$ 23	$ 17	$ 18	$ 14
Ukraine	n/a	n/a	$ 15[2]	$ 16[3]	$ 14

(1) MTS defines a "subscriber" as an individual or organization whose account shows chargeable activity within the previous 61 days (or 183 days for its "Jeans" brand tariffs) and whose account does not have a negative balance for more than this period.

(2) Calculated based on the months of March through December 2003.

(3) Calculated based on the months of March through September 2003.

In 2002, the subscriber base increased by 150.7% from 2.7 million as of December 31, 2001 to 6.6 million as of December 31, 2002. These trends continued in 2003, with MTS' subscriber base increasing by 151.7%, from 6.6 million as of December 31, 2002 to 16.7 million as of December 31, 2003. For the nine months ended September 30, 2004, the number of MTS subscribers increased by 59.3% to 26.6 million, as of September 30, 2004.

Average monthly service revenue per subscriber in Russia fell from $36 in 2001 to $23 in 2002, due to the introduction of lower tariffs in the Moscow license area and generally lower tariffs in regions, as well as penetration to mass-market. This trend continued in 2003 and during the nine months ended September 30, 2004. Average monthly service revenue per subscriber in Russia in 2003 decreased to $17 and to $14 for the nine months ended September 30, 2004. In 2003 and the nine months ended September 30, 2004, more than half of MTS' subscriber growth occurred outside of the Moscow license area. However, as a result of competition and the tariff structure in the Russian regions outside of the Moscow license area, MTS' average revenue per subscriber in the Russian regions remains lower than in the Moscow license area, though costs are generally lower there as well. MTS generally expects to see a continued decline in average monthly service revenue per subscriber due to the introduction of lower tariff plans in connection with its marketing efforts.

UMC has experienced subscriber growth from 1.0 million subscribers at December 31, 2001 to 1.7 million subscribers at December 31, 2002, to 3.4 million subscribers at December 31, 2003 and to 5.5 million subscribers at September 30, 2004, and we expect this trend to continue, assuming the Ukrainian economy continues to grow. Average monthly service revenue per subscriber grew in 2004 as a result of an extensive marketing campaign focused on subscribers with higher than average usage rates.

	Year ended December 31,			Nine months ended September 30,	
	2001	2002	2003	2003[(2)]	2004[(2)]
Subscriber Churn					
Russia	26.8%	33.9%	47.3%	34.9%	23.7%
Ukraine	n/a	n/a	23.8%[(1)]	19.4%[(3)]	16.6%

(1) Annualized value calculated based on the months of March through December 2003.

(2) Nine month data are not comparable to annual data.

(3) Seven month value calculated based on the months of March through September 2003.

MTS' subscriber churn in Russia increased from 33.9% in 2002 to 47.3% in 2003. MTS believes this trend reversed in the nine months ended September 30, 2004 as a result of our marketing initiatives, targeted to raise subscriber loyalty. MTS' subscriber churn for the nine months ended September 30, 2004 was 23.7%, as compared to 34.9% for the same period in 2003. Although its subscriber churn in Russia decreased for the nine months ended September 30, 2004, MTS believes that subscriber churn is highly dependent on competition and the number of mass-market subscribers in its overall subscriber mix. Mass-market subscribers generally choose to prepay their mobile phone usage by purchasing pre-paid packages and are more likely to switch providers to take advantage of low-tariff promotions. As a result, competition for these subscribers will likely lead to sustained downward pressure on tariffs. The other reasons for increases in subscriber churn are the absence of service contracts with subscribers in Russia that contain minimal periods of usage and the absence of connection fees, which generally prevent a subscriber's early churn. In order to decrease subscriber churn, in 2004 MTS launched a new marketing campaign that provides a 15% discount for services rendered to certain contract subscribers if they do not terminate their contracts within one year of activation. Churn, as MTS uses it, includes internal churn within its subscriber base, *i.e.,* MTS' subscribers switching between different tariff plans we offer. Internal churn increased following the launch in November 2002 of the "Jeans" tariff plan.

MGTS

MGTS' revenues are dependent on the regulated tariffs approved by the Federal Tariff Service. The following table illustrates MGTS' regulated tariff development in the period from February 1, 2001 to October 1, 2004.

Service	Feb 1, 2001	Nov 1, 2001	Jan 1, 2002	Nov 1, 2002	June 1, 2003	Aug 1, 2003	Oct 1, 2004
				(Amounts in dollars)			
Monthly subscription fee							
Residential subscribers[(1)]	2.1	2.4	2.7	3.5	4.1	4.6	5.8
Public sector subscribers[(2)]	2.6	2.9	3.3	3.9	4.1	4.6	5.8
Corporate subscribers[(2)]	5.8	5.6	5.5	5.2	5.4	5.5	6.8
Local call charges							
Public sector subscribers[(3)]	0.005	0.005	0.005	0.004	0.005	0.005	0.005
Corporate subscribers[(3)]	0.014	0.013	0.013	0.013	0.013	0.013	0.014
Exchange rate (rubles per U.S. dollar)[(4)]	28.40	29.68	30.10	31.70	30.71	30.28	29.22

(1) Includes value added tax.

(2) Includes 613 "free" minutes per month.

(3) Per minute charge for traffic exceeding the monthly "free" minutes.

(4) As of the date the tariff change became effective.

Comstar UTS

Comstar UTS operates in three major segments: corporate voice and data services; carrier and operator services; and Internet services. The following table shows the number of Comstar UTS subscribers and active service lines as of the dates indicated.

	At December 31,			At September 30,	
	2001	2002	2003	2003	2004
Corporate and public voices services	148,567	184,903	206,175	201,213	226,391
Comstar	43,079	49,135	55,896	54,319	57,726
Telmos	23,399	27,930	35,361	34,604	48,633
MTU-Inform	82,089	107,838	114,918	112,290	120,032
Corporate data services (Golden Line)	2,439	2,853	3,375	3,245	3,795
Internet services (MTU-Intel)	261,351	364,837	471,124	385,129	371,366
Dial-up subscribers	258,082	356,407	453,150	370,530	324,681
ADSL subscribers	3,269	8,430	17,974	14,599	46,685
Carrier and operator services	288,545	303,564	303,571	303,571	303,573
Comstar	13,993	13,993	13,993	13,993	13,993
Telmos	20,187	20,187	20,187	20,187	20,186
MTU-Inform	254,365	269,384	269,391	269,391	269,394

The number of subscribers for corporate voice and data services increased during the years 2001 to 2003 and the nine months ended September 30, 2004. The increase in the total number of subscribers was 24.5% and 11.5% for the years ended December 31, 2002 and 2003, respectively, and 9.8% for the nine months ended September 30, 2004.

The total number of subscribers for our Internet services increased by 39.6% and 6.0% for the years ended December 31, 2002 and 2003, respectively. For the nine months ended September 30, 2004 the number of dial-up subscribers decreased by 128,469, or by 28.4%, while the number of ADSL subscribers increased by 28,711, or by 159.7%.

The total number of active lines for carrier and operator services increased by 5.2% for the year ended December 31, 2002 and remained approximately the same for the year ended December 31, 2003 and the nine months ended September 30, 2004.

Liquidity and Capital Resources

We use a variety of sources to finance our operations, both external and internal. In addition to net cash provided by operations, our companies use short- and long-term borrowings to fund capital expenditures and strategic investments. Short- and long-term funding sources may change with time, but currently include notes issued in the international and Russian capital markets and credit facilities with international and Russian banks, denominated in both rubles and foreign currencies. In January, April, August, October 2003 and January 2004, we (including MTS) raised approximately $396.0 million, $340.6 million, $297.0 million, $396.0 million and $350.0 million, respectively, through U.S. dollar-denominated bond offerings in the international capital markets. MTS repaid its $300.0 million notes in May 2004 with the proceeds of a short-term bridge loan and operating cash flows. In September 2004, MTS entered into a $600.0 million syndicated loan facility provided by international financial institutions. In December 2004, MTS repaid notes for $300.0 million.

Our parent company, Sistema, is a holding company with direct operations mostly limited to certain functions for our group, including budgeting, corporate finance, strategic development and public relations. The ability of Sistema to repay its debts depends primarily upon the receipt of dividends, distributions and other payments from our subsidiaries, proceeds from the sale of subsidiaries and from additional borrowings. As of September 30, 2004, we had a working capital deficit of $166.3 million. In December 2004, we repaid our 10.95% notes due 2004 in principal amount of $300 million from drawings on the syndicated loan facility described in Note 22 to our interim consolidated financial statements, which significantly improved our working capital position as the notes were included in short-term liabilities. We expect to repay all long-term debts as they become due from our operating cash flows or through re-financings. We believe that our working capital is sufficient for our present and future requirements.

Working capital

Working capital is defined as current assets less current liabilities. As of the date hereof, we believe our working capital is sufficient for our present requirements. As of September 30, 2004, we had a working capital deficit of $166.3 million, compared to a deficit of $541.1 million as of December 31, 2003.

Our working capital deficit decreased as we refinanced a portion of our short-term debt with the proceeds from long-term borrowings.

Credit Ratings

Our credit ratings impact our ability to obtain short- and long-term financing, and the cost of such financing. In determining our credit ratings, the rating agencies consider a number of factors, including our operating cash flows, total debt outstanding, commitments, interest requirements, liquidity needs and availability of liquidity. Other factors considered may include our business strategy, the condition of our industry and our position within the industry. Although we understand that these and other factors are among those considered by the rating agencies, each agency might calculate and weigh each factor differently.

The credit ratings of our parent company and our subsidiaries as of the date of this document were as follows:

Name of issuer	Rating Agency	Date of Rating	Long-term Debt Rating	Outlook / Watch
Sistema	Standard & Poor's	December 17, 2004	B	Credit Watch Positive
Sistema	Fitch	January 15, 2004	B	Stable
MTS	Moody's	December 10, 2001	Ba3	Stable
MTS	Standard & Poor's	December 17, 2004	BB–	Credit Watch Negative
MGTS	Standard & Poor's	March 9, 2004	B	Stable
MBRD	Fitch	February 16, 2004	B–	Stable
MBRD	Moody's	December 15, 2004	B1	Stable

None of our existing indebtedness has any triggers related to our credit ratings.

Capital Requirements

We need funding to finance the following:

- capital expenditures, consisting of purchases of property, plant and equipment and intangible assets;
- acquisitions;
- repayment of debt; and
- changes in working capital.

We anticipate that capital expenditures, acquisitions and repayment of long-term debt will represent the most significant uses of funds for several years to come.

We expect to continue to finance most of our capital expenditure needs through our operating cash flows, and to the extent required, to incur indebtedness through borrowings or additional capital raising activities. Our future expenditures may be significantly higher, in particular if licenses relating to new telecommunication technologies become available and our investment program for expansion and full digitalization of the Moscow public switch telephone network will be implemented. We expect that capital expenditures will remain a large portion of our cash outflows in connection with the continued installation and build out of our networks.

We may continue to expand our business through acquisitions. Our cash requirements relating to potential acquisitions can vary significantly based on market opportunities.

Capital Resources

We plan to finance our capital requirements through a mix of operating cash flows and financing activities, as described above. We do not depend on off-balance sheet financing arrangements.

At September 30, 2004, our debt was comprised of the following:

	Currency	Annual interest rate (Actual rate at September 30, 2004)	September 30, 2004
			(In thousands)
Sistema Finance Notes	USD	10.3%	$ 348,808
Sistema Capital Notes	USD	8.9%	350,000
MTS Finance Notes due 2010	USD	8.4%	400,000
MTS Finance Notes due 2008	USD	9.8%	398,883
MTS Finance Notes due 2004	USD	11.0%	299,928
Sistema Finance Investments	RUR	15.0%	41,076
MGTS Bonds	RUR	10%-12.3%	84,479
Micron Bonds	RUR	15.0%	6,002
Total corporate bonds			1,929,176
Syndicated Loan	USD	LIBOR+2.5% (4.7%)	200,000
Hermes Credit Facility	EUR	EURIBOR+0.7% (2.9%)	56,578
ING-Bank (Eurasia)	USD	LIBOR+2.3%-4.2% (4.3%-6.2%)	53,333
Vendor Financing	Various	Various	26,547
Raiffeisenbank	USD	LIBOR+5.0%-7.0% (7.4%-9.4%)	23,966
Commerzbank (Eurasia)	USD	LIBOR+1.4%-5.0% (3.8-7.4%)	41,367
HSBC	USD	LIBOR+2.8% (4.7%)	20,000
Vneshtorgbank	USD, EUR	LIBOR+4.9% (7.1%), EURIBOR+5.6% (7.5%), 13%	19,882
Sberbank	RUR	10.0%-15.0%	26,455
Ericsson Project Finance	USD	LIBOR+4.0% (6.0%)	17,100
Citibank	USD	LIBOR+1.6% (4.0%)	13,160
Dresdner Bank	USD	LIBOR+3.2%-3.4% (5.4%-5.6%)	10,000
Nordea Bank Sweden	USD	LIBOR+0.4% (2.6%)	8,124
Loans from related parties	Various	Various	30,838
Other	Various	Various	56,524
Total loans			603,874
Total corporate bonds and loans			2,533,050
Less amounts maturing within one year			(558,210)
Total long-term debt			$1,974,840

The following table presents the aggregate scheduled maturities of debt principal outstanding as of September 30, 2004:

Payments due in the year ended September 30,	(In thousands)
2005	$ 558,210
2006	88,888
2007	625,064
2008	418,862
2009	415,353
Thereafter	426,673
Total	$2,533,050

In addition, we had capital lease obligations in the amount of $6.9 million as of September 30, 2004. The terms of our material debt obligations and capital lease obligations are described in Notes 20, 21 and 22, respectively, to our consolidated financial statements.

Our ability to incur further indebtedness is limited by the covenants in our outstanding notes, including (i) consolidated indebtedness to consolidated EBITDA test (as defined in the indenture relating to the notes), (ii) MTS' debt/cash flow incurrence test. The covenants in our outstanding notes also limit our ability to grant liens on our properties and to enter into mergers, acquisitions, sales and sale-leaseback transactions.

The following table presents a summary of our cash flows and cash outlays for capital expenditures and acquisitions of subsidiaries:

	Year ended December 31,			Nine months ended September 30,	
	2001	2002	2003	2003	2004
	(Amounts in thousands)				
Cash flows					
Net cash provided by operating activities	$ 27,006	$ 188,616	$ 986,402	$ 687,798	$ 1,496,130
Net cash used in investing activities	(248,143)	(151,505)	(2,365,236)	(1,895,872)	(1,287,156)
Net cash provided by/(used in) financing activities	252,343	28,194	1,504,732	1,224,550	(183,592)
Net increase in cash	31,206	65,305	125,898	16,476	25,382
Cash outlays for					
Capital expenditures[(1)]	(160,640)	(159,689)	(1,184,828)	(782,592)	(1,069,279)
Acquisition of subsidiaries, net of cash acquired	(33,466)	(12,952)	(1,005,451)	(1,019,439)	(196,860)

(1) Includes acquisition of property, plant and equipment, intangible assets and principal payments on capital lease obligations.

During the periods under review, our operating activities generated positive cash flows due to growth through organic growth and acquisitions. During the same periods, our investing activities generated negative cash flows due primarily to increases in capital expenditures in connection with the development of our telecommunications network and the acquisitions of new businesses. We expect for the foreseeable future to continue to have negative cash flows from investing activities as we continue to expand our telecommunications network in the Moscow region, into the regions outside of Moscow and into other CIS countries. We also intend to continue to expand our business through acquisitions. We intend to finance our future investments primarily through net cash flows from operations and the incurrence of additional indebtedness. The availability of financing is influenced by many factors, including our profitability, operating cash flows, debt levels, contractual restrictions and market conditions.

Competition

We operate in some of the most competitive industries in Russia, including telecommunications, technology, insurance and banking. Our businesses confront aggressive pricing practices, evolving customer demand patterns and changing technologies.

For example, in the Telecommunications Segment, our wireless business is subject to increasing competition from a number of existing and emerging companies, resulting in pricing pressures and lower margins. We compete with at least one other mobile cellular operator in each of our markets. The competition has evolved in recent years to exist primarily between MTS, Vimpelcom and MegaFon, each of which has effective national coverage in Russia. Competition is based largely on local tariff prices and secondarily on network coverage and quality, the level of customer service provided, roaming and international tariffs and the range of services offered.

We compete with a number of alternative fixed line operators servicing Moscow, St. Petersburg and other commercial centers. Intensifying competition in Moscow's alternative carrier market has resulted in increasing pressure on prices and profitability for all operators. Smaller companies with insufficient scale and limited resources are focusing on niche segments of the market while large players act as market consolidators. As a result, the alternative carrier market is presently dominated by two large operators: the companies comprising Comstar UTS and the companies forming the Golden Telecom group.

Market risks

Foreign Currency Risk

Our principal exchange rate risk involves changes in the value of the ruble and the euro relative to the U.S. dollar. As a result of inflation in Russia and Ukraine, we link our monetary assets and transactions, when possible, to the U.S. dollar. We have not entered into any significant currency hedging arrangements.

A significant part of our capital expenditures and operating and borrowing costs are either denominated in U.S. dollars or tightly linked to the U.S. dollar exchange rate. These mostly include salaries, capital expenditures and borrowings. In order to hedge against a significant portion of this risk, we also denominate tariffs for our unregulated telecommunication services in Russia, which are payable in rubles, in units linked to the U.S. dollar and require accounts to be settled at the official rate of the Russian Central Bank on the date of payment.

If the ruble or the hryvnia decline against the U.S. dollar and tariffs for our telecommunication services cannot be maintained for competitive or other reasons, our operating margins could be adversely affected and we could have difficulty repaying or refinancing our U.S. dollar-denominated indebtedness. Our investment in monetary assets denominated in rubles and hryvnias is also subject to risk of loss in U.S. dollar terms. In particular, we are unable economically to hedge the risks associated with our ruble and hryvnia bank or deposit accounts. Generally, as the value of the ruble or the hryvnia declines, our net ruble and hryvnia monetary asset position results in currency remeasurement losses.

A portion of our capital expenditures and operating and borrowing costs are denominated in euro. These include capital expenditures and certain borrowings. We currently do not hedge against the risk of decline in the U.S. dollar against the euro.

Inflation and Exchange Rates

Over the past several years, the rate of increase in the consumer price index in Russia has steadily declined, due to conservative fiscal and monetary policies and the resulting federal budget surpluses. However, inflation remains high in comparison to developed countries.

We link the unregulated tariffs of our telecommunications business to the U.S. dollar. While a majority of our costs are denominated in U.S. dollars or are closely tied to the U.S. dollar, certain of our costs, including salaries and utility costs, are sensitive to rises in the general price level in Russia. During the years ended December 31, 2001 and 2002, the ruble was devaluating against the U.S. dollar. However, the rate of inflation exceeded the rate of devaluation, resulting in real appreciation of the ruble. During the year ended December 31, 2003 and nine months ended September 30, 2004, the ruble appreciated against the U.S. dollar, both in terms of the nominal exchange rate and real appreciation. We would expect increases in ruble-denominated costs, driven by real appreciation of the ruble to put pressure on our margins. While we could seek to raise our prices and tariffs to compensate for such increases in costs, competitive pressures may not permit increases that are sufficient to preserve our operating margins. Accordingly, high rates of inflation in Russia relative to the nominal rate of devaluation could materially adversely affect our results of operations.

Overall, while the sharp decline in the value of the ruble in both nominal and real terms in the immediate aftermath of the 1998 financial crisis supported business growth and helped us to achieve positive results across most of our business lines, the subsequent appreciation of the ruble in real terms and in nominal terms for the year ended December 31, 2003 and the nine months ended September 30, 2004 has increased our costs in Russia.

Interest Rate Risk

We are exposed to variability in cash flow risk related to our variable interest rate debt and exposed to fair value risk related to our fixed-rate notes. As of September 30, 2004, approximately $477.1 million, or 18.8% of our total indebtedness, including capital leases, was variable interest rate debt, while $2,062.9 million, or 81.2% of our total indebtedness, including capital leases, was fixed interest rate debt. In December 2004, we entered into two interest rate swap agreements with respect to $250.0 million of variable-rate indebtedness. See Note 31 to our interim consolidated financial statements for further details. We continue to consider other financial instruments available to us on the market to mitigate exposure to variability in the interest rates.

For indebtedness with variable interest rates, the table below presents principal cash flows and related weighted average interest rates by contractual maturity dates as of September 30, 2004.

Contractual Maturity Dates as of September 30, 2004:

	Currency	September 30, 2005	2006	2007	2008	2009	Thereafter	Total	Average rate at September 30, 2004
		(Amounts in thousands)							
Syndicated loan	USD	—	—	200,000	—	—	—	200,000	LIBOR+2.5% (4.7%)
Citibank	USD	2,186	3,289	3,289	3,291	1,105	—	13,160	LIBOR+1.6% (4.0%)
Commerzbank (Eurasia)	USD	15,250	—	—	—	—	—	15,250	LIBOR+3.5% (5.9%)
Commerzbank (Eurasia)	USD	3,750	—	—	—	—	—	3,750	LIBOR+2.4% (4.8%)
Commerzbank (Eurasia)	USD	1,183	1,184	—	—	—	—	2,367	LIBOR+1.4% (3.8%)
Commerzbank (Eurasia)	USD	20,000	—	—	—	—	—	20,000	LIBOR+5% (7.4%)
Ericsson Project Finance	USD	10,800	6,300	—	—	—	—	17,100	LIBOR+4% (6.0%)
HSBC	USD	10,000	10,000	—	—	—	—	20,000	LIBOR+2.8% (4.7%)
ING-bank	USD	26,667	26,666	—	—	—	—	53,333	LIBOR+3.3% (5.3%)
Raiffeisen bank	USD	7,501	—	—	—	—	—	7,501	LIBOR+5.0% (7.4%)
Raiffeisen bank	USD	2,241	2,291	2,446	2,646	2,856	3,985	16,465	LIBOR+7.0% (9.4%)
Dresdner bank	USD	10,000	—	—	—	—	—	10,000	LIBOR+3.4% (5.4%)
Nordea Bank Sweden	USD	4,178	3,946	—	—	—	—	8,124	LIBOR+0.4% (2.6%)
Vneshtorgbank	USD	872	—	—	—	—	—	872	LIBOR+8% (10.4%)
Vneshtorgbank	USD	5,724	42	2,878	—	—	—	8,644	LIBOR+4.9% (7.1%)
Total USD variable debt		120,352	53,718	208,613	5,937	3,961	3,985	396,566	
Weighted average USD interest rate		5.3%	5.0%	5.0%	7.7%	8.6%	9.4%	5.2%	
Hermes Credit Facility	EUR	12,573	12,573	12,573	12,573	6,286	—	56,578	EURIBOR+0.7% (2.9%)
East-West United Bank	EUR	8,836	—	—	—	—	—	8,836	EURIBOR+5.0% (7.4%)
WestLB International S.A.	EUR	—	5,039	—	—	—	—	5,039	EURIBOR+2.0% (4.2%)
Vneshtorgbank	EUR	1,733	1,733	1,733	1,733	1,731	—	8,663	EURIBOR+5.6% (7.5%)
Total EUR variable debt		23,142	19,345	14,306	14,306	8,017	—	79,116	
Weighted average EUR interest rate		4.0%	3.6%	3.6%	3.6%	3.9%		3.7%	
MGTS bonds	RUR	1,462	—	—	—	—	—	1,462	5.0%
Total RUR variable debt		1,462	—	—	—	—	—	1,462	
Weighted average RUR interest rate		5.0%	—	—	—	—	—	5.0%	

We would experience an additional interest expense of approximately $4.7 million on an annual basis as a result of a hypothetical increase in the LIBOR/EURIBOR by 1% over the current rate as of September 30, 2004. The fair value of our publicly traded long-term notes as of September 30, 2004 ranged from 94.0% to 106.0% of the principal amount. At September 30, 2004, the fair value of our other debt approximated its book value. We have not experienced significant changes in the market risks associated with our debt obligations in the table above subsequent to September 30, 2004.

Critical accounting policies

Critical accounting policies are those policies that require the application of management's most challenging, subjective or complex judgments, 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 judgments and uncertainties that are sufficiently sensitive to result in materially different results under different assumptions and conditions. We believe that our most critical accounting policies are those described below. For a detailed discussion of these and other accounting policies, see our consolidated financial statements.

Consolidation of variable interest entities

In December 2003, FASB issued a revision to Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46R" or the "Interpretation"). FIN 46R clarifies the application of ARB No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public companies, to the end of the first reporting period ending after March 15, 2004, except that all public companies must at minimum apply the provisions of the Interpretation to entities that were previously considered "special-purpose entities" under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003.

Following the adoption of FIN 46R, we reevaluated the relationships with our related parties: Promtorgcenter, Notris, Laminea, Finescort-M, Kuntsevo-Invest, Holdbestfinance, Putney Assets and Mosdachtrest. Mosdachtrest was accounted for under the equity method for the periods prior to January 1, 2004. We determined these entities were VIEs and that we were their primary beneficiary. Accordingly, we have consolidated these companies effective January 1, 2004. All intercompany balances have been eliminated in consolidation and the results of these VIEs have been included in our consolidated statement of operations and statement of cash flows for the nine months ended September 30, 2004. In accordance with the provisions of FIN 46R, we recorded a charge for the cumulative effect of this accounting change of $35.5 million, net of income tax of nil, in the nine months ended September 30, 2004. This charge reflects the cumulative impact to our results of operations had these VIEs been consolidated since their inception.

Revenue recognition

Telecommunications

Telecommunications Segment earns revenues from the provision of wireless telecommunication services, local telephone and data transmission services and usage of its local exchange networks and facilities. Revenues are recognized on an accrual basis, when services are actually provided or title to equipment passes to the customer, regardless of when the resulting monetary or financial flow occurs. Segment revenue sources consist of the following: (a) subscription fees, (b) usage fees, (c) value-added service fees, (d) roaming fees charged to other operators for guest roamers utilizing our network, (e) connection fees and (f) sales of handsets and accessories.

We defer initial connection fees paid by subscribers for the first time activation of network service, as well as one time activation fees received for connection to various value-added services. These fees are recognized as revenue over the estimated average subscriber life. The Group periodically reviews its estimates of the expected subscriber relationship period. Effective January 1, 2004, MTS has changed its estimates of average subscriber lives. The effect of this change in estimate in the nine months ended September 30, 2004 was an increase in net income of approximately $4.3 million, or $0.5 per share.

Local telephone services provided by MGTS, totaling approximately 5%, 6%, 6%, 20% and 24% of our consolidated revenues for the nine months ended September 30, 2004 and 2003 and the years ended December 31, 2003, 2002 and 2001, respectively, are regulated tariff services, and changes in rate structure are subject to approval by the Federal Tariff Service.

MGTS is required to grant discounts ranging from 20% to 100% on installation and monthly fees to certain categories of residential subscribers, such as pensioners, military veterans and disabled individuals, and is entitled to reimbursement from the federal budget for these discounts. Due to the lack of certainty of reimbursement, MGTS accounts for such revenues upon collection.

Technology

STROM telecom's arrangements with its customers typically include multiple elements, such as equipment and software development, installation services and post-contract customer support. In accordance with the Statement of Position ("SOP") No. 97-2, "Software Revenue Recognition," the aggregate arrangement fee is allocated to each of the undelivered elements in an amount equal to its fair value with the residual of the arrangement fee allocated to the delivered elements. Fair values are based upon vendor-specific objective evidence. Fees allocated to each element of an arrangement are recognized as revenue when the following criteria have been met: a) a written contract for the delivery of an element has been executed, b) the product has been delivered to the customer, c) the fee receivable is fixed or determinable, and d) collectibility of the resulting receivable is deemed probable. If evidence of fair value of the undelivered elements of the arrangement does not exist, all revenue from the arrangement is deferred until such time evidence of fair value does exist, or until all elements of the arrangement are delivered. Fees allocated to post-contract customer support are recognized as revenue ratably over the support period. Fees allocated to other services are recognized as revenue as services are performed.

Insurance

Premiums written on non-life insurance of the Insurance Segment are recognized on a pro-rata basis over the term of the related policy coverage, normally not exceeding 1 year. The unearned premium provision represents that portion of premiums written relating to the unexpired term of the policy. Premiums from traditional life and annuity policies with life contingencies are recognized as revenue when due from the policyholder.

Banking

Interest income of the Banking Segment is recognized on an accrual basis. Loans are placed on non-accrual status when interest or principal is delinquent for a period in excess of 90 days, except when all amounts due are fully secured by cash or marketable securities and collection proceedings are in process. Interest income is not recognized where recovery is doubtful. Loans are written off against allowance for loan losses in the case of uncollectibility of loans and advances, including through repossession of collateral.

Other businesses

Revenues on construction contracts are recognized under the completed-contract method. Our other entities recognize revenues when products are shipped or when services are rendered to customers.

In arrangements where we act as an agent, including travel agency arrangements and arrangements to administer construction projects, only the agency fee is recognized as revenue.

Management estimates

The preparation of our consolidated financial statements in accordance 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 at the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. Actual results could differ from those estimates. Examples of significant estimates include the provision for doubtful accounts and valuation allowance on deferred tax assets.

License Costs and Other Intangible Assets

We capitalize the cost of licenses acquired in business combinations and directly from the government. As the telecommunications industries in Russia, Ukraine and Uzbekistan do not have sufficient experience with renewal of licenses or extensions of license terms, we amortize each license on a straight-line basis over the term of the license commencing from the date such license becomes commercially operational. We review these licenses and their remaining useful life and, if necessary, revise the useful lives based on our actual utilization. The estimated useful lives of licenses may vary depending on market or regulatory conditions, and any revision to the estimated useful lives may result in a write off or an increase in amortization costs.

Most of our current licenses provide for payments to be made to finance telecommunications infrastructure improvements, which in the aggregate could total approximately $103.6 million, as of September 30, 2004. However, no decisions regulating the terms and conditions of such payments have been formulated by the government authorities. Accordingly, we have made no payments to date pursuant to any of the current licenses, and have not made any accruals for this liability in the financial statements.

Other intangible assets represent acquired customer base, trademarks, roaming contracts with other telecommunications operators, telephone numbering capacity, rights to use premises and various purchased software costs. Trademarks, roaming contracts and telephone numbering capacity with unlimited contractual life are not amortized, but are reviewed, at least annually, for impairment in accordance with the provisions of FAS No. 142, "Goodwill and Other Intangible Assets."

Acquired customer base is amortized over the estimated average subscriber life. Deferred telephone numbering capacity costs with limited contractual life and the rights to use premises are being amortized over their contractual lives, which vary from five to twenty years. Software costs and other intangible assets are amortized over three to five years. All finite-life intangible assets are amortized using the straight-line method.

Useful Lives of Property, Plant and Equipment

We calculate depreciation expense for property, plant and equipment on a straight-line basis over their estimated useful lives. We establish useful lives for each category of property, plant and equipment based on our assessment of the use of the assets and anticipated technology evolution. We review and revise if appropriate the assumptions used in the determination of useful lives of property, plant and equipment at least on an annual basis.

Impairment of Long-Lived Assets

We periodically evaluate the recoverability of the carrying amount of our long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, we compare undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, we record impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets.

Translation Methodology

We follow a translation policy in accordance with Statement on Financial Accounting Standards ("FAS") No. 52, "Foreign Currency Translation." Due to a highly inflationary economy in the Russian Federation in 2002, the U.S. dollar (our reporting currency) has been designated as our functional currency. Accordingly, all foreign currency amounts were translated into U.S. dollars using the remeasurement method.

Starting from January 1, 2003, the Russian economy ceased to be considered highly inflationary for accounting purposes. We determined that for the fiscal year beginning January 1, 2003 the functional currency of MGTS, ROSNO, Kuban-GSM, Mikron, Detsky Mir, Detsky Mir Center, Sistema Mass Media, Media-Center and Concern RTI is the ruble. Accordingly, the reporting currency amounts for these subsidiaries were translated into their functional currency at the exchange rate current at January 1, 2003. These amounts became the new accounting basis for the non-monetary assets and liabilities. The functional currency of UMC is the hryvnia and the functional currency of STROM telecom is the Czech krona. We believe that the U.S. dollar is still the appropriate functional currency for the other subsidiaries of our consolidated group due to the prevalent use of the dollar in their operations.

Pursuant to Emerging Issues Task Force ("EITF") Issue No. 92-8, "Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary," the differences between the new functional currency bases of non-monetary assets and liabilities and their tax basis represent temporary differences, for which deferred taxes must be recognized. Income tax effect of changes in the functional currency amounting to $22.4 million, net of minority interest of $17.2 million, was reported as other comprehensive loss for the year ended December 31, 2003.

We have selected the U.S. dollar as our reporting currency and have translated financial statements of subsidiaries with a different functional currency into U.S. dollars. Assets and liabilities are translated at the exchange rates current at the balance sheet date, while income and expense items are translated at average rates of exchange prevailing during the period. The resulting translation adjustments in the amount of $35.3 million, net of minority interest of $24.4 million, and $4.9 million, net of minority interest of $3.2 million, are recorded as a separate component of other comprehensive income for the year ended December 31, 2003 and the nine months ended September 30, 2004, respectively.

The ruble is not a fully convertible currency outside of the territory of the Russian Federation. The translation of ruble-denominated assets and liabilities into U.S. dollars for the purpose of these financial statements does not indicate that we could or will in the future convert the reported values of the assets and liabilities in U.S. dollars.

Taxation

We are subject to a variety of taxes levied in the Russian Federation, including income taxes, payroll taxes, VAT, property taxes and other, and our foreign subsidiaries are subject to taxation in their respective jurisdictions.

The taxation system in Russia is subject to frequent changes, varying interpretations and inconsistent enforcement at the federal, regional and local levels. In some instances, new tax regulations have been given retroactive effect, while under the Tax Code only laws benefiting the taxpayer may have retroactive effect. In addition to our substantial tax burden, these conditions complicate our tax planning and related business decisions. For example, tax laws are unclear with respect to the deductibility of certain expenses and at times we have taken a position that may be considered aggressive by tax authorities, but that we consider to be in compliance with current law. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that are more significant than those typically found in countries with more developed tax systems.

Management believes that it has adequately provided for tax liabilities in its financial statements; however, the risk remains that the authorities could take a different position with regard to interpretive issues.

Income taxes

Effective January 1, 2002, the income tax rate in Russia declined to 24% for all companies, income tax on dividends paid within Russia was reduced to 6% (from 15% in 2001 and 2000) and the tax loss carry-forward period was extended to ten years. In July 2004, amendments to the new Tax Code were enacted increasing the rate of income tax on dividends to 9% effective January 1, 2005. The new income tax legislation also adopted a more liberal approach to tax-deductible expenses, permitting deductions so long as expenses are economically proven and justified from the business standpoint. The elimination of investment tax credits offset some of the benefits from the reduction of income tax rates. In periods prior to 2002, we were allowed to offset up to 50% of our taxable income with investment tax credits and other miscellaneous credits.

Value-added tax

During the years ended December 31, 2001, 2002 and 2003 the VAT rate in Russia was 20%. Effective January 1, 2004, it decreased to 18%.

New accounting pronouncements

In December 2004, the Financial Accounting Standards Board ("FASB") issued FAS No. 123R, "Share-Based Payment" ("FAS No. 123R"), a revision of FAS No. 123, "Accounting for Stock-Based Compensation." FAS No. 123R supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and requires all entities to recognize compensation cost in an amount equal to the fair value of share-based payments granted to employees. That cost will be recognized over the period during which an employee is required to provide service in exchange for an award of equity instruments. FAS No. 123R is effective for interim periods beginning after June 15, 2005, at which time companies can select whether they will apply the standard retroactively by restating their historical financial statements or prospectively for new stock-based compensation arrangements and the unvested portion of existing arrangements. We do not anticipate the adoption of FAS No. 123R will have a material impact on our financial position, cash flows and results of operations.

In December 2004, the FASB issued FAS No. 153, "Exchanges of Nonmonetary Assets," an amendment of APB Opinion No. 29, "Accounting for Nonmonetary Transactions." FAS No. 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets set in the APB Opinion No. 29 and replaces it with a general exception for exchanges that do not have commercial substance. FAS No. 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. FAS No. 153 is effective prospectively for nonmonetary exchanges occurring after June 15, 2005. We do not anticipate the adoption of FAS No. 153 to have a material impact on our results of operations or financial position.

In November 2004, the FASB issued FAS No. 151, "Inventory Costs," an amendment of ARB No. 43, Chapter 4. FAS No. 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facility. FAS No. 151 is effective prospectively for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not anticipate the adoption of FAS No. 151 to have a material impact on our results of operations or financial position.

In September 2004, the Emerging Issues Task Force (“EITF”) issued a final consensus on EITF Issue No. 04-1, “Accounting for Preexisting Relationships between the Parties to a Business Combination.” In this issue the EITF reached a consensus that a business combination between two parties having a preexisting relationship is a multiple-element transaction with one element being the business combination and the other element being the settlement of the preexisting relationship. This Issue requires certain additional disclosures for business combinations between parties with a preexisting relationship. EITF Issue No. 04-1 is effective for reporting periods beginning after October 13, 2004. We do not anticipate that the adoption of EITF Issue No. 04-1 will have a material impact on our financial position or results of operations.

In November 2003, the EITF reached a final consensus on Issue No. 03-10, “Application of EITF Issue No. 02-16, “Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor, by Resellers to Sales Incentives Offered to Consumers by Manufacturers.” A consensus was reached that consideration received by a reseller from the vendor in exchange for vendor sales incentives tendered by consumers should not be reported as a reduction of the cost of the reseller’s purchases from the vendor but instead should be shown as revenue. EITF Issue No. 03-10 is effective for reporting periods beginning after November 25, 2003. The adoption of Issue No. 03-10 did not have a material impact on our results of operations or financial position.

In March 2004, the EITF reached a consensus on Issue No. 03-6, “Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share.” This Issue defines participating security and clarifies some practical issues related to including participating securities in the calculation of EPS. EITF Issue No. 03-6 is effective for reporting periods beginning after March 31, 2004. The adoption of Issue No. 03-6 did not have a material impact on our financial position or results of operations.

In September 2004, the SEC staff issued the EITF Topic D-108, Use of the Residual Method to Value Acquired Assets Other Than Goodwill,” which requires the companies to use the direct value method to determine the fair value of their intangible assets acquired in business combinations completed after September 29, 2004.

Historically, we have used the residual method to determine the fair value of the telecommunications licenses acquired in business combinations, except for purchase of Uzdunrobita, where the fair value of such licenses acquired was determined using the direct method. Under the new accounting guidance, we will use the direct method to measure the fair value of licenses acquired in our future business combinations. We do not anticipate the impact from adoption of the above Commission guidance to be material to our consolidated results of operations or financial position.

In July 2004, the EITF issued EITF Issue No. 02-14, “Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock.” A consensus was reached regarding an investor that has the ability to exercise significant influence over the operating and financial policies of the investee. This type of investor should apply the equity method of accounting only when it has an investment(s) in common stock and/or an investment that is in-substance common stock. The EITF also reached a consensus on the definition of in-substance common stock and related guidance. The guidance for this EITF Issue is effective for reporting periods beginning after September 15, 2004. We are currently considering the impact of this pronouncement on our financial position and results of operations.

In October 2004, the EITF reached a consensus on EITF Issue No. 04-10, “Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds.” EITF Issue

No. 04-10 provided additional guidance on when operating segments that are below the 10% threshold can be aggregated. EITF Issue No. 04-10 states that segments can only be aggregated if they have similar economic characteristics and if they are similar in areas such as similar production processes, types of customers, distribution channels and the products themselves are similar. The consensus reached by EITF Issue No. 04-10 is effective for fiscal years ending after October 13, 2004. We are currently considering the impact of this pronouncement on our financial statement disclosures.

Income from equity investees

Our share in net assets and net income of certain entities, in which we hold 20% to 50% of the share capital and have the ability to exercise significant influence over the operations and financial policies, is included in our financial accounts using the equity method. Where we are active in day-to-day management of our equity investees and their businesses are considered core assets, we include income from equity investees in the determination of operating income.

Off-balance sheet arrangements

Obligations under guarantee contracts

In December 2002, MTU-Inform and Alfabank signed a guarantee agreement. According to the agreement, MTU-Inform guaranteed a loan of $4.0 million provided to Golden Line by Alfabank. The loan matures in November, 2005. In addition, MTU-Inform pledged equipment with a fair value of $4.7 million as security for the loan.

As of September 30, 2004, MTS has issued guarantees on behalf of MTS Belarus, an equity investee, for the total amount of $25.0 million. Under these guarantees, we could potentially be liable for a maximum amount of $46.6 million if MTS Belarus defaults on its obligations. The guarantees expire by April 2007.

Additionally, MBRD guaranteed loans for several companies, including related parties, which totaled $1.4 million as of September 30, 2004.

These guarantees would require payment by us only in the event of default on payment by the respective debtor. Under these guarantees, we could be potentially liable for a maximum amount of $49.9 million in the case of the borrower's default under the obligations. As of September 30, 2004, no event of default has occurred under any of the guarantees issued by us.

Obligations under derivative contracts

In October 2004, MTS exercised its call option in respect of 47.3% of common shares and 50% of preferred shares of TAIF Telcom, increasing our voting power in TAIF Telcom to 100%. The value of consideration equaled $63.0 million. TAIF Telcom provides GSM 900/1800 services under the MTS brand in the Republic of Tatarstan (population 3.8 million), located in the Volga region of Russia.

In connection with MTS' acquisition of 74% of the shares in Uzdunrobita in August 2004, it entered into call and put option agreements with the existing shareholders of the company to acquire the remaining 26% of the shares. See Note 3 to our interim consolidated financial statements. The exercise period for the option is 48 months from the acquisition date. The call and put option agreements stipulate a minimum purchase price of $37.7 million plus 5% per annum commencing from the acquisition date. The fair value of the put option was approximately $3.6 million as of September 30, 2004.

Tabular Disclosure of Contractual Obligations

We have various contractual obligations and commercial commitments to make future payments, including debt agreements, lease obligations and certain committed obligations. The following table summarizes our future obligations (including interest) under these contracts due by the periods indicated as of September 30, 2004:

	October 1, 2004- September 30, 2005	October 1, 2005- September 30, 2007	October 1, 2007- September 30, 2009	October 1, 2009- thereafter	Total
			(Amounts in thousands)		
Contractual obligations:					
Notes payable	538,393	639,293	948,453	433,600	2,559,739
Bank loans	140,358	393,025	39,998	27,052	600,433
Capital lease	4,937	2,284	133	262	7,616
Operating leases and services agreements	47,616	49,555	28,469	24,997	150,637
Committed Investments:					
Purchases of property, plant and equipment	331,000	—	—	—	331,000
Construction contracts	25,200	—	—	—	25,200
Total	1,087,504	1,084,157	1,017,053	485,911	3,674,625

In December 2003, MGTS announced its long-term investment program for the period from 2004 through 2012. The program was approved by a resolution of the Moscow City Government in December 2003 and provides for total capital expenditures of approximately $1.6 billion, including for the expansion and full digitalization of the Moscow telephone network, the reconstruction of 350 local telephone stations and the installation of 4.3 million new phone numbers. We expect to finance approximately 50% of the capital expenditures under the investment program.

Recent Financing Activities

MTS Financings

In October 2004, MTS obtained two committed credit facilities in an aggregate amount of approximately $121.0 million to finance the technological upgrade and expansion of its network. The arrangers and lenders of the credit facility are HSBC Bank plc and ING BHF-BANK AG. Euler Hermes Kreditversicherungs-AG, the German credit export agency, is providing export credit cover in respect to both facilities. The facilities mature in approximately 9 years and have a cost of financing of LIBOR plus 1.9% per annum.

In October 2004, Mobile TeleSystems Finance S.A., MTS' Luxembourg finance subsidiary, signed a loan agreement with Credit Suisse First Boston for $140.0 million. These funds will be used by MTS for general corporate purposes. The loan is payable in two installments of $70 million each due three and six months after the draw date, respectively (*i.e.,* in January and April 2005). The loan bears interest at a rate of LIBOR plus 2.20% and is fully and unconditionally guaranteed by MTS.

In December 2004, MTS signed an agreement with EBRD for a $150.0 million loan. The loan has a term of 7 years repayable starting from December 2005 on a biannual basis in equal installments. The interest rate is LIBOR plus 3.1%. The proceeds of the loan will be used by MTS to finance regional expansion in Russia.

In November 2004, MTS signed a loan agreement with ABN AMRO Bank N.V. (Stockholm branch) for $56.6 million and EUR 8.4 million. These funds will be used to purchase telecommunications equipment for the expansion of MTS' network. The loan is repayable on a biannual basis in equal installments over 9 years and has an interest rate of USD LIBOR/EURIBOR plus 0.35% per annum.

In January 2005, Mobile TeleSystems Finance S.A. issued $400.0 million in aggregate principal amount of notes. The notes bear interest at a rate of 8.0% per annum and mature in January 2012. The notes are guaranteed by MTS.

BUSINESS

Overview

We are the largest private sector consumer services company in Russia and the CIS, and we have over 35 million customers. Our business is developing, managing and realizing the value of market-leading businesses in the markets in which we have a presence. We operate in a few select service-based industries offering the potential for rapid growth of our businesses. Given the scale, scope and market position of our existing operations, we are uniquely positioned to exploit the growth in consumer and corporate purchasing power in the countries in which we operate. We currently operate principally in the following sectors: telecommunications, technology, insurance, banking, real estate, retail and media. Our revenues were $3,759.9 million for the year ended December 31, 2003 and $4,135.9 million for the nine months ended September 30, 2004, and our operating income before depreciation and amortization for the same periods was $1,626.7 million and $1,847.2 million, respectively.

We seek to exploit opportunities for growth by combining our close understanding of the markets of Russia and the CIS with best-in-class developed world business practices and our pool of management talent. The scope of our operations, our track record of successful strategic partnerships and our established corporate and government relationships give us unique access to investment opportunities in our markets. In exploiting these opportunities, we employ a return-based approach to the use of our capital. Our experienced management team takes an active role in the development of our businesses in order to maximize returns for our shareholders. We have management control of all our key businesses.

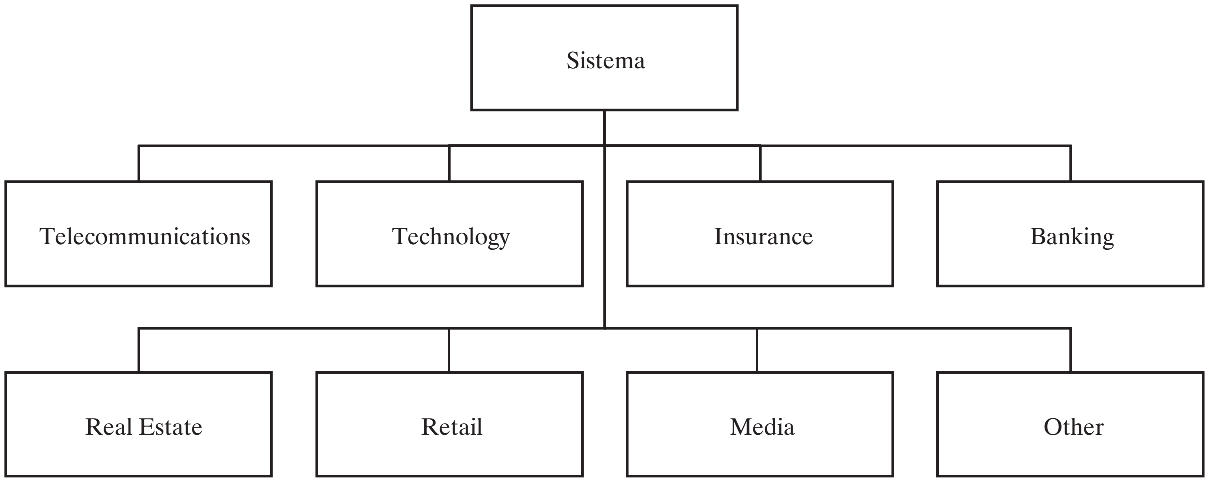
Our track record of growth is the result of organic growth in our businesses, investments in new ventures, acquisitions of established businesses with the potential to benefit from restructuring or additional investment and opportunistic disposals of selected businesses.

Since our inception, we have actively used strategic partnerships to ensure our access to the management skills, technology and know-how of best-in-class international businesses in our chosen sectors. We have a track record of establishing and managing partnerships with highly regarded corporations, including Deutsche Telekom, Allianz and Siemens.

Vladimir Evtushenkov, our President and a member of our Board of Directors, owns 78.03% of Sistema. Certain of our senior managers, directors and other individuals own Sistema's remaining shares. Mr. Evtushenkov was appointed as President and Evgeny Novitsky was appointed as Chairman of our Board of Directors on January 23, 2005. Prior to that date, Mr. Evtushenkov had, since 1994, served as Chairman of our Board of Directors, and Mr. Novitsky had, since 1995, served as our President.

Our Business

We operate principally in the following sectors: telecommunications, technology, insurance, real estate, banking, retail and media. Our other businesses consist of travel services, international operations, radio and space technology, pharmaceuticals and biotechnology, as well as the operations of our parent company.



Telecommunications. The companies in our Telecommunications Segment form the largest privately held telecommunications group in Russia in terms of revenues and number of subscribers. The segment has two divisions: wireless communications services and fixed line communications services. Our wireless telecommunications services division consists of MTS, the largest wireless operator in Russia and the CIS, and Sky-Link, a CDMA 2000 operator in Moscow, St. Petersburg and the surrounding regions. We beneficially own a 50.6% interest in MTS, which generated net standalone revenues of $2,546.2 million and $2,807.3 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively.

Our fixed line communications services division consists of MGTS, the incumbent PSTN operator in Moscow, and Comstar UTS, a leading provider of unregulated telecommunications services in Moscow. MGTS had approximately 4.2 million active lines in service as of September 30, 2004, and Comstar UTS had over 26,200 corporate and public sector customers and approximately 394,019 Internet subscribers, of which 47,338 were ADSL subscribers. Sistema has management control of these two businesses. We beneficially own 46% of MGTS. Our voting interest in MGTS is equal to 56%. Comstar UTS is currently being formed as a single legal entity and integrated business through the restructuring of our interests in existing alternative operators and Internet service provider businesses including Comstar, MTU-Inform, Telmos, Golden Line and MTU-Intel. We plan to complete the restructuring during 2005. Upon completion of the restructuring, we expect that Sistema will own at least a 51% stake in Comstar UTS and MGTS will own at least an additional 45% stake in Comstar UTS. Our Telecommunications Segment accounted for 81.0% of our consolidated revenues and 98.6% of our consolidated operating income before depreciation and amortization for the nine months ended September 30, 2004.

Technology. Our Technology Segment consists of CSC and its subsidiaries. The segment has four divisions: telecommunications equipment and software; IT and systems integration; semiconductor design and manufacturing; and electronic devices and consumer electronics. For the nine months ended September 30, 2004, our Technology Segment accounted for 6.8% of our consolidated revenues.

Insurance. Through ROSNO and its subsidiaries, we are one of the leading providers of insurance, reinsurance and related products in the Russian insurance market. ROSNO's principal activities are non-life and life insurance, as well as insurance-related services, such as obligatory insurance. We have a strategic partnership with ROSNO's 47% shareholder, Allianz, one of the largest European insurance companies. Our Insurance Segment accounted for 4.5% of our consolidated revenues for the nine months ended September 30, 2004.

Banking. Our Banking Segment is represented by MBRD, a joint stock bank incorporated in 1993. MBRD has historically performed internal treasury functions for us and our subsidiaries. However, we intend to develop MBRD's business, particularly in the retail banking sector. MBRD has a history of steady development despite several recent financial crises in Russia. Our Banking Segment accounted for 0.8% of our consolidated revenues for the nine months ended September 30, 2004.

Real Estate. We are a leading real estate owner, developer and manager predominantly focused on the Moscow market in the segments of Class A and B offices, elite housing, cottages and land development. We have been in the real estate business since the early 1990s, making real estate one of our first businesses. Since 1994, we have successfully completed more than 20 projects totaling over 150,000 sq.m. of space, utilizing funding from internal sources and from third parties. Our real estate strategy is two-pronged: (i) continue to develop, redevelop and build profitable projects on our current sites or sites to be sourced by us in the future through our extensive network of market contacts and (ii) redevelop those properties in our significant real estate holdings that are no longer fully used by our operations.

Retail. We are the largest retailer of children's goods in Russia through our children's goods retailer Detsky Mir. Detsky Mir is among the most recognized brands in Russia. As of September 30, 2004, we operated seven stores in Moscow, including the flagship Detsky Mir store in central Moscow, and two stores outside of Moscow with a total retail space of 21,719 sq.m. We plan to expand Detsky Mir by opening new stores in Moscow and other Russian cities and to undertake a significant refurbishment of our flagship store.

Media. Our media business has historically operated in three main areas: advertising, print distribution and other media, which includes a number of secondary companies that operate in areas such as publishing, film production and news services. As a result of a recent strategic review of our activities, we will be focusing on the development of our pay-TV and interactive services, including multiple distribution platforms (video over DSL, MMDS, HFC cable) and content aggregation and production.

Other Businesses. Our other businesses include travel services, international operations, radio and space technology, pharmaceuticals and biotechnology, as well as the operations of our parent company.

Our Other Businesses Segment, which includes our real estate, retail and media businesses for financial reporting purposes, accounted for 6.8% of our consolidated revenues for the nine months ended September 30, 2004.

Strategy

Our strategy is to capitalize on our competitive advantages to build market-leading businesses in select sectors which exploit the growth in consumer and corporate purchasing power in the Russian and CIS markets.

Competitive Strengths

- ***Track Record of Creating and Realizing Shareholder Value.*** We have a considerable track record of successful investments in Russia and the CIS. Our track record is a key factor in attracting further management expertise, strategic partners and capital to our businesses.
- ***Access to Attractive Investment Opportunities.*** We enjoy a competitive advantage in sourcing new investment opportunities due to the scale and scope of our operations, our track record of successful strategic partnerships and our network of relationships in the corporate and public sectors.
- ***Unmatched Customer Base.*** Our businesses collectively have one of the largest customer bases in Russia and the CIS, with over 35 million customers. Our customer base is a testament to our strength in services-based industries and provides us with unparalleled insight into consumer behavior and market trends. This allows us to maintain leadership in our existing businesses, exploit cross-selling opportunities between our businesses and identify potential investments in new sectors more quickly than our competitors.
- ***Superior Pool of Management Resources.*** We have developed a unique pool of management resources combining entrepreneurs with proven ability to create and develop successful businesses, managers with diverse industry and government experience and younger, Western-educated professionals. We have a successful track record of retaining our senior managers and ensuring their career development through exposure to a broad range of industries, enabled by the scope of our operations.
- ***Successful Partnerships.*** We have a track record of successful partnerships with leading international companies such as Deutsche Telekom with respect to our telecommunication business, Allianz with respect to our insurance business and Siemens with respect to our technology business. We believe such partnerships help our businesses to develop more rapidly by providing us with strategic and operational expertise, as well as best-in-class management resources.
- ***Access to Capital.*** We believe that as a result of our track record of successful investments and the scale and scope of our operations, we have superior access to capital as compared to many of our competitors. We and our subsidiaries have a proven track record of attracting investment from the international capital markets, leading international companies and other third parties, in part, due to our leadership in financial transparency. This access to capital enables us to accelerate the development of our businesses and take advantage of new investment opportunities.
- ***High Corporate Governance and Financial Reporting Standards.*** We seek to adhere to high standards of financial disclosure and corporate governance. Our financial statements have been prepared in accordance with U.S. GAAP since 1998. Standard & Poor's awarded our subsidiary MTS one of the highest corporate governance rankings of any Russian company. Our commitment to high standards of corporate governance is critical to attracting capital and ensuring the long-term development of our businesses.

Investment and Operating Principles

- ***We Employ a Return-Based Approach to Investments.*** We employ a disciplined approach to our investment decisions with the aim of maximizing returns for our shareholders. Our internal performance benchmarks require that our businesses achieve certain operational, revenue and profitability targets, which also reflect the nature of these individual businesses. Progress against these targets is monitored and used to develop annual budgets, long-term business plans and capital allocation strategies. Companies that fail to achieve their objectives in a specified time frame generally cease to be beneficiaries of direct investments from Sistema and, should they continue to fall short of our objectives, may be sold. Similarly, we may dispose of businesses in industries that have largely fulfilled their growth potential.

- ***We Have a Focused Approach to Growth Opportunities.*** We have finite financial and managerial resources and, therefore, we concentrate our resources on select sectors in which we believe we can capitalize on our competitive advantages to build market-leading businesses. We exploit our close understanding of the markets in which we operate, as well as our established corporate and government relationships to source attractive investment opportunities in a variety of industries at an early stage. In doing so, we capitalize on our management team, which brings substantial experience of growing businesses across a broad range of sectors in Russia and the CIS. Our business development strategy is focused on achieving growth both through organic development of our businesses and through acquisitions. We provide capital, management, administrative and other resources to accelerate the business plans of our companies through business line extension, geographic expansion, participation in industry consolidation and cross-selling with our other businesses. We constantly evaluate potential entry into new high-growth sectors that may meet our investment requirements. We also evaluate selective international expansion opportunities in cases where we can capitalize on our competitive strengths. Where appropriate, we will accelerate the development of our businesses by capitalizing on our ability to access the international capital markets.

- ***We Actively Manage Our Investments.*** We have management control of our key businesses and operate as an active investor. We contribute significant management and other resources to accelerating the development of our businesses, particularly in the early stages of their life-cycles. For example, the rapid growth of our telecommunications businesses is largely a function of our ability to attract and retain skilled management. Continuing to attract and retain top quality managers to develop our businesses will remain one of our key priorities in the future.

- ***We Seek to Develop Strategic Partnerships.*** Strategic partners have also played an important role in the development of certain of our businesses. Our strategic partnerships with Deutsche Telekom and Allianz have accelerated the growth of our wireless communications and insurance businesses, respectively. We have also recently concluded a long-term partnership agreement with Siemens to assist in the development of our technology business. We will evaluate the potential to enter into further strategic partnerships in certain of our other businesses wherever a strategic partner can add significant value to that business through their brand strength, intellectual property contribution, operational expertise or international presence.

- ***We Exploit Intra-Group Synergies.*** As the largest private sector consumer services company in Russia and the CIS, we believe our businesses present certain cross-selling opportunities, as well as the potential to benefit from economies of scale in their purchasing and selling activity. We also endeavor to capitalize on our vertical integration capabilities and exploit synergy opportunities, for example, by taking advantage of our combined customer base of over 35 million customers in Russia and the CIS.

Recent Developments

In line with our strategy of pursuing profitable growth opportunities, we are currently reviewing a potential opportunity to invest in India's mobile telecommunications market, partially using debt financing from the Russian Government, involving a swap of Indian sovereign debt from Russia to Sistema. In December 2004, we entered into a preliminary and non-binding agreement with Sterling, a conglomerate that owns mobile telecommunications assets in India. The parties intend that Sistema will form a wholly owned subsidiary in India to acquire 51% of Sterling's subsidiary, ATVL, through the injection of $450 million in the equity capital of ATVL.

ATVL currently holds 100% of Aircel Limited and Aircel Cellular Limited, leading mobile telecommunications operators in the Tamil Nadu and Chennai regions. It is intended that by the time of completion, ATVL would also own 100% of Dishnet Wireless Limited, a greenfield operation holding UAS licenses in seven circles in North-Eastern India with plans to acquire UAS licenses in three additional circles.

Completion of this transaction is subject to a number of conditions, including reaching an agreement on the terms of a share purchase agreement and a shareholders' agreement with Sterling, obtaining favorable debt financing from the Russian Government or governmental agency for the transaction and receipt of the required regulatory approvals.

Telecommunications

Overview

The telecommunications market in Russia, estimated at approximately $11.2 billion in 2003, remains under-penetrated, with telecommunications spending as a proportion of GDP of only 3.7%, compared to 4.5% to 6.5% in the economies of Poland, the Czech Republic and Hungary, according to IDC. The penetration of key telecommunication services in Russia such as mobile telephony and Internet access (both dial-up and broadband) lags behind not only Western Europe but also other Central and Eastern European countries. For example, mobile penetration in Russia as of June 30, 2004 stood at 38%, compared with 86% in Western Europe and 98%, 74% and 40% in the Czech Republic, Hungary and Poland respectively, according to Global Mobile.

We believe that the telecommunications sector in Russia has the potential for significant growth, driven by continued macro-economic growth in Russia and an increase in the proportion of gross domestic product accounted for by telecommunications spending in Russia.

The companies in our Telecommunications Segment form the largest privately held telecommunications group in Russia and the CIS in terms of revenues and number of subscribers. The segment has two divisions: wireless communications services and fixed line communications services. Our wireless communications services division consists of MTS, the largest wireless operator in Russia and the CIS and a NYSE-listed company, and Sky-Link, a CDMA 2000 operator in Moscow, St. Petersburg and the surrounding regions. As of September 30, 2004, MTS had 26.6 million subscribers and Sky-Link had 176,000 subscribers. As of December 31, 2004, MTS had 34.2 million subscribers. We beneficially own 50.6% of MTS' share capital and have management control over MTS. We beneficially own 42% of Sky-Link. Our voting interest in Sky-Link is equal to 50%, and we share the management function of Sky-Link with RTDC, a Russian telecommunications company that owns the remaining 50% of the share capital of Sky-Link. We account for Sky-Link under the equity method.

In September 2004, we acquired an additional 29.8% voting interest in MTT, an operator of a nationwide transit network providing telecommunications services and network interconnection for mobile and fixed network operators throughout Russia, for cash consideration of $39.8 million, thereby increasing our beneficial ownership interest to 35.8% and our voting interest to 44.8%.

Our fixed line communications services division consists of MGTS, the incumbent PSTN operator in Moscow, and Comstar UTS, a leading provider of unregulated telecommunications services in Moscow. MGTS had approximately 4.2 million active lines in service as of September 30, 2004, and Comstar UTS had over 26,200 corporate and public sector customers and approximately 394,019 Internet subscribers, of which 47,338 were ADSL subscribers. Sistema has management control of these two businesses. We beneficially own 46% of MGTS. Our voting interest in MGTS is equal to 56%. Comstar UTS is currently being formed as a single legal entity and integrated business through the restructuring of our interests in existing alternative operators and Internet service provider businesses including Comstar, MTU-Inform, Telmos, Golden Line and MTU-Intel. We plan to complete the restructuring during 2005. Upon completion of the restructuring, we expect that Sistema will own at least a 51% stake in Comstar UTS and MGTS will own at least an additional 45% stake in Comstar UTS. Our Telecommunications Segment accounted for 81.0% of our consolidated revenues and 98.6% of our consolidated operating income before depreciation and amortization for the nine months ended September 30, 2004.

Our Telecommunications Segment revenues were $3,247.6 million and $3,350.4 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively, and its operating income before depreciation and amortization was $1,609.9 million and $1,821.1 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively.

The following table presents revenues and operating income before depreciation and amortization of our consolidated subsidiaries within our Telecommunications Segment, prior to intercompany eliminations:

	Years ended December 31,						Nine months ended September 30,			
	2001	% of revenues	2002	% of revenues	2003	% of revenues	2003	% of revenues	2004	% of revenues
	(Amounts in thousands, except percentages)									
Revenues										
Wireless services										
MTS[(1)]	$ —	—%	$ —	—%	$2,639,363	81.3%	$1,867,662	82.2%	$2,865,097	85.5%
P-Com[(2)]	31,405	7.5	44,544	9.2	51,305	1.6	38,034	1.7	—	—
Total	31,405	7.5	44,544	9.2	2,690,668	82.9	1,905,696	83.8	2,865,097	85.5
Incumbent fixed line services										
MGTS[(3)]	274,371	65.1	303,021	62.8	380,389	11.7	279,412	12.3	343,830	10.3
Alternative fixed line services										
MTU-Inform[(4)]	91,436	21.7	92,259	19.1	101,296	3.1	75,760	3.3	73,634	2.2
Telmos[(5)]	33,874	8.0	36,722	7.6	37,548	1.2	26,098	1.1	34,638	1.0
Comstar[(6)]	—		—		66,548	2.0	—	—	56,185	1.7
Total	125,310	29.8	128,981	26.7	205,392	6.3	101,858	4.5	164,457	4.9
Internet and data services										
MTU-Intel[(7)]	13,839	3.3	29,386	6.1	46,122	1.4	33,292	1.5	44,836	1.3
Golden Line[(8)]	—	—	11,830	2.5	14,293	0.4	10,109	0.4	11,654	0.3
Total	13,839	3.3	41,216	8.5	60,415	1.9	43,401	1.9	56,490	1.7
Other telecom subsidiaries	8,859	2.1	14,684	3.0	21,669	0.7	13,523	0.6	35,986	1.1
Intercompany eliminations	(32,628)	(7.7)	(49,723)	(10.3)	(109,771)	(3.4)	(71,126)	(3.1)	(115,481)	(3.4)
Total	$421,156	100%	$482,723	100%	$3,247,568	100%	$2,272,764	100%	$3,350,379	100%
OIBDA[(9)]										
Wireless services										
MTS	$ —	—%	$ —	—%	$1,382,623	85.9%	$ 973,233	87.3%	$1,646,138	90.4%
P-Com	6,311	2.2	14,103	4.1	13,114	0.8	(8,632)	1.0	—	—
Total	6,311	2.2	14,103	4.1	1,395,737	86.7	964,601	88.2	1,646,138	90.4
Incumbent fixed line services										
MGTS	115,790	40.0	120,584	35.2	142,200	8.8	107,406	9.6	117,212	6.4
Alternative fixed line services										
MTU-Inform	61,935	21.4	51,405	15.0	41,153	2.6	46,758	4.2	38,590	2.1
Telmos	10,918	3.8	11,205	3.3	1,547	0.1	(335)	(0.0)	8,510	0.5
Comstar	—	—	—	—	17,471	1.1	—	—	12,837	0.7
Total	72,853	25.2	62,610	1	60,171	3.7	46,423	4.2	59,937	3.3
Internet and data services										
MTU-Intel	1,052	0.4	3,679	1.1	803	0.0	(1,257)	(0.1)	1,234	0.1
Golden Line	—	—	6,325	1.8	7,034	0.4	4,990	0.4	5,453	0.3
Total	1,052	0.4	10,004	2.9	7,837	0.5	3,733	0.3	6,687	0.4
Affiliates	96,328	33.3	122,638	35.8	—	—	—	—	—	—
Other telecom subsidiaries	(2,686)	(0.9)	5,273	1.5	1,754	0.1	(1,270)	(1.1)	(1,252)	(0.1)
Intercompany eliminations	—	—	6,982	2.0	2,227	0.1	(5,624)	(2.2)	(7,573)	(0.4)
Total	$289,648	100%	$342,194	100%	$1,609,926	100%	$1,115,269	100%	$1,821,149	100%

(1) There were no intercompany eliminations for MTS in any of the periods presented. For 2001 and 2002, we accounted for our investment in MTS under the equity method. Effective January 1, 2003, MTS' accounts have been consolidated in our financial statements, with pre-acquisition earnings on the additional 10% interest purchased in April 2003 included in minority interest in the statement of operations.

(2) There were no intercompany eliminations for P-Com in any of the periods presented.

(3) Intercompany eliminations were $15.1 million, $26.2 million and $51.0 million for the years ended December 31, 2001, 2002 and 2003, respectively and $26.8 million and $48.4 million for the nine months ended September 30, 2003 and 2004, respectively. The figures also include revenues from Internet and data services, which accounted for less than 5% of MGTS' total revenues in each period.

(4) Intercompany eliminations were $16.8 million, $10.7 million and $41.5 million for the years ended December 31, 2001, 2002 and 2003, respectively, and $30.0 million and $28.4 million for the nine months ended September 30, 2003 and 2004, respectively. The figures also include revenues from Internet and data services, which accounted for less than 5% of MTU-Inform's total revenue in each period.

(5) Intercompany eliminations were $0.8 million, $0.5 million and $3.4 million for the year ended December 31, 2001, 2002 and 2003, and $2.4 million and $2.0 million for the nine months ended September 30, 2003 and 2004, respectively. The figures also include revenues from Internet and data services, which accounted for less than 5% of Telmos' total revenue in each period.

(6) Intercompany eliminations were $3.9 million for the year ended December 31, 2003 and nil and $3.2 million for the nine months ended September 30, 2003 and 2004, respectively.

(7) Intercompany eliminations were $1.4 million for the year ended December 31, 2003. There were no intercompany eliminations for MTU-Intel for the nine months ended September 30, 2003 and 2004.

(8) There were no intercompany eliminations for Golden Line in any of the periods presented.

(9) OIBDA represents operating income before depreciation and amortization. OIBDA is not a measure of financial performance under U.S. GAAP. You should not consider it an alternative to net income as a measure of operating performance or to cash flows from operating activities as a measure of liquidity. Our calculation of OIBDA may be different from the calculation used by other companies and, therefore, comparability may be limited. We believe that OIBDA provides useful information to investors because it is an indicator of the strength and performance of our ongoing business operations, including our ability to fund discretionary spending such as capital expenditures, acquisitions of subsidiaries and other investments and our ability to incur any services debt. While depreciation and amortization are considered operating costs under U.S. GAAP, these expenses primarily represent non-cash current period allocation of costs associated with long-lived assets acquired or constructed in prior periods.

The following table presents key operating statistics of our consolidated telecommunications subsidiaries on a standalone basis:

	At December 31,			At September 30,	
	2001	2002	2003	2003	2004
Wireless services					
MTS					
Subscribers(1)(2)	2,650,539	6,644,628	16,718,282	13,896,733	26,633,113
Sky-Link					
Active subscribers(3)	55,981	79,851	131,416	116,883	175,631
Incumbent fixed line services					
MGTS					
Active lines in service(4)					
Residential subscribers	3,287,332	3,369,698	3,409,841	3,398,475	3,448,361
Public sector subscribers(5)	472,622	481,968	481,096	481,921	482,641
Corporate subscribers	236,632	232,816	235,854	234,599	239,540
Total	3,996,586	4,084,482	4,127,791	4,114,995	4,170,542
Alternative fixed line services					
MTU Inform					
Active lines in service(6)					
Corporate subscribers	78,327	103,169	108,274	108,409	115,300
Mobile operators(7)	254,365	269,384	269,391	269,391	269,394
Other	3,762	4,669	6,644	3,881	4,732
Total	336,454	377,222	384,309	381,681	389,426
Comstar					
Active lines in service(8)	57,072	63,128	69,889	68,312	71,719
Telmos					
Active lines in service(9)	43,586	48,117	55,548	54,791	68,819
MTU-Intel					
Active subscribers(10)					
Dial-up residential subscribers	252,069	349,450	445,350	362,818	317,175
Dial-up corporate subscribers	6,013	6,957	7,800	7,712	7,506
Total dial-up subscribers	258,082	356,407	453,150	370,530	324,681
ADSL residential subscribers	—	784	4,357	3,729	30,265
ADSL corporate subscribers	1,958	5,167	7,893	6,642	9,682
ADSL shared-access subscribers	1,311	2,479	5,724	4,228	6,738
Total ADSL subscribers	3,269	8,430	17,974	14,599	46,277
Other (data transmission channels)	2,439	2,853	3,375	3,245	3,795

(1) MTS defines a subscriber as an individual or organization whose account shows chargeable activity within the previous 61 days (or 183 days in the case of the "Jeans" brand tariff) and whose account does not have a negative balance for more than this period.

(2) MTS does not include its subscribers in Belarus in its operating information, because MTS' joint venture in Belarus is accounted for as an equity investment and therefore is not consolidated in its financial statements.

(3) A subscriber is considered to be "active" if the subscriber has a positive balance on its account. Sky-Link was established in June 2003, and we contributed our stakes in P-Com and MCC to Sky-Link during 2004. See "—Wireless communications services—Business Description—Sky-Link." Active subscriber data for 2001 include CDMA subscribers of P-Com; active subscriber data for 2002 and the nine months ended September 30, 2003 include CDMA subscribers of P-Com and Delta Telecom; and active subscriber data for 2003 and September 30, 2004 include CDMA subscribers of P-Com, Delta Telecom and MCC.

(4) A line is considered to be "active" if the subscriber has paid a monthly subscription fee within the last 45 days.

(5) Includes state-owned enterprises and governmental agencies funded by the federal budget.

(6) A line is considered to be "active" if the subscriber has paid a monthly subscription fee within the last 30 days.

(7) Data represent underlying number of wireless subscribers for which Comstar UTS has provided numbering capacity.

(8) A line is considered to be "active" if the subscriber has paid a monthly subscription fee within 10 to 40 days from the billing date.

(9) A line is considered to be "active" if the subscriber has paid a monthly subscription fee within 10 to 40 days upon billing.

(10) A dial-up subscriber is "active" if the subscriber has used MTU-Intel's Internet service within the last 30 days. A broadband subscriber is "active" if the subscriber has paid a monthly subscription fee within the last 30 days.

The strategy for our Telecommunications Segment is to take advantage of our unique position in the Russian telecommunications market to build on or develop market-leading positions in both fixed line and wireless telecommunications services in order to exploit the rapid growth in telecommunications spending in Russia and the CIS.

We believe that the companies in our Telecommunications Segment are strategically positioned with respect to a range of key technologies. This enables us to provide a broad range of services including GSM wireless telephony and emerging broadband wireless voice and data services; basic fixed line network technology services, such as voice and dial-up Internet access; advanced fixed line services, such as broadband Internet access via ADSL and direct fiber optic connections; IP-enabled voice and data services; and emerging Pay-TV applications. We intend to continue to exploit those key existing and emerging technologies, which we believe will enable us to deliver the services demanded by our customers, including retail customers, government entities, corporations and other telecommunications operators.

Our strategy in the Telecommunications Segment is to preserve and strengthen our position as the leading wireless operator in Russia and the CIS and the leading provider of fixed line services in Moscow. We intend to leverage our dominant presence in Russia and to expand selectively to enhance our presence in selected Russian regions and in other CIS countries.

Wireless communications services

Business Description

MTS. MTS is a leading provider of GSM technology-based wireless communications services in Russia, Ukraine and certain other CIS countries. For the nine months ended September 30, 2004, MTS generated net revenues of $2,807.3 million and had a subscriber base of 26.6 million (20.8 million in Russia, 5.5 million in Ukraine and 0.3 million in Uzbekistan) at September 30, 2004, making it the largest wireless operator in each of these three countries in terms of subscribers. MTS is listed on the NYSE and the Moscow Interbank Currency Stock Exchange.

In addition to standard voice services, MTS offers its subscribers value-added services including voice mail, SMS, GPRS, various SMS- and GPRS-based information and entertainment services (including MMS) and data and fax transmission. MTS also offers its subscribers the ability to roam automatically throughout Europe and in much of the rest of the world, and as of September 30, 2004, MTS had bilateral roaming agreements with 283 wireless operators in 159 countries.

MTS has grown rapidly since 1999 through organic growth, as well as acquisitions. The table below sets forth MTS' total subscribers as of the end of, and net revenues for each of, the last five years and the nine months ended September 30, 2004:

Period	Subscribers[1]	Net revenues
	(Amounts in thousands)	
1999	306	$ 358,327
2000	1,194	535,712
2001	2,650	893,247
2002	6,644	1,361,756
2003	16,720	2,546,198
September 30, 2004	26,633	2,807,338

(1) MTS defines a subscriber as an individual or organization whose account shows chargeable activity within the previous 61 days (or 183 days in the case of the "Jeans" brand tariff) and whose account does not have a negative balance for more than this period.

Russia is MTS' principal market, both in terms of subscribers and revenues. At September 30, 2004, approximately 78% of MTS' subscriber base was in Russia and approximately 21% was in Ukraine. For the nine months ended September 30, 2004, approximately 79% of MTS' revenues came from its operations in Russia and 21% from its operations in Ukraine.

According to AC&M-Consulting, MTS had a 35% market share of total wireless subscribers in Russia at September 30, 2004. MTS' market share in the Moscow license area, which encompasses the City of Moscow and the Moscow region, was higher at 45%. The Moscow license area accounts for approximately 25% of MTS' total subscriber base. In Ukraine, MTS had a 52% market share at September 30, 2004, according to AC&M-Consulting. MTS' subscriber base continued to grow in the fourth quarter of 2004. At December 31, 2004, MTS had approximately 34.2 million subscribers, of which 26.5 million were in Russia, 7.4 million were in Ukraine and 0.3 million were in Uzbekistan.

Overall wireless penetration in Russia was at approximately 41% at September 30, 2004, and higher in Moscow at 87%, according to AC&M-Consulting. Wireless penetration in Ukraine was lower than in Russia at approximately 22% at September 30, 2004, according to AC&M-Consulting. Mobile cellular penetration in Uzbekistan was at approximately 2% at September 30, 2004, according to AC&M-Consulting. The low level of wireless penetration in the markets in which MTS operates presents it with future growth opportunities.

As of September 30, 2004, MTS had licenses to operate in 87 regions of Russia with a population of approximately 142.6 million people, or approximately 98% of the country's total population, and in the entire territory of Ukraine, which has a population of approximately 48 million people. As of September 30, 2004, MTS had commercial operations in 63 regions of Russia, with a combined population of approximately 125.3 million people in all of Ukraine and in selected areas of Uzbekistan. As of September 30, 2004, MTS had numbering capacity for over 12.4 million subscribers in the Moscow license area.

MTS currently operates one of four experimental third-generation networks existing in Russia utilizing rented network equipment. The 3G Association, an industry group charged with advising the Russian government on the procedure for allocating third-generation licenses and regulating third-generation operations, has proposed that MTS, Vimpelcom and MegaFon each be issued a third-generation license, and that a fourth license be issued to a fourth operator. Though the government was expected to announce the license allocation procedure during the second half of 2002 and issue the licenses during 2003, to date, no allocation procedures have been announced.

To maintain and increase its market share and brand awareness, MTS uses a combination of print media, radio, television, direct mail and outdoor advertising, focusing on brand and image advertising, as well as promotion of particular tariff plans. Supporting these efforts, MTS has developed an extensive distribution network with over 300 proprietary sales and customer service offices and an additional 27,000 points of sale operated by its dealers as of September 30, 2004.

MTS seeks to minimize its exposure to the credit risk of its subscribers through its advance-payment billing system, which is used by over 98% of its subscribers in Russia and approximately 80% of its subscribers in Ukraine. Under this system, MTS' subscribers prepay their access, usage and value-added service fees.

MTS also has equity investments in a wireless operator in Belarus, which had a total of 0.97 million subscribers as of September 30, 2004 and, according to AC&M-Consulting, a market share of 49%. The subscriber base of MTS Belarus grew to 1.2 million at December 31, 2004. Belarus, a country with a population of approximately 9.8 million, had a wireless penetration rate of 20% at September 30, 2004 according to AC&M-Consulting.

MTS shareholders approved dividends in the amount of $111 million and $220 million for 2002 and 2003, respectively, which equaled 31.3% and 48.0% of the profit of MTS determined under Russian Accounting Standards and 40.0% and 42.5% of MTS' standalone U.S. GAAP net income for these years.

T-Mobile currently owns 10.1% of the outstanding common shares of MTS, after having disposed of a 15.1% stake in MTS in December 2004.

Sky-Link. Sky-Link was established in June 2003 as a joint venture between Sistema and RTDC, a Russian telecommunications company, in order to consolidate the assets of wireless NMT and CDMA 800 operators. This consolidation will create the only national wireless data and voice services provider operating using CDMA 2000 technology in Russia.

We acquired a 42% beneficial ownership interest and a 50% voting interest in Sky-Link in October 2003. In August 2004, we sold our 83.5% interest in P-Com, a Moscow CDMA 800 operator, to Sky-Link as our contribution to Sky-Link's charter capital. In October 2004, we sold our 23.5% interest in MCC, a Moscow-based NMT-450 operator, to Sky-Link as our further contribution to Sky-Link's charter capital. As of September 30, 2004, MCC had 25,400 active subscribers. The remaining 50% voting interest in Sky-Link is controlled by RTDC, and the corporate governance of Sky-Link is jointly undertaken by us and RTDC. We have appointed the current Chief Executive Officer of Sky-Link, as well as three out of the seven members of Sky-Link's board of directors.

Sky-Link is in the process of further consolidating various telecommunication companies under its umbrella, including St. Petersburg-based operator Delta Telecom and Svyazinvest's NMT-450 companies. This restructuring has further streamlined our telecommunication assets with the goal of positioning Sky-Link as a national CDMA 2000 operator.

The targeted market segment for CDMA 2000 services consists of selected corporate and heavy user private subscribers desiring wireless transfer of multimedia data, high-speed Internet access and significant volumes of high-quality voice traffic.

Strategy

MTS' primary goal is to maintain its position as a leading wireless operator in Russia and the CIS by strengthening its position across the markets in which it operates and deploying a customized approach to different customer segments. To accomplish this, MTS intends to implement the following strategies:

- Maintain its leading position by growing its subscriber base and focusing on the quality of its subscriber mix.

- Selectively expand its network to areas in which it does not already operate, focusing on high-density population areas and on areas along transportation routes.
- Continue to provide clearly structured tariff plans and branding propositions, as well as value-added service options, which appeal to the various groups of subscribers within its network, including SMS- and GPRS-based services.
- Continue to take advantage of its strong position in the major urban license areas, including Moscow and St. Petersburg, as a platform from which to test and launch new products and services.
- Further develop subscriber loyalty programs aimed at retaining its most valuable high-revenue subscribers.

In the past few years, MTS has rapidly expanded into the Russian regions and select CIS countries through launches of operations in territories in which it had licenses and through acquisitions of other mobile operators. Starting in 2003, MTS has become particularly focused on the integration of its existing businesses into a single company with a unified marketing approach and centralized network and operations management. MTS is currently working to complete the implementation of a centrally-managed corporate function to enhance performance and efficiency at all levels of its operations and simultaneously integrate its operations. In addition, MTS intends to continue to consolidate its ownership in regional subsidiaries by acquiring remaining minority stakes.

MTS' capital expenditures (consisting of purchases of property, plant and equipment and intangible assets) in 2003 and for the nine months ended September 30, 2004 were $958.8 million and $780.2 million, respectively, and MTS estimates having invested approximately $400 million in the fourth quarter of 2004 and expects to invest approximately $1.8 billion in 2005. These investments are required to support the growth of MTS' subscriber base (*i.e.*, to improve network capacity) and to develop its network in the new regions for which it received licenses in 2003 and 2004.

MTS may also expand its operations into other countries of the CIS through the acquisition of existing operators or new licenses as attractive opportunities arise.

Implementation of these strategies is subject to a number of risks. See "Risk Factors—Risks Relating to Our Business—Risks Relating to Our Telecommunications Business" for a description of these and other risks MTS faces.

While we will continue to promote GSM as the technology of choice for the Russian wireless communications market, we believe that our Sky-Link operations will allow us to benefit from and control the development of the alternative CDMA technology in Russia, and provide us with an important presence in the wireless broadband market. Our entry into this niche market is driven, in part, by the uncertain license allocation, development path and timeframe for other broadband technologies. See "Risk Factors—Risks Relating to Our Business—Risks Relating to Our Telecommunications Business—MTS may be unable to obtain licenses for third-generation, or UMTS, wireless services on commercially reasonable terms or at all, which would hinder it from competing effectively with operators who are able to provide these services and limit its ability to expand its services."

Market and Competition

The Russian wireless telecommunications market

The Russian wireless telecommunications market is characterized by rapid growth in subscribers and revenues and increasing consolidation among a few large national operators. As of September 30, 2004, overall wireless penetration in Russia was 41%, or approximately 59 million subscribers, according to AC&M-Consulting. According to AC&M-Consulting, total revenues in the Russian wireless communications market reached $5.5 billion in the nine months ended September 30, 2004, representing an increase of 77% over the same period in 2003. According to Pyramid Research, the Russian wireless market is expected to continue growing at 18% per annum in revenue terms from 2004 through 2007.

Demand for wireless communications services in Russia grew rapidly over the last ten years due to rising disposable incomes, increased business activity and declining prices due to intensified competition among wireless communications providers. The number of wireless subscribers more than doubled in each of the last two years, with Russia's regional markets growing at almost triple the rate of Moscow and St. Petersburg. The Russian market has achieved high levels of penetration in Moscow and St. Petersburg, with more than 79 subscribers per 100 residents at September 30, 2004, according to AC&M-Consulting. Regional markets remain relatively under-penetrated, with an average of less than 33 subscribers per 100 residents.

The following table sets forth key data on Russia's wireless telecommunications market:

	As of December 31,					As of September 30,
	1999	2000	2001	2002	2003	2004
	(Amounts in millions, except percentages)					
Subscribers[1]	1.0	3.0	6.3	18.0	36.3	59.0
Subscriber penetration	1%	2%	4%	12%	25%	41%
% Prepay customers	N/A	30%	31%	41%	65%	71%

Source: AC&M-Consulting.

(1) Based on registered subscribers. There is no uniform definition of active lines in service in the Russian fixed line market.

As of December 31, 2003 and September 30, 2004, respectively, MTS accounted for 43% and 45% of subscribers in Moscow, 34% and 32% of subscribers in the North-West region and 37% and 35% of total Russian subscribers, according to AC&M-Consulting and our own data.

MTS competes with at least one other wireless operator in each of its markets. The competition has evolved in recent years to exist primarily between MTS, Vimpelcom and MegaFon, each of which has effective national coverage in Russia. Competition today is based largely on local tariff prices and secondarily on network coverage and quality, the level of customer service provided, roaming and international tariffs and the range of services offered. For a description of the risks MTS faces from increasing competition, see "Risk Factors—Risks Relating to Our Business—Risks Relating to Our Telecommunications Business—MTS faces increasing competition from existing licensees that may result in reduced operating margins and loss of market share, as well as different pricing, service or marketing policies."

The following table illustrates the number of wireless subscribers for each network operator in Russia as of December 31, 2001, 2002, 2003 and at the nine months ended September 30, 2004:

	Years ended December 31,			Nine months ended
Operator	2001	2002	2003	September 30, 2004
MTS[1]	2,650,539	6,644,628	16,718,282	26,633,113
Vimpelcom[2]	2,111,500	5,153,088	11,436,900	20,550,000
MegaFon group[3]	913,004	2,935,936	6,340,335	11,487,353
Others[4]	2,365,496	3,275,976	5,082,765	6,867,443

(1) According to MTS' data.

(2) Source: AC&M-Consulting.

Vimpelcom. Vimpelcom, which operates both D-AMPS and GSM 900/1800 networks, is one of MTS' primary competitors in Russia, and it is the second largest GSM wireless operator in Russia in terms of subscribers.

In the Moscow license area, we believe that Vimpelcom will continue to be MTS' primary competitor for the foreseeable future. Vimpelcom and its subsidiaries also hold licenses to operate GSM networks in the North-West region, Central region and Central Black Earth region, the Volga region, the North Caucasus region and the Siberian region. Vimpelcom's entry into the North-West region, which includes St. Petersburg, in April 2003 has led to an increase in competition in that area, and may lead MTS to invest additional amounts in its operations in the region.

According to AC&M-Consulting, Vimpelcom had approximately 20.6 million subscribers in Russia at September 30, 2004, including 6.6 million in the Moscow license area. At September 30, 2004, according to AC&M-Consulting, Vimpelcom had a 45% market share in Moscow and a 34% market share of total wireless subscribers in Russia.

MegaFon. In addition to Vimpelcom, MTS also competes with MegaFon, which is the third largest operator in Russia in terms of subscribers.

The MegaFon group has a GSM 900/1800 license for the Moscow license area and is MTS' primary competitor in the North-West region, where St. Petersburg is located. MegaFon has licenses to operate in all 89 regions of the Russian Federation.

According to AC&M-Consulting, MegaFon had a subscriber base of 11.5 million in Russia at September 30, 2004, including 1.4 million subscribers in the Moscow license area. At September 30, 2004, according to AC&M-Consulting, MegaFon had a 46% market share in the North-West region and a 19% market share of total wireless subscribers in Russia.

In addition, there has been speculation in the media of a merger between MegaFon and Vimpelcom following Alfa Group's August 2003 purchase of a 25.1% stake in MegaFon. For a description of the potential impact of such merger on MTS, see "Risk Factors—Risks Relating to Our Business—Risks Relating to Our Telecommunications Business—A merger between MTS' two largest competitors would result in a change in its relative market share in the Russian wireless communications market."

Other Operators. In addition to MTS' principal competitors, Vimpelcom and MegaFon, MTS also competes with local GSM and D-AMPS operators in several Russian regions.

In Nizhny Novgorod, MTS' primary competitor is Nizhny Novgorod Cellular Communications, which had approximately 523,000 subscribers as of September 30, 2004. In Ekaterinburg, MTS competes with Ekaterinburg Cellular Communications, a D-AMPS operator with over 326,000 subscribers as of September 30, 2004. In Tartarsan, MTS competes primarily with Tatinkom, a D-AMPS operator with over 120,000 subscribers as of September 30, 2004. The preceding subscriber numbers, in each case, are according to AC&M-Consulting.

The Ukrainian wireless telecommunications market

The Ukrainian wireless telecommunications market has been characterized, until recently, by low levels of penetration and historical underinvestment in wireless telecommunications infrastructure. Since 2000, the Ukrainian wireless telecommunications market has enjoyed rapid growth, in part, due to broader economic recovery in Ukraine, changes in ownership of the two major operators and the more recent introduction of calling-party pays billing arrangements. In 2003, overall wireless penetration in Ukraine increased 6% to reach 14%, or approximately 6.5 million subscribers, according to AC&M-Consulting. According to the same agency, total revenues in the wireless communications market reached $815 million in 2003, representing an increase of 38% in 2003.

The following table shows the number of subscribers as of the dates indicated and the coverage area of UMC and MTS' competitors in Ukraine:

Operator	December 31, 2003	September 30, 2004	Coverage Area
UMC	3,348,610	5,527,519	Nationwide
Kyivstar	3,036,000	5,040,000	Nationwide
Golden Telecom	41,000	57,000	Kiev, Odessa
DCC	85,000	85,000	Kiev, Odessa, Dnepropetrovsk, Donesk, Lugansk, Crimea
WellCOM	40,200	47,000	Kiev

Source: MForum.ru.

In Ukraine, MTS competes primarily with Kyivstar, a GSM operator with over 5.0 million subscribers as of September 30, 2004. Kyivstar is owned by Telnor and Alfa Group. Kyivstar offers wireless services using GSM 900 and GSM 1800 technologies and was the market leader in terms of subscribers from June 2001 until September 2003, according to Kyivstar press releases. Golden Telecom Ukraine, which is beneficially owned by Alfa Group, Telnor and Rostelecom, offers wireless services using GSM 1800 technology. DCC holds a license to provide wireless cellular services using the D-AMPS standard and, through its subsidiary Astelit, holds a GSM-1800 license. According to press reports, Turkcell has acquired a controlling interest in DCC. URS WellCOM has a license and operates a limited network in the GSM-900 standard. In addition, Telesystemy Ukrainy and Elsakom-Ukraine each hold licenses to offer wireless services in Ukraine but are not yet in operation.

Incumbent PSTN fixed line communication services

Business Description

MGTS is the incumbent fixed line PSTN operator in the Moscow metropolitan area. MGTS owns Moscow's PSTN infrastructure, including switches, transmission network, underground ducts and properties housing MGTS' offices and equipment. We acquired our interest in MGTS in the period from 1995 to 1998. In April 1995, we won a privatization tender for MGTS and were issued 25% of MGTS' shares. As part of our tender obligations, we committed to invest approximately $106 million in MGTS over a three-year period. In 1998, upon satisfying our tender obligations, we were issued additional share capital representing 50% of the share capital of MGTS at the time. At the time we took possession of this stake, there were press reports that certain minority shareholders of MGTS had filed complaints with the prosecutor's office and the Federal Commission on the Securities Market objecting to the share issuance. Although no formal action or claim by MGTS shareholders or any governmental entity was ever made, we cannot assure you that the privatization of MGTS will not be challenged in the future. See "Risk Factors—Risks Related to Our Business—General Risks—In the event that deficiencies or ambiguities in privatization legislation are successfully exploited to challenge our ownership in our privatized subsidiaries and we are unable to defeat these challenges, we risk losing our ownership interests in our subsidiaries or their assets, which could materially adversely affect our prospects, business and results of operations."

As of September 30, 2004, MGTS had approximately 4.2 million active lines in service, a cable network of over 94,000 kilometers and 18,568 payphones. Although MGTS' core backbone network is fully digital and is based on state-of-the-art Synchronous Digital Hierarchy, or SDH technology, only around 19% of its automatic telephone exchanges were digital as of September 30, 2004. Residential subscribers accounted for approximately 82.7% of MGTS' total lines, corporate subscribers for 11.6% and government subscribers for 5.7%.

We have a 56% voting interest and 46% beneficial interest in MGTS, and Svyazinvest, MGTS' other major shareholder, has a 28% voting interest. Svyazinvest is a state-controlled company with ownership stakes in fixed line and wireless operators throughout Russia. The remaining shares of MGTS are publicly held and traded through the Russian Trading System, or the RTS Stock Exchange, and the Moscow Interbank Currency Exchange, or MICEX. In addition, MGTS participates in a Level 1 ADR program.

Currently, MGTS owns directly 51% of MTU Inform, 50% of Comstar, 40% of Telmos and 30% of MTU Intel, and Sistema owns directly or through wholly-owned subsidiaries 48% of MTU Inform, 50% of Comstar, 40% of Telmos and 70% of MTU-Intel. We are currently in the process of simplifying this ownership structure and legally consolidating these alternative fixed line operators into a single entity called Comstar UTS in order to realize operational, financial and strategic positioning benefits. See "—Alternative fixed line communication services—Strategy" below. As this restructuring is entirely within our consolidated group, we do not expect this restructuring to have any effect on or require any adjustment to our consolidated financial statements. Following the completion of this restructuring, we expect that Sistema will own at least a 51% stake in Comstar UTS and MGTS will own at least an additional 45% stake in Comstar UTS. For our internal management purposes, we evaluate the performance of MGTS and Comstar UTS separately and such businesses are separately presented in this offering memorandum. Thus, references to MGTS in this offering memorandum are to the business of MGTS excluding the alternative fixed line operators mentioned above, and references to Comstar UTS are to the combined businesses of the alternative fixed line operators. See "Business—Telecommunications—Alternative fixed line communication services" below for a full discussion of Comstar UTS.

MGTS holds licenses and regulatory approvals to provide, among others, the following services:

- local telephony;
- DLD/ILD voice telephony through licensed DLD/ILD operators;
- interconnection to other operators;
- Internet and data transmission, including leased DLD/ILD services;
- inquiry and information, including telephone directories;
- use of payphones; and
- numbering capacity to other telecommunications operators.

MGTS is not licensed to provide DLD/ILD telecommunications services directly to its subscribers but must route such traffic through a licensed DLD/ILD operator. As a result, DLD/ILD traffic originated by MGTS subscribers is carried by Rostelecom, the largest provider of DLD/ILD services in Russia, which bills MGTS subscribers directly. MGTS has a revenue sharing agreement with Rostelecom, pursuant to which MGTS is entitled to receive a certain portion of DLD/ILD revenues generated from MGTS subscribers based on traffic. We believe the portion of DLD/ILD revenue received by MGTS is significantly lower than the revenue share received by other regional PSTN operators for DLD/ILD calls originated by their subscribers.

Regulated services

As the only licensed PSTN operator in Moscow, MGTS is considered a monopoly under Russian antitrust regulations. Consequently, the Federal Tariff Service regulates MGTS' tariffs for voice telephony services provided to its PSTN subscribers, including monthly subscription fees, installation fees and local call charges. Most of the services provided by MGTS are subject to governmental regulation. Revenues from regulated services accounted for approximately 65.5% of MGTS' service revenues in 2003 and approximately 61.2% in the nine months ended September 30, 2004.

MGTS is not permitted to charge residential subscribers for local traffic without approval from the Federal Tariff Service. Residential subscribers accounted for approximately 87% of the local traffic on MGTS' network in the nine months ended September 30, 2004. In addition, MGTS is required to grant discounts ranging from 20% to 100% on installation and monthly fees to certain categories of residential subscribers, such as pensioners and military veterans. In 2003, approximately 35% of MGTS' residential subscribers received discounts. Although MGTS is entitled to full reimbursement of these discounts from the federal budget, the company received only partial compensation in 2001, and had not been reimbursed previously. In 2002 and 2003, the federal budget reimbursed approximately $8.0 million and $7.6 million of these discounts, respectively. MGTS' right to reimbursement is not reflected in our consolidated financial statements as accounts receivable or otherwise, due to the uncertainty of collection. However, according to the new Law on Telecommunications, and effective as of January 1, 2005, all subscribers will be required to pay the full price for residential service, and those entitled to discounts are to receive reimbursement from the government rather than discounts from MGTS.

The Federal Tariff Service sets the tariffs MGTS can charge taking into account cost of services, network investment and a certain profit margin. However, the current tariffs do not fully compensate MGTS for the cost of services provided to residential and government subscribers. As a result, MGTS effectively subsidizes those services with revenues received from corporate subscribers and unregulated services. According to Russian legislation, MGTS is allowed to petition the Federal Tariff Service for tariff increases upon certain conditions, such as inflation or increases in the cost of services. Historically, MGTS has petitioned the Federal Antimonopoly Service for tariff increases once or twice per year.

The following table illustrates MGTS' regulated tariff development in the period from May 1, 1999 to October 1, 2004:

Service	May 1, 1999	Jan 1, 2000	Feb 1, 2001	Nov 1, 2001	Jan 1, 2002	Nov 1, 2002	June 1, 2003	Aug 1, 2003	Oct 1, 2004
	(Amounts in dollars)								
Monthly subscription fee									
Residential subscribers[4]	1.2	1.9	2.1	2.4	2.7	3.5	4.1	4.6	5.8
Public sector subscribers[1]	2.3	2.0	2.6	2.9	3.3	3.9	4.1	4.6	5.8
Corporate subscribers[1]	6.8	6.1	5.8	5.6	5.5	5.2	5.4	5.5	6.8
Local call charges									
Public sector subscribers[2]	0.005	0.004	0.005	0.005	0.005	0.004	0.005	0.005	0.005
Corporate subscribers[2]	0.017	0.015	0.014	0.013	0.013	0.013	0.013	0.013	0.014
Exchange rate (rubles per U.S. dollar)[3]	24.16	27.00	28.40	29.68	30.10	31.70	30.71	30.28	29.22
Installation fee									
Residential subscribers[4]	41.4	37.0	35.2	202.2	199.1	189.0	195.4	198.2	205.3
Public sector subscribers	136.6	122.2	116.2	303.2	298.6	283.6	293.1	297.2	308.0
Corporate subscribers	273.2	244.4	232.4	303.2	298.6	283.6	293.1	297.2	308.0

(1) Includes 613 "free" minutes per month.

(2) Per minute charge for traffic exceeding the monthly "free" minutes.

(3) As of the date the tariff change became effective.

(4) Includes value-added tax.

Unregulated services

According to Russian legislation, interconnection services, DLD/ILD services provided by licensed non-monopoly operators, public payphones, data transmission services, value-added services and a number of other services are not subject to tariff regulation. Revenues from these unregulated services represented approximately 34.5% of MGTS' service revenues in 2003 and 38.8% for the nine months ended September 30, 2004. Among others, MGTS provides the following unregulated services:

- numbering capacity provided to other operators;
- leased lines and data transmission services;
- interconnect services;
- inquiry and information services (including telephone directories); and
- payphones.

MGTS provides numbering capacity and leased line services to alternative fixed line communications operators and wireless operators in Moscow. MGTS' major clients are Comstar UTS and Golden Telecom, as well as many of our other consolidated companies and affiliates in the Telecommunications Segment.

MGTS, in conjunction with its affiliate MTU-Intel, has also established an active presence in the data transmission market. Its public data transmission network, or PDTN, which was introduced in 2001, allows MGTS to provide high quality high-speed ADSL Internet access on a wholesale basis to other operators. In addition, MGTS' network allows it to provide virtual private networks, or VPNs, to corporate customers.

MGTS' ADSL services are provided on a wholesale basis to Comstar UTS, and Comstar UTS markets them on the basis of interconnect and line lease agreements between Comstar UTS and MGTS. According to these agreements, MGTS receives installation fees and monthly fees for each ADSL subscriber of Comstar UTS. Although MGTS' network has been partially upgraded, the capacity to offer ADSL services is limited, and further growth will require additional investment.

The following table presents selected financial data for MGTS on a stand-alone basis. This data has been derived from our accounting records, which are the basis for the preparation of our audited annual and unaudited interim consolidated financial statements. Certain operating data derived from company operating records for MGTS on a standalone basis is also presented.

	Years ended December 31,			Nine months ended September 30,	
	2001	2002	2003	2003	2004
	(Amounts in thousands, except Blended ARPL and Lines per employee)				
Operating revenues	$ 274,163	$ 303,021	$ 380,389	$ 279,412	$ 343,830
Operating expenses, net	(148,431)	(180,408)	(246,508)	(172,125)	(224,131)
Depreciation and amortization	(59,514)	(52,367)	(51,377)	(43,571)	(48,675)
Operating income	66,218	70,246	82,504	63,716	71,024
Net income	39,703	1,130	50,090	40,337	41,161
Assets	925,365	968,361	1,104,584	1,065,292	1,224,038
Capital expenditures	100,103	82,504	99,106	77,207	128,631
Indebtedness[(1)]	186,299	169,676	143,528	158,012	176,006
Cash and cash equivalents	15,251	27,092	31,742	40,615	25,097
Blended ARPL	3.9	3.6	4.6	4.5	5.1
Employees	20,432	20,433	20,304	20,300	19,732
Lines per employee	196	200	203	202	211
Connected wholesale ADSL lines	1,915	5,922	15,500	14,090	46,875

(1) Includes short-term debt, long-term debt, including current portion, and capital lease obligations, including current portion.

Strategy

Our strategy with regard to incumbent fixed line communications is to continue improving the profitability of MGTS by benefiting from planned increases in monthly subscription fees and the implementation of a cost reduction and modernization program. We expect to take advantage of local call price increases, which will permit us to invest in our network. We also expect to introduce flexible tariffs for local calls, including permanent charging. We are also seeking to negotiate a more favorable revenue sharing agreement with Rostelecom and/or obtain a license for the provision of DLD/ILD telephony. Subject to further improvements in the regulatory environment and increases in local access tariffs, we plan to invest in upgrading and digitalizing MGTS' network with the aim of increasing our revenue stream from value-added services, reducing our employee headcount and reducing maintenance and repair costs. We also plan to capitalize on our extensive local loop network, which currently covers the entire City of Moscow, and the rapid expansion of broadband Internet use in Moscow by providing our infrastructure on a wholesale basis to broadband Internet access providers such as Comstar UTS.

As part of our primary mission to maximize shareholder value, we are considering various options to optimize the shareholder structure of MGTS. Among these options is the acquisition of Svyazinvest's 28% voting stake in MGTS, and we are currently in discussions with Svyazinvest regarding our potential acquisition of this stake. We are also in discussions to participate in the upcoming privatization of Svyazinvest. While the timing of the privatization of Svyazinvest remains uncertain, we are continuing to assess our options for increasing our stake in MGTS.

Market and Competition

The Russian fixed line telecommunications market is characterized by relatively low telephone penetration, low levels of digitalization and significant waiting lists for telephone line installation. In 2003, telephone penetration in Russia was 26.6%, or approximately 37.5 million lines, according to the Russian Ministry of Information Technologies and Communications.

Demand for fixed line communications services in Russia grew rapidly over the last ten years due to rising disposable incomes, increased business activity and declining prices due to the intensified competition among fixed line communications providers.

Moscow's fixed line communications market is the largest in Russia and accounted for 39% of total fixed line revenues in 2003, according to RosBusinessConsulting, a Russian market research company.

The following table illustrates Moscow's fixed line telecommunications market:

	As of December 31,					As of September 30,
	1999	2000	2001	2002	2003	2004
	(Amounts in millions, except percentages)					
Active lines[1]	4.3	4.6	4.7	5.1	5.4	5.5
Active line penetration	42%	45%	46%	49%	52%	53%
Total fixed line revenues	$272.6	$522.7	$729.4	$831.8	$1,060.3	$1,048.7

Source for data on third parties: Pyramid Research.

(1) There is no uniform definition of active lines in service in the Russian fixed line market.

Total revenues from fixed line communications services in Moscow and the Moscow region totaled $1,060.3 million and $1,048.7 million in 2003 and for the nine months ended September 30, 2004, respectively, according to Pyramid Research. The total fixed line communications market in Moscow grew by 27.5% in 2003 in terms of revenues. The major operators in Moscow's alternative fixed line market are Golden Telecom and Comstar UTS. According to Pyramid Research, total revenues in the alternative fixed line market reached $692.2 million and $682.8 million in 2003 and for the nine months ended September 30, 2004, respectively.

According to Pyramid Research, MGTS accounted for 76.0% of active lines in Moscow's fixed line telephony market and 34.9% of this market's revenues, as of September 30, 2004.

As Moscow's only PSTN operator, MGTS faces limited competition in the market for residential local telephony services in Moscow, where it serves the vast majority of all residential subscribers. MGTS is also a dominant player in the local telephony market for corporate subscribers with approximately 480,000 subscribers as of December 2003. In this market segment, MGTS provides services primarily to small- and medium-sized enterprises.

The market for DLD/ILD telephony services in Moscow is dominated by Rostelecom, which has a virtual monopoly in Russia and directly bills MGTS subscribers for DLD/ILD calls. In addition to our investee company, MTT, the telecommunications subsidiaries of the Railways Ministry, or Transtelecom, of the electricity monopoly RAO Unified Energy Systems of Russia and of the gas monopoly Gazprom, or Gaztelecom, are building their own national transit networks and lobbying for DLD/ILD licenses.

Alternative fixed line communication services

Business Description

We also provide fixed line communications services in Moscow and other select metro areas in Russia and the CIS through our local exchange carrier, Comstar UTS. Comstar UTS is a leading alternative fixed line provider with over 529,964 active lines in service and over 26,200 corporate clients as of September 30, 2004 in the Moscow market, which accounts for approximately 30.1% of total Russian telecom spending. Comstar UTS had revenues of $248.0 million in 2003 and $208.5 million for the nine months ended September 30, 2004.

Comstar UTS is licensed to provide local, domestic and international long distance communications, including numbering capacity for other carriers, voice telephony, leased lines, virtual private network services and value-added services, data transmission services, Internet access services and digital terrestrial television services. We are also licensed to provide voice and data transmission services in 16 regions of the Russian Federation. In addition, Comstar UTS has both the technical ability and the required licenses to route DLD and ILD traffic for selected corporate clients, thus bypassing Rostelecom's network. This gives us a significant advantage by allowing us to generate comparatively high margins on these services.

We have one of the most extensive alternative fixed line communications networks in Moscow and the Moscow region. We operate our own Digital Network with Integrated Services, which is based on digital exchanges and a fiber optic backbone, and have more than 3,500 kilometers of fiber optic backbone, more than 900 SDH multiplexers and 500 network nodes and data run rates of up to 10 gigabits per second. We also have the widest access to MGTS' PSTN network, with interconnection at 500 transit and local exchanges, which allows us to deliver traffic within the local public network. As of September 30, 2004, we had more than 37,500 interconnection lines and had constructed the infrastructure necessary to support 60,000 ports, each corresponding to a unique telephone number. Since 1996, Comstar UTS has carried direct traffic between Moscow and St. Petersburg over its own fiber optic network. Our network also interconnects directly with other fixed line and cellular operators in Moscow and with Rostelecom. Our managed data center is the leading hosting center in Russia.

In order to capture significant operating and investment synergies, Comstar UTS has operated as an integrated business since early 2004. To complement this operational integration, we are currently in the process of legally reorganizing Comstar UTS through the contribution of our holdings in our alternative operator subsidiaries, MTU-Inform, Telmos and Comstar, and our Internet service provider and data business, MTU Intel. Following the completion of the reorganization, which is expected during the first half of 2005, we intend to further exploit business synergies and benefit from the improved market position and optimized cost structure of these businesses. In particular, the reorganization of these businesses has allowed us to offer a full suite of value-added telecommunications solutions to our customers. We intend to offer all of our integrated telecom services under the "Comstar UTS" umbrella brand, which was launched in May 2004. Upon completion of the reorganization, we expect that Sistema will own at least 51% of the outstanding shares of Comstar UTS and MGTS will own at least an additional 45% stake in Comstar UTS. The exact shareholding will be determined in accordance with an independent, third-party evaluation of the interests being contributed along with any minority stakes in the subsidiaries that we may purchase. Completion of this reorganization is subject to a number of conditions, including several corporate and governmental approvals. See "Risk Factors—Risks Relating to Our Business—General Risks—Our planned business combinations and restructurings may be delayed or fail to occur."

Comstar UTS operates in three major segments: Corporate Voice and Data Services; Carrier and Operator Services; and Internet Services.

Corporate Voice and Data Services

The Corporate Voice and Data Services division of Comstar UTS provides a wide range of services to small and medium-sized enterprises, corporations and government clients. As of September 30, 2004, our Corporate Voice and Data Services division had over 26,200 customers and 529,964 active lines in service.

We offer the following services to small and medium-sized enterprises, corporations and government clients:

- local access services;

- domestic and international long distance services, using our intercity transmission network, leased capacity between major Russian cities, VSAT satellite services or through interconnection with Rostelecom's network;
- dedicated data transmission services, including frame relay, asynchronous transfer mode, Internet protocol and private line services;
- integrated voice and data services, including voice over IP, voice over frame relay and ISDN services;
- value-added services such as dedicated hosting, co-location and IP virtual private networks; and
- installation, configuration and maintenance of customer premises equipment.

Our customers cover all industry segments including business centers, hotels, financial institutions, professional services firms, consumer goods companies, manufacturers and companies involved in extractive industries. Customers also range from large multinational and Russian corporate groups to small and medium-sized Russian enterprises to government agencies, including the Central Bank of Russia, Bank of Moscow, Reuters, the United States Embassy and the Moscow City Administration.

Carrier and Operator Services

The Carrier and Operator Services division of Comstar UTS provides a wide range of services to other fixed line telecommunications operators, Internet service providers and wireless telecommunications providers. As of September 30, 2004, we had 53 fixed line and four wireless operator customers.

We offer the following services to carrier and operator customers:

- numbering capacity rental, through which Comstar UTS rents a portion of its allocation of coveted "095" prefix Moscow telephone numbers to other alternative fixed line communications and mobile operators;
- call completion services for calls terminating in Russia, whether originating in Russia, CIS or from international locations;
- international call completion services for calls originating in Russia and CIS;
- data transmission services, including frame relay, synchronous digital hierarchy capacity and IP virtual private networks;
- IP transit ports; and
- installation and maintenance of customer premises equipment.

We are active in the alternative fixed line communications market, offering numbering capacity and leased lines to large operators in Moscow, such as Golden Telecom and Equant. We generate most of our revenues in the Carrier and Operator Services division from the provision of numbering capacity to cellular operators such as MTS, Vimpelcom, MegaFon and Sky-Link.

Internet Services

The Internet Services division of Comstar UTS offers a broad range of Internet access services to residential and corporate subscribers, including dial-up and broadband Internet access, voice over Internet protocol, VPNs and data center services. We are the largest dial-up and broadband Internet access provider in Moscow by number of active subscribers. As of September 30, 2004, we had approximately 324,681 active dial-up and 47,338 active ADSL Internet subscribers. We believe Comstar

UTS is strongly positioned in the broadband segment due to our strong brand recognition, high-quality services and access to MGTS' last-mile network.

For the provision of dial-up services, we utilize our own network infrastructure, as well as MGTS' network to access end-customers. Our dial-up network was built on Cisco Systems and U.S. Robotics digital servers, which provide speeds of up to 56 kilobits per second. We believe the high quality of our services enables us to compete effectively with other dial-up providers.

For the provision of broadband services, we have secured access to MGTS' network allowing data transmission of up to 7.5 megabits per second along installed copper lines using ADSL technology. As of September 30, 2004, 80% of MGTS' central offices were DSL-enabled. MGTS intends to have 100% of its central offices DSL-enabled by year end. In addition, we utilize MGTS' PDTN to provide quality high-speed Internet access and create VPNs for corporate subscribers.

We began offering ADSL services to corporate subscribers in May 2000 under the brand "Tochka.ru." ADSL services to residential subscribers were subsequently introduced in 2002. We are developing customized services targeted at all segments of the residential and corporate Internet market and are seeking to increase subscribers in the residential segment by reducing tariffs for ADSL services. In February 2004, we introduced our new residential focused brand, STREAM, and reduced ADSL tariffs by 50%, which resulted in rapid subscriber increase to 30,265 by September 30, 2004. We have also introduced a range of tariff plans under the STREAM brand aimed at meeting the needs of various groups of subscribers, including the unlimited use STREAM-NEO tariff plan. We are currently developing collective-access broadband Internet services by building local area networks, or LANs, for residential subscribers, which, due to shared buildout costs, could be priced attractively for lower-income subscribers.

The following table presents selected financial data for Comstar UTS on a stand-alone basis. This data has been derived from our accounting records, which are the basis for the preparation of our audited annual and unaudited interim consolidated financial statements. Certain operating data derived from company operating records for Comstar UTS on a standalone basis is also presented.

	Year ended December 31, 2003	Nine months ended September 30, 2004
	(Amounts in thousands, except Active lines in service and Active subscribers)	
Operating revenues	$ 247,952	$ 208,525
Operating expenses, net	(158,444)	(139,891)
Depreciation and amortization	(32,101)	(22,569)
Operating income	57,407	46,065
Net income	41,567	36,264
Assets	357,223	392,122
Capital expenditures	59,514	30,446
Indebtedness[(1)]	26,805	22,615
Cash and cash equivalents	15,186	16,459
Active lines in service[(2)]		
Corporate subscribers	201,385	218,825
Mobile operators	303,571	303,573
Residential subscribers	9,511	7,566
Total	514,467	529,964
Active subscribers[(3)]		
Dial-up residential subscribers	465,350	339,175
Dial-up corporate subscribers	7,804	7,506
Total dial-up subscribers	473,154	346,681
ADSL residential subscribers	4,357	30,265
ADSL corporate subscribers	7,893	10,335
ADSL shared-access subscribers	5,724	6,738
Total ADSL subscribers	17,974	47,338
Data transmission	3,375	3,795

(1) Includes short-term debt, long-term debt, including current portion, and capital lease obligations, including current portion.

(2) A line is considered to be "active" if the subscriber has paid a monthly subscription fee within 10 to 40 days from the billing date.

(3) A dial-up subscriber is "active" if the subscriber has used Comstar UTS' Internet service within the last 30 days. A broadband subscriber is "active" if the subscriber has paid a monthly subscription fee within the last 30 days.

Strategy

Our primary strategic goal with regard to our alternative fixed line communication businesses is to complete the legal reorganization of our alternative fixed line subsidiaries, MTS-Inform and Telmos, and our Internet and data operation subsidiaries MTU Intel and Golden Line, into Comstar UTS, and to continue realizing operational, financial and positioning benefits from this restructuring. The reorganization is aimed at fortifying Comstar UTS' position as a leading alternative provider of corporate communication and residential Internet services in Moscow and, subsequently, in other Russian regions, and is expected to be completed in the first half of 2005. Comstar UTS intends to continue developing its position as a leading provider of unregulated value-added fixed line and Internet services to corporate and premium residential customers by introducing new products, cross-selling products to its existing base of over 26,200 corporate and public sector customers and targeted acquisitions.

We also plan to preserve and strengthen the position of Comstar UTS as a leading ADSL and dial-up Internet service provider in Moscow and, subsequently, in other Russian regions, by combining our access to MGTS' last-mile network with the strong marketing and sales capabilities of Comstar UTS. We intend to extend the capacity of our Internet protocol network, which presently allows us to reach 30% of Moscow's population, to accommodate anticipated growth in the number of broadband Internet subscribers and to provide other value-added services. In addition, Comstar UTS plans to expand into the Russian regions through a combination of acquisitions of local Internet service providers, partnerships with local PSTNs and alternative fixed line operators and by opening branch offices.

Market and Competition

We compete with a number of alternative operators servicing Moscow, St. Petersburg and other commercial centers. Intensifying competition in Moscow's alternative carrier market has resulted in increasing pressure on prices and profitability for all operators. Smaller companies with insufficient scale and limited resources are focusing on niche segments of the market while large players act as market consolidators. As a result, the market is presently dominated by two large operators: the companies forming the Golden Telecom group and our telecommunications subsidiaries comprising Comstar UTS.

The following table illustrates the corporate subscriber market shares of the main alternative fixed line providers in Moscow as of December 31, 2003 (excluding incumbent operators):

Company	% of Active Lines in Service
Comstar UTS	35%
Golden Telecom (including Combelga)	25%
Other	40%
Total	100%

Source: Cominfo Consulting.

Our principal competitor in the alternative fixed line communications market is Golden Telecom, a facilities-based telecommunications provider with presence in Russia, Ukraine, Kazakhstan and other countries of the CIS. The company targets business subscribers and offers fixed line services, voice and call center services, dedicated Internet access and design and installation and management of private networks. Moscow is the primary base of Golden Telecom's operations. In December 2003, Golden Telecom acquired Russian alternative fixed line operator Combelga, a provider of local, DLD/ILD telephony, Internet access, videoconferencing and telephone card services.

According to Pyramid Research, Internet penetration in Russia was at 5.7% as of September 30, 2004, lower than the Internet penetration rates in the Czech Republic (23.7%), Poland (11.9%) and Hungary (8.1%). According to Hot Telecom, Russia will have an estimated 18 million Internet users by the end of 2004, which it estimates will increase to 50 million by 2008. Between 1999 and 2002, growth in the number of Internet users in Russia averaged 30% per year, according to the International Telecommunications Union, and in 2003, the number of users grew by an additional 40%, according to the Ministry of Information Technologies and Communications. The primary reasons for Russia's Internet growth are the country's well educated population, the growth of consumer wealth and improvement in the telecommunications infrastructure.

The following table illustrates Moscow's Internet access market:

	As of December 31,					As of September 30,
	1999	2000	2001	2002	2003	2004
	(Amounts in millions, except percentages)					
Active dial-up subscribers	247	346	509	795	1,021	1,176
Dial-up penetration	2.4%	3.4%	4.9%	7.7%	9.8%	10.8%
Active broadband subscribers (cable and ADSL)	34	42	60	78	108	203
Broadband penetration	0.3%	0.4%	0.6%	0.7%	1.0%	1.9%
Total Internet access revenues	$66.6	$73.2	$83.5	$132.1	$162.5	$146.9

Source for data on third parties: Pyramid Research.

According to Pyramid Research, MTU-Intel had a 36.5% market share of the active Internet subscribers in Moscow as of September 30, 2004. MTU-Intel is the largest Internet service provider in Moscow by number of active subscribers. MTU-Intel's major competitor in the Internet access market is Golden Telecom, which as of September 30, 2004 controlled 17.6% of Moscow's Internet access market. MTU-Intel is the leader in the broadband market segment in Moscow, with 46,685 residential and corporate subscribers as of September 30, 2004.

The table below illustrates competitive positions in the Internet access and data transmission market in Moscow, as of December 31, 2003:

Company	% of Total Revenues
Comstar UTS	42%
Golden Telecom (including Combellga)	28%
Equant	15%
Other	15%
Total	100%

Source: Cominfo Consulting.

Other Services

We own a 35.8% beneficial ownership interest and a 44.8% voting interest in MTT. MTT, a "carriers' carrier," owns a transit telecommunications network connecting the networks of wireless and fixed line operators in 86 regions of the Russian Federation, covering 99% of the population. As of September 30, 2004, MTT's client base totaled 127 wireless operators, and 80 fixed line operators. In 2003, the company generated $18 million of net income on revenues of $78 million.

Capital Expenditures

Capital expenditures for our wireless telecommunications division for the next three years are expected to be primarily driven by MTS, reflecting ongoing spending on improving the quality and capacity of its network both in Russia and in the other CIS countries in which it operates. In 2005, MTS expects to spend $1.8 billion on capital expenditures, primarily financed out of cash flows generated by operations and debt financing. In addition, Sky-Link is expected to invest in the development of its CDMA network as part of its strategy to become the first nationwide CDMA operator. The level of capital expenditures will depend on the development of Sky-Link's market, including 3G license developments and the evolution of demand for wireless broadband services. Sky-Link expects equipment vendors to finance approximately 50% of its capital expenditures.

In our fixed line telecommunications division, MGTS expects further improvements in the regulatory environment and, as a result, plans to invest approximately $290 million in capital expenditures in 2005-2006. These expenditures will be directed to: upgrading the company's network in order to facilitate provision of additional value-added services; enabling the company to further reduce its employee headcount; and accelerating the company's other cost reduction initiatives. MGTS will finance its capital expenditure program out of its own operating cashflow, and may potentially seek new external sources of financing, including accessing the debt or equity capital markets

In addition, in December 2003, MGTS announced its long-term investment program for the period from 2004 through 2012. The program was approved by a resolution of the Moscow City Government in December 2003 and provides for total capital expenditures of approximately $1.6 billion, including for the expansion and full digitalization of the Moscow telephone network, the reconstruction of 350 local telephone stations and the installation of 4.3 million new phone numbers. We expect to finance approximately 50% of the capital expenditures under the investment program.

Comstar UTS will invest approximately $95 million in capital expenditures in 2005-2006, which will be used primarily for extending and upgrading its network and regional expansion. Comstar UTS is expected to finance its capital expenditure program primarily out of its own operating cash flow.

Management and Employees

The following table sets forth the average number of employees in our Telecommunications Segment for the years ended December 31, 2001, 2002 and 2003.

Year	Telecommunications Segment employees average for the year ended December 31,	% increase/(decrease) over prior year
2001	26,776	15%
2002	32,988	23%
2003	40,380	22%

Vladimir S. Lagutin is the General Director of Sistema Telecom and is the Chairman of the Board of MTS, MGTS and Comstar. Mr. Lagutin has also served as a member of our Board of Directors since 2001. See "Management" for additional information regarding Mr. Lagutin.

George V. Kikvadze is the Head of Investments at Sistema Telecom, responsible for mergers and acquisitions and investment policy. Prior to joining Sistema in 2002, Mr. Kikvadze worked at GRC Capital Partners, KPMG Barents and PCG-CALPERS.

Vassily V. Sidorov has served as MTS' President since October 2003. He is also a member of MTS' board of directors. From 2000 until August 2003, Mr. Sidorov served as First Vice-President for Finance and Investments at Sistema Telecom. From 1997 until 2000, Mr. Sidorov was Deputy General Director (Chief Financial Officer) of Svyazinvest.

Nikolai V. Tsekhomsky has served as MTS' Vice-President of Finance/Chief Financial Officer since July 2003. From September 2002 through June 2003, he served as MTS' Finance Director. Prior to joining MTS, Mr. Tsekhomsky served as Finance Director at Renaissance Capital from August 1999 to September 2002 and as Financial Controller at Brunswick UBS from August 1998 to August 1999.

Alexei V. Goltsov is the General Director of MGTS. Mr. Goltsov joined MGTS in 1987. From 2001 until 2003, he served as Head of MGTS' Digital Network Management Center. From 2003 until the end of 2004, he served as Deputy General Director of MGTS responsible for network development and reconstruction. He is a recipient of a number of MGTS corporate awards and a state medal.

Semyon V. Rabovsky is the General Director of Comstar United Telesystems. From 1997 until 2003, he was First Deputy General Director of MGTS. Mr. Rabovsky has over 25 years' experience working in the telecommunication sector. He is a recipient of the Master of Communications Award from the Russian Federation.

Vsevolod Rozanov has served as the Deputy General Director of Comstar United Telesystems, responsible for finance and economics since June 2004. He joined Sistema in 2002 as the Deputy General Director of MTU-Inform. Prior to that, he served as a consultant at Bain & Company (Moscow, London and Stockholm offices).

Raisa G. Rozinova has served as the General Director of Sky-Link since October 2004. Prior to that, she was General Director of Telmos from 1997. Ms. Rozinova is a corresponding member of the International Communications Academy and the International Academy of Informatization.

Legal Proceedings

For a description of recent litigation in Ukraine relating to our purchase of UMC, see "Risk Factors—Risks Relating to Our Business—Risks Relating to Our Telecommunications Business—If MTS' purchase of UMC is found to have violated Ukrainian law or the purchase is unwound, MTS' business, prospects and results of operations would be materially adversely affected."

Technology

Overview

As of September 30, 2004, our Technology Segment operated in four core business divisions:

- Telecommunications equipment and software, through STROM telecom, a hardware and software solutions provider for telecommunications operators in Russia and Eastern Europe;
- IT and systems integration, through Kvazar-Micro, a company based in Ukraine with a presence throughout Central and Eastern Europe;
- Semiconductor design and manufacturing, through several Russian companies and two research institutes; and
- Electronic devices and consumer electronics, through our OEM-manufacturing facilities and the Sitronics consumer electronics brand.

Our Technology Segment revenues were $85.9 million and $319.8 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively. We had operating loss of $3.3 million and income of $13.9 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively.

The facilities of our technology companies are primarily located in the city of Zelenograd in the Moscow region. Zelenograd has a high concentration of research institutes and manufacturing facilities for microelectronics research and production, primarily relating to the defense industry. We also have technology operations in Voronezh, Russia, the Czech Republic and Ukraine.

We established our Technology Segment upon our acquisition of semiconductor and industrial electronics assets through a combination of privatization and private transactions from 1994-1998. In 2002, we expanded this segment with the launch of Sitronics, a consumer electronics brand, and further expanded into telecommunications equipment and software during 2002 with our acquisition of STROM telecom, a Czech telecommunication equipment and software manufacturer. In July 2004, we purchased a controlling stake of KM Corporation, or Kvazar-Micro, an IT and systems integration company. We are currently considering further acquisitions to strengthen our telecommunications equipment and software and IT and systems integration divisions.

Consistent with our strategy of integrating our technology businesses, we are continuing to reorganize our Technology Segment. In November 2002, we established CSC as the new holding company for our technology businesses, and we hold most of our technology businesses through CSC. We beneficially own 78% of CSC, and the remainder is owned by third parties, including certain managers of Mikron.

The table below illustrates our ownership of our technology subsidiaries as of December 31, 2004:

Company	Beneficial ownership(1)	Voting interest(2)
Corporate		
CSC	78%	78%
Concern Scientific Center	78%	100%
Koncel	78%	100%
Telecommunications Equipment and Software		
STROM telecom	52%	67%
IT and Systems Integration		
Kvazar-Micro	50%	51%
Semiconductor Design and Manufacturing		
Mikron	60%	77%
Corona(3)	30%	100%
VZPP-Mikron	40%	51%
NIITM	58%	88%
ICM	58%	88%
Electronic Devices and Consumer Electronics		
Elion	58%	90%
Elaks	62%	80%
Sitronics	78%	100%
Minority Investments		
Angstrem	10%	16%
Angstrem-M	9%	14%
Kvant(4)	26%	35%

(1) "Beneficial ownership" represents the percentage of ownership interests of the relevant entity that are beneficially owned by Sistema directly or indirectly, based on Sistema's proportionate ownership of the relevant entity through its consolidated subsidiaries.

(2) "Voting interest" represents the percentage of ownership interests of the relevant entity which Sistema or any of its consolidated subsidiaries has the power to vote.

(3) In December 2002, Mikron acquired from Hua Ko Electronics an irrevocable power of attorney to vote a 50% stake in Corona in exchange for the transfer by CSC of 8% of Mikron's shares to Hua Ko Electronics. As a result of this exchange, our voting control over Corona increased from 50% to 100%. In 2004, we fully integrated Corona's assets into Mikron, and it currently operates as a production unit of Mikron.

(4) We are currently in a legal dispute with another shareholder of Kvant over certain issues relating to control of the company and the size of our ownership interest.

Business Description

For the nine months ended September 30, 2004, IT and systems integration, telecommunications equipment and software, semiconductor design and manufacturing and electronic devices and consumer electronics accounted for 64.5%, 14.9%, 11.5% and 8.5%, respectively, of our Technology Segment's total sales. Over the same period, IT and systems integration, telecommunications equipment and software and semiconductor design and manufacturing recorded operating income of $0.2 million,

$15.5 million and $0.7 million, respectively. Electronic devices and consumer electronics recorded an operating loss of $1.5 million for the nine months ended September 30, 2004.

The following tables set forth key financial information for the core business divisions of our Technology Segment for the years ending December 31, 2001, 2002 and 2003 (other than for IT and systems integration division) and for the nine months ended September 30, 2003 and 2004.

IT and systems integration	Nine months ended September 30, 2003	Nine months ended September 30, 2004
	(Amounts in thousands)	
Revenues	$—	$206,441
Operating income	—	205
Capital expenditures	—	2,895

Telecommunications equipment and software	Year ended December 31, 2001	2002	2003	Nine months ended September 30, 2003	2004
	(Amounts in thousands)				
Revenues	$ —	$27,840	$37,344	$28,914	$47,552
Operating income/(loss)	—	3,288	(4,124)	(2,263)	15,488
Capital expenditures	—	—	4,749	2,733	443

Semiconductor design and manufacturing	Year ended December 31, 2001	2002	2003	Nine months ended September 30, 2003	2004
	(Amounts in thousands)				
Revenues	$27,334	$39,734	$41,215	$29,361	$36,836
Operating income/(loss)	(506)	4,183	3,799	3,800	674
Capital expenditures	1,562	4,645	3,753	3,001	956

Electronic devices and consumer electronics	Year ended December 31, 2001	2002	2003	Nine months ended September 30, 2003	2004
	(Amounts in thousands)				
Revenues	$ 2,059	$ 9,705	$ 7,367	$ 4,409	$27,216
Operating loss	(133)	(1,938)	(3,023)	(1,560)	(1,535)
Capital expenditures	189	803	708	284	1,413

Telecommunications equipment and software

In December 2002, we added a telecommunications equipment and software division, consisting of our subsidiary STROM telecom, to our Technology Segment. STROM telecom was established in 1993 and operates the Tesla plant in Votice, which is 50 kilometers outside of Prague, Czech Republic, where it utilizes approximately 16,000 sq.m. for its manufacturing needs.

Our telecommunications equipment and software division produces a wide variety of telecommunications equipment and information systems. In 2004, we began the production of automatic telephone switches for the Russian market at our Elaks facility in Zelenograd. We also produce software products such as billing systems, operation support systems and call center systems. STROM telecom's flagship product is Medio, a digital switching platform for telecommunications operators. Medio is an easily expandable system, enabling the construction of exchanges ranging from several hundred to several hundred thousand subscriber lines. Another STROM telecom product, FORIS OSS, is an integrated operating support system. It provides full operational support for data collection, storage, processing and exchange; billing systems; management of network elements; customer care; and financial systems for telecommunications operators.

More than half of STROM telecom's products are sold in Russia and the remainder are exported elsewhere, mostly to Germany. This division's largest customers include MTS and MGTS, which represented 51.1% and 20.8% of the division's gross revenue in 2003, respectively. Intragroup sales for the division were $17.8 million and $28.2 million, representing 63.8% and 75.5% of the division's gross revenue in 2002 and 2003, respectively. The division's sales for the year ended December 31, 2003 and for the nine months ended September 30, 2004 were $37.3 million and $47.6 million, respectively.

IT and systems integration

In July 2004, we purchased 51.0% of Kvazar-Micro, a holding company incorporated in the Netherlands, with its main business operations located in Ukraine and other countries of Central and Eastern Europe. We expect that the IT and systems integration division will become the largest revenue contributor to CSC upon the full integration of Kvazar-Micro business into CSC.

Established in 1990, Kvazar-Micro is a leading IT company in Ukraine. It conducts business in PC parts distribution, PC assembling, systems integration and software development, and it serves over 3,000 clients in Ukraine, Russia, the Czech Republic, Hungary and other countries of Central and Eastern Europe. Kvazar-Micro runs its distribution business in nine countries of Eastern Europe through nine regional offices. According to IDC, Kvazar-Micro was the second largest PC assembler in Ukraine and controlled approximately 13% of the Ukrainian PC market in 2003. Its PC assembly facility, built in 2003, has the capacity to assemble 200,000 units per annum and is international ISO 9001-2000 certified.

The key segments of its systems integration services are business consulting, project management, LAN & WAN construction, OLAP-systems, ERP systems, turn-key projects and Kvazar-Micro Training Center services. KM Soft, the software division of Kvazar-Micro, develops software solutions for corporate and governmental clients in Ukraine and Eastern Europe. The software division conducts business in the following segments: custom software development, dedicated development centers and personnel leasing. KM Soft also develops its own products, including games for mobile phones and pension fund software. KM Soft's processes are ISO 9001-2000 certified.

Semiconductor design and manufacturing

Our Technology Segment's semiconductor design and manufacturing division is a leading domestic manufacturer of integrated circuits under the Mikron brand name. Although it is at an early 1990s level by international standards, we believe our Technology Segment possesses the most advanced technology among Russian manufacturers, capable of manufacturing at line widths of 0.8-2.0 μm on 4" and 6" wafers.

Our Technology Segment's semiconductor wafer fabrication facilities produce over 400 functionally different types of analog and digital integrated circuits. Digital integrated circuits are produced primarily for the domestic market. Analog products represent the majority of CSC's export sales. We primarily produce packaged integrated circuits and discrete components for the Russian market. Our exports consist mainly of sales of integrated circuits on wafers to resellers in China that cut and package them for sale to original equipment manufacturers. DDI, an Asian distributor of semiconductor products, represented approximately 20% of the division's revenue in 2003; no other customer represented more than 10% of the division's revenue, and intragroup sales for the division were immaterial in 2003. See "—Market and Competition" below. Our semiconductor design and manufacturing division primarily relies on the facilities of two plants, Mikron and VZPP-Mikron. We own the plant and equipment at each of these facilities and hold long-term leases from the local government for the land on which these facilities are located. Our manufacturing facilities are leased for terms of 49 years, and these leases expire in 2043 and 2053.

Electronic devices and consumer electronics

Sitronics, our consumer electronics brand, was launched in November 2002 and is still in its early stages. Currently, its main products are television sets, monitors, DVDs, LCD monitors and TVs, home theaters, land-line telephones, notebooks and personal computers. Sitronics plans to extend its product line to mobile phones and other products in the near future. Sitronics' distribution strategy is based on selling through a regional distribution network. In 2003, Sitronics sold 27,600 television sets. As a result of restructuring and implementation of a new marketing strategy, Sitronics television set sales reached 55,600 units for the nine months ended September 30, 2004. No customer represented more than 10% of the division's revenue. Intragroup sales for the division were immaterial in 2002 and 2003. Sitronics sources most of its products from Chinese suppliers.

In addition, electronic devices and consumer electronics are produced and assembled mainly from imported components and sub-assemblies for sale to original equipment manufacturers at the Elaks and Elion plants in Zelenograd. Elaks assembles consumer electronics products under our Sitronics brand. Elaks also assembles electronics products for other manufacturers, such as televisions for TCL and Rolsen and personal computers for Fujitsu-Siemens, among others. Its production facility currently has the capacity to produce 1,000,000 mobile phones and 360,000 TVs or 1,000,000 PCs per annum. We plan to start production of mobile phones and LCD-matrixes for notebooks and TVs at Elaks during 2004-2005. We own the physical plant and equipment of the Elaks plant and lease the land on which it is located from the local government under a 49-year lease expiring in 2044. The Elion plant primarily produces components for products sold under our Sitronics brand and components and finished products for outside customers. Elion's production facilities currently have the capacity to produce 600,000 TV cases; 2,500,000 mobile phone cases; and 150,000 computer server cases per annum. We own the plant and equipment of the Elion plant and lease the land on which it is located from the local government under a 49-year lease expiring in 2045.

Strategy

Our goal for our Technology Segment is to strengthen its telecommunications equipment business, build IT and systems integration expertise, maintain and strengthen its position as the leading Russian manufacturer of integrated circuits and develop Russia's first umbrella consumer electronics brand.

To meet this goal, we have formulated the following strategic objectives for our Technology Segment:

- *Telecommunications equipment and software.* In the telecommunication equipment and software division, we have a good range of niche products and essential experience in the localization of both hardware and software products according to the specifications of Russian telecommunications companies. Our customer base of Sistema's telecommunications companies provides us with a solid starting point for expansion in Russia and other countries. We plan to make STROM telecom one of the leading players in the Russian telecommunications equipment market, with a focus on software solutions like billing systems, customer relations management systems, call center systems and other software solutions for telecommunications operators. We believe that localization of manufacturing in Russia enables STROM telecom to manufacture its products at a lower cost, brings it geographically closer to its major customers and provides it with the status of domestic manufacturer, which is important for obtaining government certifications and participating in local tenders. We will also consider attractive acquisition opportunities to enhance STROM telecom's software product line. We view Eastern Europe and other CIS countries as our main markets for further growth. We are building technology expertise to develop new products through partnerships with such industry leaders as Siemens, Huawei, Alcatel and others. In addition, as our product range is often complementary to product ranges of certain market leaders, we will seek distribution agreements with such companies that would allow us to promote and sell their products in selected markets and allow them to sell our products in other markets.

- *IT and systems integration.* In the IT and systems integration division, we have vast experience in providing offshore programming and systems integration services from our programming centers in Ukraine while maintaining relatively low engineering labor costs compared to Europe and even to Russia. We plan to grow Kvazar-Micro into a leading IT company in Central and Eastern Europe with a focus on such high value-added businesses as IT services and systems integration. In particular, we plan to increase its share of the systems integration market by developing new corporate clients in Russia, as well as by attracting clients among other Sistema companies within the telecommunications, insurance and other segments. We also plan to increase our software development business, particularly outsourcing services for international and local companies.
- *Semiconductor design and manufacturing.* We believe that our extensive microelectronics assembly facilities, Zelenograd's 40-year history in semiconductor manufacturing and highly-trained, qualified and relatively low-cost design and production engineering staff represent a base upon which we can develop a successful semiconductor business. On the domestic market, we will seek to strengthen our position as a leading provider of advanced solutions for defense contractors and other industries, such as energy. On the international markets, we will seek to increase our revenues and profits in the semiconductor design and manufacturing division by increasing our production of packaged integrated circuits, which would enable us to sell directly to end users, primarily original equipment manufactures. As part of this strategy, we have established a sales office in China, our primary export market. We also plan to maintain our production facilities in Zelenograd and Voronezh and upgrade control equipment to enable us to produce more value-added products, including application specific integrated circuits, or ASIC.
- *Electronic devices and consumer electronics.* In the electronic devices and consumer electronics division, we believe that we are well-positioned with our local market knowledge to increase our share of the Russian and CIS electronics markets. We plan to strengthen Sitronics' position as a national consumer electronics umbrella brand by entering into and expanding new high value-added product groups like home theaters, plasma panels, LCD TVs, DVDs, notebooks and others. We position Sitronics as a national umbrella brand, which offers high quality products at reasonable prices. To increase our distribution network, we plan to work with regional distributors as well as large retail chains.

We are exploring opportunities to increase the output of our OEM plants without substantial investment by leveraging the capacity of our existing production and assembly facilities and our relatively low-cost design and production engineering staff. We plan to launch the production of mobile phones and LCD-matrixes in 2004-2005. We also plan to develop more efficient manufacturing processes for our industrial electronic devices, such as power measuring equipment and control systems and precision electronic devices.

We may make some additional acquisitions both in Russia and other countries of Central and Eastern Europe where such acquisitions are expected to provide sufficient synergies with our existing technology businesses and create shareholder value.

Capital Expenditures

We plan to make approximately $150 million in equity investments in our technology businesses in 2005 to 2006. These investments will be focused on developing the service businesses of STROM telecom (based in the Czech Republic) and Kvazar-Micro (based in Ukraine). We may also consider a number of potential mergers and acquisitions in 2005 to 2007 to enhance the software development divisions of STROM telecom and Kvazar-Micro.

Investments in our semiconductor design and manufacturing division and electronic devices and consumer electronics division will be focused on improving the profitability of our existing operations and optimizing the use of existing assets in Russia. We plan to finance these capital needs mainly through revenue-generated cash flow, vendor financing and commercial credit lines from banks.

Management and Employees

The following table sets forth the average number of employees in our Technology Segment for the years ended December 31, 2001, 2002 and 2003:

Year	Technology Segment employees average for the year ended December 31,	% increase/(decrease) over prior year
2001	6,555	1%
2002	6,982	7%
2003	5,275	(25)%

Alexander Y. Goncharuk has served as the General Director of CSC since July 2003. He is also a member of our Board of Directors. For additional information regarding Mr. Goncharuk, see "Management."

Nihad Hurem founded STROM telecom in 1993. He serves as the chief executive officer of STROM telecom and as first deputy CEO of CSC in charge of business development.

Eugene Utkin founded Kvazar-Micro in 1990. He serves as the president of Kvazar-Micro and as first vice-president of CSC.

Dmitry Ivanov has served as first deputy chief executive officer of CSC in charge of finance and investments since July 2003. Mr. Ivanov joined Sistema in 2001 as the head of the Financial Analysis and Planning Department.

Intellectual Property

Kvazar-Micro owns numerous trademarks, mainly in Ukraine, including Kvazar-Micro, Advantis, Premium and others. Sistema owns the Sitronics trademark for consumer electronics in Russia. STROM telecom owns trademarks for its hardware and software products, including Medio and Foris.

Market and Competition

Telecommunications equipment. Russia's telecommunications equipment market is characterized by strong competition. According to J'son&Partners research agency, the Russian wireless and wireline infrastructure market in 2003 totaled $1.7-$1.8 billion. Major international players, such as Alcatel, Siemens, Ericsson, Nokia, Lucent, Cisco Systems and Huawei, actively participate in this market. Rapid development of wireless networks is the main driver of growth. We estimate that we had approximately a 3% market share in the Russian telecommunications equipment market as of September 30, 2004.

IT and systems integration. According to IDC, IT spending in Russia reached $7.1 billion in 2003, and is projected to reach $17.2 billion by 2008. In 2003, hardware sales totaled $4.7 billion, packaged software totaled $892 million and IT Services totaled $1.5 billion, according to IDC.

According to IDC and Gartner, about 3.8 million PCs were sold in Russia in 2003, which accounted for 7% of the EMEA market, the fourth largest EMEA market after the U.K., Germany and France. Desktops accounted for 92% of units sold, notebooks for 6% and servers for 2%. The market grew 23-26% in 2003, as compared to 2002. Notebooks demonstrated the highest growth rate, increasing more than 75% from 2002. According to IDC, about 2 million computers were sold in

Russia during the first six months of 2004, representing a growth of 32% compared to the first half of 2003.

According to RosBusinessConsulting, the sales of the 15 largest Russian IT companies exceeded $3.9 billion in 2003, with the top companies demonstrating higher growth than the market on average. The systems integration market is driven by large projects coming from the government and from corporate clients mainly from the oil, metal, finance, insurance and retail industries.

Semiconductor design and manufacturing. According to the Electronics Publishing House, the Russian semiconductor market (excluding complicated chips like processors and memories) grew 31% and reached $0.9 billion in 2003. The largest customers in this market come from the following segments: industrial electronics, telecom equipment, defense, auto electronics and security systems.

The Russian semiconductor market is dominated by foreign producers. There have been virtually no investments to upgrade domestic production lines since Soviet times. The 0.8 μm technology is the best commercially available in Russia, although most local manufacturers have only 1.0-2.0 μm technologies, preventing them from entering such market segments as auto electronics, security systems, computers and telecom equipment. However, domestic manufacturers have a strong position in certain market niches like defense electronics and equipment, industrial electronics and some others where they account for 10-15% of the market, according to the Electronics Publishing House.

According to the Electronics Publishing House, CSC is the largest domestic semiconductor producer. We had about a 40% market share in the defense segment in 2003, according to the Electronics Publishing House. Integral (Minsk), Angstrem (Zelenograd) and Monolit (Vitebsk) are our main competitors in the domestic market.

Mikron also sells standard digital chips for consumer electronic devices to China and other countries of Asia. Mikron competes mostly with Chinese companies in these markets. However, Mikron's products are distinguishable by their low prices and its ability to customize standard products to customer specifications.

Electronic devices and consumer electronics. The general economic situation in Russia has favored the development of the market for consumer electronics. According to Euromonitor, sales of consumer electronics in Russia reached nearly $2.9 billion in 2003, a 15% increase from 2002. In 2003, according to Euromonitor, video product sales reached nearly $2.1 billion, accounting for 72.3% of total consumer electronics sales, and grew by 8.3% in terms of volume.

According to Euromonitor, imported brands have a dominant market share in Russia, with domestic brands controlling only about 10% of the market in 2003. Although competition varies significantly depending on the type of product, our Sitronics brand faces competition from international brands, including Samsung, LG Electronics, Sony, and Philips, as well as domestic brands, including Rolsen, Rubin and Sokol. Russian-manufactured products occupy the lower-price segment of the domestic market.

Insurance

Overview

Through ROSNO and its subsidiaries, we are one of the leading providers of insurance, reinsurance and related products in Russia. ROSNO's Gross Written Premiums, or GWP, totaled $218.2 million and $259.6 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively. Non-life GWP comprised 40.3% and 44.8% of total GWP for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively. ROSNO's net income was $8.5 million and $9.1 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively.

As of September 30, 2004, ROSNO had 96 active regional branches and five subsidiaries. ROSNO's main subsidiaries include ROSNO-MS, Reinsurance Company ROSNO-Center, American Hospital Group, Allianz ROSNO Asset Management, Allianz ROSNO Life. ROSNO-MS also owns 20% of Medexpress, a leading medical services provider in the medium and upper-medium pricing segment.

The table below presents ROSNO's U.S. GAAP segmental financial information. For a further discussion of ROSNO's financial results see "Management's Discussion and Analysis of Financial Condition and Results of Operations—Segment Financial Results Overview—Insurance."

	Years ended December 31,			Nine months ended September 30,	
	2001	2002	2003	2003	2004
	(Amounts in thousands, except percentages)				
Income statement					
GWP	$131,090	$158,013	$218,247	$156,592	$259,642
Insurance result	12,269	28,987	56,611	30,985	44,640
Investment result	(2,990)	5,388	7,938	5,517	6,437
Operating expenses and other	(20,358)	(33,231)	(56,026)	(27,386)	(38,077)
Net income	(11,079)	1,144	8,523	7,563	9,066
Balance sheet					
Total assets(1)	136,617	176,813	256,046	233,434	329,697
Minority interest	78	65	84	88	5
Shareholders' equity	27,961	29,105	38,697	33,957	46,727
Ratios					
Loss ratio(2)	73.0%	62.4%	56.6%	70.0%	59.2%
Expense ratio(3)	42.3%	40.0%	38.9%	40.3%	34.3%
Combined ratio(4)	115.3%	102.4%	95.5%	110.3%	93.5%

(1) Total assets include consolidation adjustment amounts of $16.1 million in 2001, $14.8 million in 2002 and $15.1 million in 2003, and $13.3 million and $20.4 million in the nine months ended September 30, 2003 and 2004.

(2) Loss ratio represents incurred claims over net premiums earned. Incurred claims represent paid claims plus change in claims reserve.

(3) Expense ratio represents acquisition expenses less reinsurance commission plus administrative expenses all over net premiums earned. Reinsurance commission represents acquisition expenses that the reinsurer pays to the insurer.

(4) Combined ratio represents loss ratio plus expense ratio.

We are ROSNO's largest shareholder and beneficially own 49% of ROSNO's share capital. Our voting interest in ROSNO is equal to 51%. We exercise management control over ROSNO through our ability to nominate a majority of its board of directors, and ROSNO's financial results are accordingly consolidated with ours. ROSNO's other principal shareholders are Allianz, which owns 47% of the share capital, and members of ROSNO's management, who collectively own 3% of its share capital.

Allianz became a strategic investor in ROSNO in 2001. Allianz is one of the largest financial services companies in the world. Through Allianz, ROSNO has access to the technical know-how of one of the leading global insurance groups, including product development and sale techniques, risk management expertise, planning and controlling procedures.

Operational control and consolidation by Sistema with the intention of maintaining a balance of power between the two major shareholders in strategic decision making became the main principle of the shareholders' agreement signed between Allianz and Sistema in June 2001. Although we control ROSNO, management decisions are generally made on the basis of shareholder consensus and we cooperate with Allianz in developing both strategic goals and short-term targets for ROSNO. In September 2003, Sistema and Allianz amended the shareholders' agreement to include ROSNO's initial public offering as one of the major strategic goals for the company and its shareholders. In the event of ROSNO's IPO, Sistema may lose control over, and its ability to consolidate, ROSNO.

Business Description

ROSNO is one of the leading providers of insurance, reinsurance and related products in Russia. It sells life, non-life and reinsurance products to a broad range of clients, including both corporate entities and private individuals.

ROSNO's client base is comprised of three segments: large corporations, small and medium corporations and individuals. Its corporate clients generated 84% of its revenues in 2003 and are primarily in the telecommunications, oil and gas, banking, retail and manufacturing sectors. ROSNO's corporate clients are generally evenly divided between large corporations, defined as having over $100 million in turnover, and small and medium corporations, defined as having up to $100 million in turnover. The remaining 16% of ROSNO's revenues, in 2003, were generated from sales to individuals, primarily of motor and property insurance products.

In 2003, the top 15 clients of ROSNO comprised 35% of ROSNO's GWP. Sistema and RAO UES group companies are important clients of ROSNO, generating 4% and 26% of ROSNO's GWP in 2003, respectively.

ROSNO sells insurance products through a variety of distribution channels. As of September 30, 2004, our traditional distribution channels consisted of over 190 direct sales staff, over 960 agents and partnerships with approximately 80 insurance intermediaries and brokers. We have also partnered with certain non-insurance intermediaries that have the capacity and desire to sell insurance products together with their core products. As of September 30, 2004, this partnership network included over 700 businesses, including car dealers, leasing companies, banks, tour operators, tour agencies, trade companies and others. We also engage in work site marketing, which we define as the direct sale of insurance products to employees of companies that are ROSNO corporate clients, and participate in certain insurance programs and activities with government bodies.

Product Information

The table below summarizes ROSNO's GWP by product line, and other financial information for the periods indicated:

	Years ended December 31,						Nine months ended September 30,			
	2001		2002		2003		2003		2004	
	(Amounts in thousands, except percentages)									
Product lines										
Voluntary medical	$ 47,336	36.1%	$ 53,537	33.9%	$ 62,223	28.5%	$ 51,026	32.6%	$ 77,145	29.7%
Property	39,424	30.1	18,388[(1)]	11.6	25,462	11.7	18,945	12.1	29,057	11.2
Motor own damage	20,902	15.9	24,029	15.2	33,503	15.4	22,905	14.6	42,149	16.2
General third-party liability	2,293	1.7	2,823	1.8	3,201	1.5	2,139	1.4	6,592	2.5
Voluntary motor third-party liability	4,493	3.4	5,231	3.3	3,168	1.5	2,573	1.6	1,424	0.5
Obligatory motor third-party liability	—	—	—	—	14,993	6.9	5,058	3.2	27,818	10.7
Marine, aviation and transport	6,604	5.0	7,968	5.0	7,838	3.6	4,336	2.8	10,814	4.2
Personal accident	3,922	3.0	4,140	2.6	7,044	3.2	3,599	2.3	4,359	1.7
Other non-life insurance	507	0.4	1,867	1.2	2,988	1.4	2,287	1.5	5,030	1.9
Life insurance	1,511	1.2	1,968	1.2	1,710	0.8	1,124	0.7	977	0.4
Reinsurance inward	4,098	3.1	38,062	24.1	56,117	25.7	42,600	27.2	54,277	20.9
Total GWP	$131,090	100%[(2)]	$158,013	100%	$218,247	100%	$156,592	100%	$259,642	100%

(1) Increase in reinsurance inward and decrease in property GWP for the year ended December 31, 2002 relates to the disposal of our subsidiary Insurance Joint Stock Company Leader, or Leader, on December 28, 2001. ROSNO disposed of Leader to RAO Unified Energy Systems of Russia, or RAO UES, the monopoly energy supplier in the Russian Federation. ROSNO repurchased Leader in October 2004. See "—Inward Reinsurance" below.

(2) Numbers do not total 100% due to rounding.

Voluntary medical insurance. ROSNO is a leading provider of VMI in Russia. ROSNO has established partner relationships with medical institutions and has cooperation agreements with more than 300 clinics in Moscow and the Moscow region, including leading state medical centers and private clinics. In addition, to better manage costs and claims, ROSNO takes part in the operation of a network of 14 out-patient clinics, two ambulance centers in Moscow and St. Petersburg and a hospital facility that provide medical assistance for ROSNO customers across Russia. ROSNO also exercises management control and beneficially owns equity interests in a number of leading medical organizations, such as Medexpress and American Hospital Group, the operator of the American Medical Center clinic. In the future, we intend to further expand our clinics network and to establish diagnostic centers through Medexpress and the American Medical Center.

Property insurance. ROSNO offers various property insurance products, including commercial property, homeowners' and casualty insurance. In coordination with Allianz, ROSNO has introduced a number of innovative property insurance products in Russia.

Motor own damage insurance. ROSNO provides both commercial and individual MOD insurance (which excludes motor third-party liability), which covers damage or loss to a policyholder's vehicle. ROSNO also arranges vehicle repairs after the insurance event. ROSNO currently has arrangements with approximately 180 car servicing centers that provide consultation and service to policyholders throughout the life of the policy, as well as emergency and round-the-clock roadside assistance.

Newly passed laws regulating the obligatory motor third-party liability insurance market, which were adopted in 2003, may stimulate the expansion of sales to individuals in the MOD insurance sector.

Voluntary and Obligatory Motor Third-Party Liability. Voluntary Third-Party Liability (VMTPL) historically has been used by consumers to supplement MOD. With the launch of Obligatory Motor Third-Party Liability (OMTPL) in July 2003, our GWP for VMTPL declined. At the same time, the introduction of OMTPL contributed to the general growth of the Russian insurance market in the second half of 2003.

ROSNO has taken a cautious approach to the new OMTPL business line, focusing sales on the most profitable segments. This has led to one of the best loss ratios in the industry (62%, excluding loss adjustment expense, for the first 9 months of 2004), albeit, at the expense of market share, especially in comparison with aggressive industry players. OMTPL pricing is regulated by law, and an adverse change in current regulations is possible. Nevertheless, based on ROSNO's strong loss ratio in this segment, we may consider gradual expansion of our OMTPL sales for specific customer segments.

Inward Reinsurance. Inward reinsurance accounted for $56.1 million, or 25.7%, of ROSNO's GWP for the year ended December 31, 2003, and for $54.3 million, or 20.9%, of ROSNO's GWP for the nine months ended September 30, 2004, respectively. ROSNO's inward reinsurance business has provided reinsurance almost exclusively to Leader insurance company, which ROSNO disposed of in 2001 to RAO UES. Following the disposal, ROSNO continued to carry out the management function of Leader pursuant to a management agreement between ROSNO and Leader. Leader insures RAO UES's extensive energy property assets which ROSNO, in turn, reinsures. We are able to reinsure these assets due to our entry into an outward reinsurance contract with a syndicate of reinsurers. See "—Reinsurance Policy—Outward Reinsurance" below for a description of this contract. As a result, this business line has demonstrated strong growth both in GWP and profitability since 2001.

ROSNO repurchased Leader from RAO UES in October 2004 in order to benefit from the run-off portfolio of Leader. Industrial property insurance comprised the overwhelming majority (97.3%) of Leader's portfolio as of September 30, 2004, according to Leader's financial statements audited in accordance with Russian Accounting Standards. Other Leader businesses include private property insurance and VMI.

Life insurance. We have also developed our life insurance portfolio over the last few years. However, we are in the process of phasing out this portfolio and have established a separate legal entity, Allianz ROSNO Life, to develop our life insurance business in order to meet Russian legal requirements for the sale of life insurance products. Since establishing Allianz ROSNO Life in 2004, we have focused on forming a specialized life insurance sales force, which as of September 30, 2004 consisted of over 150 agents. We expect this number to increase further in the near future.

Other (General Third-Party Liability (GTPL), Marine, Aviation and Transportation (MAT), Personal Accident Insurance (PA), Other). In the first nine months of 2004, our other lines of business demonstrated strong growth (from 215% in GTPL to 24% in PA) with positive run-offs in Marine and GTPL. In the same period, our other business lines demonstrated a combination of low loss ratios (from -0.6% in GTPL to 13.7% in PA) with high expense ratios (from 70.5% in MAT to 63.3% in GTPL).

Reinsurance Policy—Outward Reinsurance

ROSNO cedes reinsurance in the normal course of business. This approach allows us to cede risks that exceed the retention we consider appropriate.

In recent years, ROSNO has switched from reinsuring with Russian reinsurance to Western reinsurance, and is currently working closely with Allianz. ROSNO now has contracts with several large Western European reinsurers, either directly or via international brokers. ROSNO also entered into a property reinsurance agreement in 2001 with a syndicate of reinsurers which has been renewed annually since then. Under the terms of the current agreement, the reinsurers have agreed to provide reinsurance to ROSNO for losses of over $3 million in an amount of up to $75 million. This agreement has allowed us access to otherwise unavailable business by allowing us to write larger property insurance policies, especially in relation to energy sector properties. As of January 1, 2004, all but five reinsurers under this contract were rated "A" or higher by S&P or the equivalent by AM Best; four are rated "A–" by AM Best and S&P and one is rated "BBB+" by S&P.

Insurance Reserves—ROSNO Guidelines

ROSNO meets the regulatory insurance reserve requirements and its internal reserve requirements by forming the following reserves:

Loss provision. Loss provision represents the accumulation of estimates for ultimate losses and includes outstanding claims provision, or OCP, and provision for losses incurred but not yet reported, or IBNR. Estimates of claims handling expenses are included in both OCP and IBNR. OCP is provided in respect of material claims reported, but not settled as at the balance sheet date. The estimation is made on the basis of information received by ROSNO during the investigation of insurance cases after the balance sheet date. IBNR is actuarially determined by ROSNO by line of business, and includes assumptions based on prior years' claims and claims handling experience. The methods of determining such estimates and establishing the resulting provisions are continually reviewed and updated. Resulting adjustments are reflected in the consolidated statement of income as they arise. The loss reserves are estimated on an undiscounted basis due to the relatively quick pattern of claims notification and payment.

Unearned premium reserve. Provision for unearned premiums represent the proportion of premiums written in the year that relate to unexpired terms of policies in force as at the balance sheet date, calculated on a time apportionment basis.

Unexpired risk provision. Unexpired risk provision, or URP, is recognized when unearned premiums are insufficient to meet claims and expenses, which may be incurred after the end of the financial year. To estimate the unexpired risk provision, ROSNO uses historical experience and forward-looking assumptions of ultimate loss ratios (including claims handling expenses) and the level of in-force portfolio maintenance expenses. The expected claims are calculated having regard to events that have occurred prior to the balance sheet date.

Stabilization Reserve. ROSNO has also established a stabilization reserve in accordance with regulatory requirements.

Life reserve. The life reserve is actuarially determined by ROSNO and Allianz ROSNO Life. ROSNO uses the gross premiums method on a policy-by-policy basis. This valuation method specifically takes into account cash inflows (expected premium income and investment yields) and cash outflows (expected mortality and morbidity and future maintenance expenses). The assumptions underlying the life actuarial provision valuation are based on the combination of ROSNO's historical experience and the best estimates of the future evolution of the main valuation parameters.

Preventive Measures Reserve. In accordance with Russian law, ROSNO established Preventive Measures Reserves, or PMR, using a specified portion of the premiums it receives. The intention of PMR is to provide funds for the cost of financing measures that prevent the occurrence of insurable events and promote general safety. There is no obligation that the funds actually be used, nor is there a requirement to return unused funds to the insured. However, ROSNO is restricted from distributing these funds to shareholders in the form of dividends or from using them for any purpose other than financing the foregoing measures.

For a description of the regulatory insurance reserves requirements, see "Regulation—Insurance—Insurance reserve requirements."

Investments

ROSNO's investments amounted to $105.1 million as of September 30, 2004. A break-down of these investments is as follows:

Investment	As of September 30, 2004
	(Amounts in thousands)
Deposits with banks	$40,613
Trading securities	28,755
Promissory notes and other originated loans	25,409
Other investments in securities	10,353

ROSNO's investment strategy combines a conservative approach with a focus on profitability and liquidity. Our investment activities are exposed to a variety of financial risks, including market risk, credit risk and currency risk. According to statutory restrictions, accumulated insurance reserves can be invested only in permitted assets, such as Russian debt and equity securities, real estate, banking instruments, cash and certain other defined investments. In addition to statutory requirements for portfolio structure, an internal risk management procedure has been established by ROSNO to monitor and control risks by ensuring that exposure to risks stays within the established limits. ROSNO has also developed an asset-liability management (ALM) procedure to manage duration and currency mismatches. ROSNO's investments (corporate share and bond portfolios) outperformed the market both in 2003 and in the first half of 2004. These portfolios were benchmarked against the RTSI for shares and against the ZETBI-Corp 10 for bonds.

In 2004, we established a separate asset management company under the brand Allianz ROSNO Asset Management (ARAM) by merging our investment company "Sistema-Investments" and "Deutscher Investment Trust Moscow" (DIT), an investment company formerly affiliated with Allianz. Creation of this new company combines the experienced sales force of DIT and the assets of Sistema-Investments with the specialized expertise of the Asset Management Department of ROSNO. This new entity works in close cooperation with Allianz Dresdner Asset Management, the asset management entity of Allianz Group, which is the second largest asset manager worldwide. While the primary task of ARAM is to conservatively allocate ROSNO's reserves, it also offers asset management services to third parties. See "—Strategy" below for additional information.

Solvency

ROSNO currently meets the statutory requirements established by the Federal Service for Insurance Supervision, or FSIS. In addition to local solvency requirements, Allianz introduced Underlying Operating Performance (UOP) principles within ROSNO, based on S&P's Capital Adequacy Model, which also specifies certain solvency requirements. The UOP model is used to evaluate management performance. For a description of statutory solvency requirements established by FSIS, see "Regulation—Insurance—Solvency."

Strategy

Our insurance strategy is to build a balanced, diversified portfolio of profitable insurance product lines and increase our market share in these segments by providing customized products and a superior level of service. We aim to become the company of choice for our clients and to sustain long-term customer relationships. A prudent business approach is the basis for our growth strategy. To achieve these goals we plan to:

- *Focus on the individual and SME (small and medium enterprises) insurance markets, while maintaining our current strong position in the corporate segment.* As a top priority, we aim to increase our sales to individual and SME customers to up to 70% of our non-life portfolio by

2006. To advance this effort, we intend to simplify and standardize our business processes to facilitate purchases of our products, streamline claims handling and set appropriate tariffs for our products. We also expect to continue to improve the quality of the services ROSNO provides in its corporate insurance operations and deliver a tailored approach to each industrial and commercial customer. Our strategic partnership with Allianz provides us with valuable expertise to further develop our business in this segment.

- *Increase the services and reach of our distribution network by developing different distribution channels.* We aim to streamline and continue to develop our multi-channel distribution network in order to meet the needs of different customer classes. In particular, we plan to increase the productivity of ROSNO's existing distribution network through automated sales and sales management processes, intensive coaching of sales staff and agents, adoption of enhanced sales training, modular product design and IT solutions that provide instant help during the sales process. We also plan to develop new channels like tele-insurance and a network of agencies largely concentrated in Moscow.
- *Strengthen our existing non-life insurance network in the Russian regions.* We are currently restructuring ROSNO's distribution network in the regions in which it operates. This restructuring will include changes to ROSNO's organizational structure, implementation of strict financial control guidelines and procedures in each branch, a cost reduction plan and centralized cash and reserves management. We also plan to launch special training programs for our regional sales agents. Our aim is to collect at least 50% of our non-life premiums from the regions outside Moscow and the Moscow region by 2008.
- *Explore additional growth opportunities via selective acquisitions in Russia and the CIS.* We may explore potential mergers and acquisitions opportunities with regional insurance companies, national peers and attractive targets in other CIS countries. Potential targets will meet certain baseline criteria, including having a minimum customer base and market share, a profitable portfolio or portfolio capable of becoming profitable within one year from acquisition, and business practices consistent with ROSNO's policies. We will consider opportunities associated with expected changes in the Russian state health care system and related obligatory medical insurance (OMI) regulations.
- *Gain a leading position in long-term life insurance.* We plan to expand our life insurance and asset management services to individuals. Allianz ROSNO Life is developing new distribution channels and introducing specialized training programs for our sales agents and flexible and convenient pricing for our individual life insurance products. We expect the individual life insurance sector to grow significantly in the coming years due to the increasing per capita income combined with the low penetration of life insurance products in Russia.
- *Develop our asset management operation.* We plan to further develop ARAM, our asset management operation, in an effort to optimize our investments, as well as service the asset management requirements of third parties. We believe significant opportunities in this area have emerged as a result of the rapid development of the Russian financial markets.
- *Use cross-selling and co-branding opportunities within the Sistema group of companies.* Given Sistema's position as the leading private sector consumer services company in Russia and the CIS, we are increasingly using our combined customer base of over 35 million customers through joint projects with other Sistema businesses. These projects include providing travel insurance services through Intourist, cross-selling products with Sistema telecommunications companies, and developing bundled financial products in conjunction with MBRD. All of these initiatives and projects are being developed through joint intercompany working groups. Although relatively new to the market and to us, we view these projects as an important component of our strategy in the medium- to long-term.

Capital Expenditures

We and our equity partner plan to invest our proportionate shares of an aggregate amount of approximately $90 million to enhance ROSNO's capital base and to finance any capital expenditures (excluding capital expenditures for acquisitions) required to implement our strategy during 2005-2006. These capital expenditures are expected to be made in relation to our operations in Russia.

Management and Employees

The following table sets forth the average number of ROSNO employees for the years ended December 31, 2001, 2002 and 2003:

Year	Full time employees	Agents	Total	% increase/(decrease) over prior year
2001	1,461	3,627	5,088	127%[(1)]
2002	3,529	2,068	5,597	10%
2003	3,955	2,205	6,160	10%

(1) Percentage increase due to increase in the number of branches, acquisition of two insurance companies, an increase in ROSNO's agents' network and general restructuring of the company.

As of September 30, 2004, ROSNO's head office in Moscow had approximately 1,860 employees, of whom approximately 475 were administrative staff, 250 were insurance center staff and 1,135 were full-time sales staff. In addition, as of September 30, 2004, ROSNO had more than 2,500 active freelance agents in its head office. The increase in full-time employees in 2002 over 2001 is due to the reclassification of ROSNO's tied agents from agents to full-time employees.

Leonid Melamed has served as the chief executive officer of ROSNO since September 2003. He is also a member of the board of directors and chairman of ROSNO's management board. Mr. Melamed is a co-founder of ROSNO and a minority shareholder in the company.

Vladimir Gurdus has served as the first deputy CEO of ROSNO since October 2003. Mr. Gurdus is a co-founder of ROSNO and a minority shareholder in the company.

Hannes Chopra has served as a member of ROSNO's board of directors since November 2001 and as a member of ROSNO's management board since March 2004. Prior to joining ROSNO's management, Mr. Chopra served as vice-president responsible for the CIS, the Middle East and Africa for Allianz.

Market and Competition

A competitive insurance market began to develop in Russia in 1989 as the country started its transformation to a market economy and many private companies entered the market. Until 1988, there had been only two insurance companies operating in Russia, both of which were state owned. As of July 1, 2004, according to the State Insurance Register, there were 1,435 insurance companies operating in the Russian market. Many of these companies primarily participate in financial and tax optimization schemes designed to minimize payroll taxes and VAT that would not be classified as insurance activities by international standards. Moreover, due to widespread use of insurance companies for financial and tax optimization schemes, there is a wide discrepancy between official market data compiled by FSIS and analysts' estimates, which exclude these schemes.

Russia is currently perceived by insurance experts to be one of the few remaining insurance growth markets. Industry consolidation is expected to continue and, at the same time, foreign companies are expected to enter the Russian market. Recent trends also indicate that insurance products are becoming increasingly commoditized. As a result, we expect competition to intensify.

The Russian insurance market is divided into voluntary and obligatory insurance. Voluntary insurance includes property, personal, liability and life insurance. Obligatory medical insurance, a significant category in terms of GWP, involves the payment of a fixed commission to insurance companies by the government on payments by insurance companies to medical service providers and does not involve any actuarial risk on the part of insurance companies.

The table below illustrates the volume of the Russian insurance market in terms of GWP, according to Russian accounting standards, for 2000, 2001, 2002 and 2003:

Product lines	**2000**		**2001**		**2002**		**2003**	
	(Amounts in billions, except percentages)							
Personal	$0.6	9%	$1.0	11%	$1.0	11%	$ 1.4	10%
Property	1.4	22	2.0	21	2.9	30	4.1	29
Liability	0.2	4	0.3	3	0.4	4	0.4	3
Obligatory(1)	1.1	18	1.4	15	2.0	21	3.4	24
Life(2)	2.8	47	4.8	50	3.3	34	4.8	34
Total	$6.1	100%	$9.5	100%	$9.6	100%	$14.1	100%

Source: FSIS.

(1) Under international accounting standards, premiums for obligatory medical insurance are not recorded as gross written premiums, but are recorded as commission income because they do not involve any actuarial risk on the part of insurance companies.

(2) Figures include premiums collected from traditional insurance products, as well as from payroll tax-optimization schemes. We believe such schemes account for a vast majority of the GWP in the life insurance market segment.

The foregoing table includes payroll optimization schemes. Excluding these schemes, we estimate the volume of the Russian insurance market in terms of GWP was $5.2 billion in 2003. In 2003, Moscow was the largest insurance market in Russia in terms of GWP, accounting for 55.2% of total GWP, according to FSIS.

The Russian insurance market has experienced considerable consolidation over the last two years. As of January 1, 2004, ten insurance companies accounted for 55.6% of non-life GWP, according to FSIS. We expect this trend to continue in the future, particularly if restrictions on investment by foreign insurers in certain business lines, including long-term life insurance, are lifted.

Banking

Overview

We conduct our banking business primarily through the Moscow Bank for Reconstruction and Development, or MBRD, a joint stock bank incorporated in the Russian Federation in 1993. MBRD's operating income was $2.1 million and $13.7 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively. MBRD's net income was $7.1 million for the year ended December 31, 2003 and $7.7 million for the nine months ended September 30, 2004. MBRD's assets, prior to intragroup eliminations and excluding provisions for intragroup balances, were $683.2 million and $640.0 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively.

We beneficially own a 95% interest in MBRD's share capital and exercise voting control over 99% of MBRD's share capital. Our beneficial ownership and voting interest include a 13.7% stake we acquired for approximately $10 million in January 2005 from Alrosa, a state-controlled diamond producer. In November 2004, shareholders of MBRD approved an issue of 130,000 shares of common stock in a closed subscription. The shares of the new issue will be acquired by the existing shareholders for a price of RUR 4,600 per share. In addition to MBRD, we own a 49% stake in East-West United Bank, a Luxembourg-based commercial bank operating under the banking laws and regulations of Luxembourg. As of September 30, 2004, East-West United Bank's share capital was $37.7 million.

Historically, MBRD's main function has been to allocate resources and to provide financing to us and our affiliates. While most of MBRD's business consists of transactions with companies related to our consolidated group, and the bank continues to act as the internal treasurer for the Sistema group companies, MBRD has been successfully attracting new corporate clients unrelated to Sistema since 2001. MBRD has over 4,715 corporate customers, including us and our affiliates. It is a member of the Association of Russian Banks, the Moscow Banking Union, the Exchange Chamber, the Moscow Interbank Currency Exchange, the National Securities Market Association and the Moscow Stock Exchange. It has branches in St. Petersburg, Rostov-on-Don, Krasnodar and Syktyvkar. In 2003, Fitch Ratings gave MBRD a credit rating of "B" for short-term borrowing in foreign currency and "B−" for long-term borrowing in foreign currency with a stable outlook. Both ratings were confirmed by Fitch in 2004. Also in 2004, Moody's Investors' Service gave MBRD a "B1" long-term currency and a not prime (NP) short-term foreign currency deposit rating, with a stable outlook.

We are currently focusing on developing and expanding MBRD's retail banking business in Moscow and major cities throughout Russia and, to this end, are seeking equity partners to help fund the growth and provide retail banking sector expertise, as well as debt financing. In July 2004, we and Sabre Capital Worldwide Inc. signed a non-binding "Term Sheet for Acquisition by Sabre Group Investors of Shares in Moscow Bank for Reconstruction and Development" containing the principal terms of a share purchase agreement between Sistema and Sabre Capital Group's investors, a shareholders agreement between Sistema, MBRD and Sabre Capital Group's investors, and a management agreement between Sistema, MBRD and Sabre Capital. We expect the agreements to be signed and the transaction to close during the first half of 2005. Sabre Capital is a London-based private equity firm whose principals have expertise in developing retail banking in emerging markets. Upon closing of the transaction, Sabre Capital's investors are expected to own 25% plus one share of the outstanding share capital of MBRD in return for an equity investment in MBRD and a payment to us. Following the transaction with Sabre Capital, we will beneficially own approximately 70% of the outstanding share capital of MBRD. The parties intend to involve Sabre Capital in the management of MBRD, particularly in connection with the plans to enlarge its retail banking business.

Completion of this transaction is subject to a number of conditions. See "Risk Factors—Risks Relating to Our Business—General Risks—Our planned business combinations and restructurings may be delayed or fail to occur."

On May 31, 2004, two principals of Sabre Capital, Gurvirendra (Rana) Singh Talwar and Peter Nigel Kenny, were elected to the board of directors of MBRD.

The following table sets forth summary financial data for MBRD, prior to intragroup eliminations and excluding provisions for intragroup balances. During the periods presented, MBRD's principle functions were to provide treasury services to and adequate liquidity for Sistema and its affiliates.

	Years ended December 31,			Nine months ended September 30,	
	2001	2002	2003	2003	2004
	(Amounts in thousands, except percentages)				
Income statement					
Revenues	$ 19,072	$ 36,660	$ 57,513	$ 40,063	$ 49,220
Operating income	5,979	7,219	2,077	5,746	13,659
Net income	2,524	3,937	7,080	8,021	7,726
Balance sheet data					
Loans and advances to banks(1)	97,501	28,165	162,712	97,358	92,121
Loans and advances to customers(1)	178,337	181,365	308,477	261,926	460,498
Total assets	366,528	329,685	683,210	479,024	640,010
Deposits from financial institutions	8,447	41,189	58,186	33,412	78,920
Customer accounts	217,510	153,831	423,526	241,144	368,630
Debt securities issued	47,451	37,474	94,371	71,725	74,809
Equity	91,076	94,879	104,476	105,433	113,248
Key performance ratios					
Net interest margin(2)	5.5%	4.7%	5.5%	5.4%	3.9%
Cost income ratio(3)	39.2%	54.6%	56.2%	58.1%	55.5%
ROAA(4)	1.0%	1.1%	1.4%	2.0%	1.2%
ROAE(5)	4.5%	4.1%	7.0%	8.0%	7.1%
Capital adequacy ratio(6)	N/A	34.9%	17.5%	21.9%	14.8%

(1) Less allowance for loan losses.

(2) Net interest income divided by average interest-earning assets.

(3) Operating expenses over net bank income before provisions for any loan losses.

(4) ROAA means return on average assets, which represents net income over average total assets.

(5) ROAE means return on average equity, which represents net income over average equity.

(6) Calculated according to the requirements of the Central Bank of Russia.

Business Description

MBRD has two main business lines, corporate banking and retail banking, and also performs treasury functions for us and our affiliates. Corporate banking accounts for the largest proportion of MBRD's net banking income, and is also responsible for most of MBRD's loans and deposits. However, in line with its strategy, MBRD is working to increase the volume of retail customers in its combined customer base.

Business Divisions

Corporate banking. MBRD's banking activities include lending, deposit taking and trade finance. As of September 30, 2004, MBRD had outstanding a total of $460.5 million in loans to customers, including $276.2 million in loans to other Sistema group companies, $38.6 million in loans to other related parties and $145.7 million in loans to third parties. As of September 30, 2004, MBRD had a total of $368.6 million in deposits from customers, including $245.6 million in deposits from other Sistema group companies, $22.8 million in deposits from other related parties and $100.2 million in third-party deposits. As of September 30, 2004, term deposits from MTS accounted for approximately 42.7% of the total amount of MBRD's term deposits from customers.

MBRD clients include prominent Russian consumer goods companies, government-controlled defense contractors such as MIG and Sukhoi, and other private and government-controlled companies, including Sheremetevo International Airport, Russia's leading international airport. To better serve our corporate clients' needs, MBRD established a Corporate Customers Relationship Management, or CRM department, which assigns CRM specialists to particular sets of clients.

Retail banking. Development of retail banking is a key focus of MBRD. Throughout 2003 and 2004, MBRD actively pursued retail customers through aggressive pricing of deposits and by expanding its range of products. As a result, current accounts and deposits from private clients grew to approximately $59.4 million, or by more than 83.7%, during the first nine months of 2004. Currently, MBRD offers its clients a wide range of term, savings and current deposits in addition to credit card and consumer lending products. In particular, it has developed co-branded MasterCard products with MTS, and began issuing co-branded credit cards in November 2004. We expect to further develop and expand our activities in this area by involving third-party equity investors in MBRD who have retail banking expertise. For a description of our planned sale of a 25% plus one share stake in MBRD to third-party investors, see "—Overview."

As of September 30, 2004, MBRD had one full service branch and 16 mini-branches in Moscow and four regional branches in St. Petersburg, Rostov-on-Don, Krasnodar and Syktyvkar. MBRD's network of electronic banking terminals had more than 150 ATMs, including 20 ATMs in the regions. It installed ATMs in nine MGTS branches. The bank has reached an agreement with MTS to launch seven mini-branches in MTS retail offices. In 2003, MBRD launched its own processing center certified by MasterCard and Visa.

At present, MBRD's most common retail product is payroll cards. As of September 30, 2004, MBRD had issued 24,713 payroll cards. One-month overdraft credit is available for certain payroll card holders, typically employees of MTS and MGTS. The credit is secured by the individual's future payroll deposits. As of September 30, 2004, MBRD had issued 549 payroll cards with the overdraft credit feature.

Treasury. MBRD maintains current accounts for Sistema group companies and provides short-term liquidity to them.

Risk management

Lending Policies and Procedures. Ruble-denominated loans to Russian customers represent a significant portion of MBRD's loan portfolio. Loans advanced are typically short-term and secured by collateral. MBRD has established procedures for approving and monitoring loan quality and for extensions and refinancing of existing loans. These procedures are set out in the credit policy approved by MBRD's management board and apply to all loans, including those to related parties. The performance of outstanding loans is subject to monitoring by the bank's internal control department, credit department and the treasury.

At the center of MBRD's lending and approval process is its eight-member credit committee, which makes all decisions with respect to any loan made by the bank's headquarters to corporate clients and with respect to loans to individuals in excess of the ruble equivalent of $10,000. Loans made by the regional branches in excess of 5 million rubles are also subject to approval by the credit committee. The final decisions with respect to transactions with a volume exceeding 25% of the bank's total assets and transactions with interested parties (as defined under Russian law) are made by MBRD's board of directors or its shareholders' meeting, within their respective areas of competence. Some transactions between MBRD and interested parties or affiliated companies require the approval of disinterested directors or shareholders. See "Risk Factors—Risks Relating to Our Business—General Risks—In the event that the minority shareholders of our subsidiaries were to successfully challenge past interested party transactions or do not approve interested party transactions in the future, we could be limited in our operational flexibility and our results of operations could be materially adversely affected."

The head office of MBRD periodically establishes lending limits for the branches, as well as, subject to the Central Bank of Russia's loan concentration regulations, limits for types of credit instruments, individual borrowers, groups of related borrowers and credit portfolios.

MBRD evaluates borrowers on the basis of their credit history, quality of the collateral offered and financial condition. In addition, it may take into account certain business relationships when determining the interest rate of loans to certain related parties. Usually, the bank requires credit support or collateral as security for the loans and credit facilities that it grants. The main forms of credit support and collateral are guarantees, real estate, Russian government securities, liquid promissory notes, other liquid assets and, in the case of related parties, shares of companies affiliated with Sistema.

Assessments of Provisions for Loan Impairment. MBRD establishes general loan provisions at the time loans are extended and revises them on a monthly basis. Specific provisions are made against loans for which, as a result of the appraisal of the loan portfolio, recovery is considered doubtful. The bank divides its loan portfolio into five subcategories: standard, watch, substandard, doubtful and loss. For these categories, it creates reserves of 0%, 1%, 21%, 51% and 100%, respectively, before taking into account the quality of the collateral. Upon recommendation of the credit committee, MBRD's board of directors or management board make, within their respective areas of competence, the decision on the charge-off of bad debts. Generally, loans are classified as "bad debts" when MBRD believes that there is no realistic prospect of recovery on them. In addition, MBRD's credit policy provides that, where a loan was granted to insiders or exceeds 1% of MBRD's capital, the write-off of the loan may be made on the basis of a court determination that the debtor's assets are not sufficient to satisfy its obligations.

Liquidity management. Liquidity is managed via borrowings in the inter-bank market and investments in liquid securities. The majority of MBRD's securities portfolio consists of liquid promissory notes of large domestic issuers, fixed income government bonds and corporate bonds. The bank is cautious in its equity investments and, historically, the volume of these transactions has been relatively low. The following table summarizes MBRD's trading securities as of December 31, 2003:

Trading securities	Position size (Amounts in thousands)	% of total
Eurobonds of the Russian Federation Government	$ 52,708	47%
Corporate promissory notes	32,705	29
Corporate bonds	13,343	12
OVGVZ bonds	6,561	6
Municipal bonds	2,971	3
Russian State Bonds (OFZ)	2,177	2
Corporate shares	855	1
Total	$111,320	100%

In order to better manage liquidity, MBRD regularly requests from its major corporate customers a schedule of upcoming changes in their deposit and loan balances. On the retail banking side, MBRD carries out scenario analysis and stress testing to forecast likely customer behavior.

MBRD aims to match the terms of loans and deposits whenever possible. Gap analysis is used to monitor liquidity positions on a weekly basis. The maximum gap is set on the basis of current market conditions and MBRD's ability to accumulate liquidity. Stress testing is also carried out on a monthly basis using statistical analysis on the stability of deposits. The following table sets forth the liquidity gap analysis based on the data from MBRD's standalone financial statements.

Liquidity gap as of December 31, 2003	<1 month	1-3 months	3 months-1 year	1 year-5 years	>5 years
		(Amounts in thousands)			
Assets	$365,134	$ 81,246	$161,023	$44,443	$ 1,751
Liabilities	194,243	259,639	117,525	5,855	—
Liquidity gap	$170,891	$(178,393)	$ 43,498	$38,588	$ 1,751
Cumulative gap	$170,891	$ (7,502)	$ 35,996	$74,584	$76,335

Forex risk management. Foreign exchange risk is managed via derivative investments (foreign currency forward and swap contracts) with domestic and foreign banks. MBRD's financial committee approves stop-loss limits, both on securities and foreign currency trading portfolios, securities position limits and foreign currency position limits. The largest limit, set for our ruble/U.S. dollar exposure, is $9 million, which is in line with the Central Bank of Russia's requirements on foreign currency exposure (this amount, calculated in accordance with Russian accounting standards, may differ from the size of our exposure set forth in the table below, which was calculated in accordance with U.S. GAAP). Stop-loss limits are reviewed on a monthly basis, and positions are monitored and revalued daily. They are monitored in terms of mark-to-market exposure and for compliance with limits. A Value at Risk, or VaR, calculation (with a 99% confidence interval, historical data for 12 months and a holding period of 10 days) is also used. In addition, the bank carries out stress testing procedures. The following table sets forth the currency mismatch analysis based on the data derived from MBRD's standalone financial statements.

Currency mismatch as of December 31, 2003	Ruble	U.S. dollar	Other
	(Amounts in thousands)		
Assets	$318,414	$375,137	$5,759
Liabilities	215,760	357,285	4,217
Currency exposure	$102,654	$ 17,852	$1,542

Interest rate risk management. MBRD has exposure to interest rate risk both through its bonds portfolio and interest bearing assets and liabilities that are held to maturity. The interest rate gaps are divided by maturity, and are monitored by MBRD's financial committee on a weekly basis. The bank also carries out scenario analysis, and stop-loss limits are reviewed and approved by the financial committee as described above in "Forex risk management."

Counterparty risk management. MBRD considers credit ratings by independent rating agencies, as well as its own internal policies and procedures to assess the risk associated with a particular counterparty. The largest aggregate limit (mostly for current account balances) of $110 million applies to a high quality foreign bank. The largest limits set for Russian banks are equivalent to a maximum of 24% of MBRD's own capital and are applied to state-owned banks. MBRD's credit committee is responsible for approving aggregate limits for each bank, which in turn, are divided into sub-limits by instrument.

Credit risk concentration. MBRD aims to diversify its credit portfolio in order to avoid credit risk over-concentration. According to the bank's policy, MBRD's exposure to a single borrower should not exceed 25% of MBRD's own capital, which is in line with the mandatory requirement of the Central

Bank of Russia. The following table represents a list of MBRD's ten largest borrowers as of September 30, 2004.

Rank by loan size	Exposure (Amounts in millions)	Industry in which borrower operates
1	$23.1	Telecommunications
2	22.3	Financial Services
3	22.1	Manufacturing
4	20.9	Real estate management & development
5	20.9	Real estate management & development
6	20.2	Financial Services
7	20.2	Financial Services
8	20.0	Construction
9	20.0	Manufacturing
10	17.1	Financial Services

Capital adequacy. MBRD's capital ratios comply with the requirements established by the Central Bank of Russia. However, MBRD plans to further improve its capital ratios and increase its shareholders' equity by attracting capital from third-party investors. The bank's medium-term minimum target BIS capital adequacy ratio is 12%.

The following table sets forth MBRD's capital amounts and capital adequacy ratios as of the dates presented, based on MBRD's Russian statutory accounts:

	Years ended December 31,			Nine months ended September 30,	
Capital adequacy	2001	2002	2003	2003	2004
	(Amounts in thousands, except percentages)				
MBRD Capital[(1)]	N/A	$90,126	$95,532	$90.269	$95,984
Capital adequacy ratio	N/A	34.9%	17.5%	21.9%	14.8%

(1) Translated into U.S. dollars at exchange rate as of the end of each period.

Strategy

Our strategy is to further develop MBRD into a full-service bank offering corporate and retail banking services on a nationwide basis. In particular, MBRD will focus initially on the development of retail banking services in Moscow and subsequently expand into other Russian regions. MBRD will also continue to act as the internal treasurer of the Sistema group companies.

Corporate banking. As part of our strategy to develop MBRD into a full-service bank, we are seeking to diversify its banking services and to increase the number of corporate clients unrelated to Sistema. On the corporate banking side, we plan to upgrade the range of MBRD's banking and investment products with the aim of increasing the share of unaffiliated clients on both the assets and liabilities sides of MBRD's balance sheet to more than 70% by 2008 from the current level of about 30%.

Retail banking. MBRD intends to initially expand its retail banking activities by capitalizing on the retail potential of our Telecommunications and Insurance Segments. Sistema group companies collectively have relationships with over 35 million people. Our understanding of the needs, spending habits and other characteristics of this customer base provides us with a unique opportunity to access potential retail banking customers and to capitalize on the group's broad range of marketing channels to promote MBRD's services. We believe that MBRD will be able to provide a broad range of competitive retail products that are in demand by MTS and MGTS subscribers. Initially, MBRD plans to focus on credit card and consumer lending. In particular, it has developed co-branded MasterCard products with MTS and began issuing co-branded credit cards in November 2004. As MBRD expands, it eventually plans to add residential mortgages to its product portfolio.

During the initial phase of retail expansion, MBRD plans to distribute its products through its distribution network, which includes branches and mini-offices in MTS and MGTS outlets, Internet banking, telephone banking and mobile phone banking. To secure access to MTS and MGTS subscribers, MBRD plans to install a wide network of ATMs and cash-ins, and open new cash desks in MTS and MGTS branches. MBRD also plans to build up a network of points of sale in retail outlets to provide express consumer loans, to establish its own network of sales agents and to utilize the ROSNO sales agent force to sell co-branded products.

By the end of 2007, we expect that MBRD's infrastructure will include 15 full service branches and 40 mini-branches in Moscow, 20 regional branches and more than 400 ATMs. At the second stage of development, we are considering the possibility of expanding into Ukraine and Belarus through the acquisition of local banks. The ultimate goal of the strategic plan for MBRD is to be among the 10 largest retail banks in Russia.

We plan to implement and fund our retail banking development strategy by involving third-party equity investors in MBRD with retail banking expertise. See "—Overview" above for a description of our planned sale of a 25% plus one share stake in MBRD to third-party investors, and "—Capital Expenditures" below for a description of the planned use of proceeds from such sale.

Capital Expenditures

We estimate the total amount of investment necessary to implement our retail banking development program in Russia to be approximately $40 million through the end of 2007. Our current plan envisions the involvement of an external investor group led by Sabre Capital to provide substantially all of the required financing. For a description of the equity investment in MBRD expected to be made in the first half of 2005 by Sabre Capital, see "—Overview" and "Risk Factors—Risks Relating to Our Business—General Risks—Our planned business combinations and restructurings may be delayed or fail to occur."

Management and Employees

The following table sets forth the average number of MBRD's employees for the years ended December 31, 2001, 2002 and 2003, including staff employed by MBRD's regional branches:

Year	MBRD employees average for the year ended December 31,	% increase/(decrease) over prior year
2001	341	52%
2002	418	23%
2003	567	36%

Sergey Cheremin serves as the chairman of the management board of MBRD. Prior to joining MBRD in 2003, Mr. Cheremin served as President of North-East Alliance Bank in Moscow.

Oleg Maslov serves as first deputy chairman of the management board of and the head of MBRD's Operations Division, Credit Department, Depositary and Planning Department. Mr. Maslov has been with MBRD since 1995.

Alexei Rukavishnikov serves as first deputy chairman of the management board and the Head of MBRD's Investment Division and Treasury. Prior to joining MBRD in 2002, Mr. Rukavishnikov was deputy CEO of the Russian Bank for Development.

We expect changes to the bank's management following the planned sale of a minority stake in MBRD to third-party investors, as well as significant involvement by the new investors in the bank's management. See "—Overview" above for a description of our planned sale of a 25% plus one share stake in MBRD to third-party investors.

Market and Competition

The banking sector in Russia is highly fragmented and very competitive. According to the Central Bank of Russia, there were 1,329 banks operating in Russia as of January 2004. However, a small number of Moscow-based banks dominate the Russian banking industry. As of May 2004, the top five banks in terms of asset size accounted for 43% of the total value of bank assets in Russia, according to the Central Bank of Russia. Government-owned Sberbank dominates the Russian retail and corporate banking industry. Alfa Bank is the largest domestic private bank, ranked by the Russian Expert rating agency in April 2004 as fourth in total assets, third in total value of individual deposits and second in total value of loans to customers.

Consumer lending, a segment of the retail banking market where MBRD plans to expand, experienced significant growth in 2000-2004. From January 1, 2000 to July 1, 2004, according to the Central Bank of Russia, the volume of consumer loans grew at an average annual rate of 83%. By July 2004, the total volume of consumer loans reached $15 billion, according to the Central Bank of Russia. According to Finansovye Izvestia, the volume of consumer loans in Russia is expected to reach $40-$50 billion by the end of 2008. Among the leaders in this segment are Sberbank, Alfa Bank, Home Credit & Finance, Russky Standart, a leading provider of short-term express-loans sold in retail outlets, and DeltaBank, the leading issuer of Visa credit cards in Russia. This segment of the retail market has also been attracting attention from global players. According to The Moscow Times, in August 2004, GE purchased DeltaBank.

Credit card issuance and use is expected to exhibit dynamic growth in Russia over the next five years due to the general absence of credit card products in Russia prior to 2001. In particular, Euromonitor estimates that the number of cards in circulation will increase from 300,000 in 2003 to 7.9 million in 2008, the number of credit card transactions will increase from 7.1 million in 2003 to 186.5 million in 2008 and the value of credit card transactions will increase from $525 million in 2003 to over $15 billion in 2008.

Real Estate

Business Overview

We are a leading real estate owner, developer and manager predominantly focused on the Moscow market in the segments of Class A and B offices, elite housing, cottages and land development.

We have been in the real estate business since the early 1990s, making real estate one of our first businesses. Our real estate development and management activities are principally conducted through our subsidiary, Sistema-Hals, which we established in 1994. Sistema-Hals' principal activities are development, project management and property management, which it undertakes both on behalf of Sistema and its group operating companies, as well as for third parties. Within the development process, Sistema-Hals typically handles feasibility studies, business plan preparations, acquisitions, construction permits, financing and marketing. Services such as architectural and engineering design, construction and equipment installation are generally outsourced to third parties.

Since 1994, we have successfully completed more than 20 projects totaling over 150,000 sq.m. of space utilizing funding from internal sources and from third parties. We have successfully developed or redeveloped properties on behalf of major international companies including Alrosa, Banque Nationale de Paris, DaimlerChrysler, Dresdner Bank, MTS, Raiffeisenbank, Samsung Electronics and others. The principal completed projects include Class A and B office buildings, upscale fitness clubs, and elite residential apartments and cottages in the Moscow area. For the DaimlerChrysler headquarters, Sistema won several Russian and international awards, including "Best Project of the Millennium" award at the 13th International Construction Awards in Paris in 2001, "Best Project of the Millennium" award at the 15th Golden Europe Awards for Quality in 2001 and "Best Project" in the field of construction in Moscow from 1990-2000 in the Office Buildings/Business Centers category awarded by the City of Moscow.

We have inherited significant real estate interests from the Soviet era, some of which are no longer fully required in our operations and which have redevelopment potential. In addition, we have been successful in sourcing sites in Moscow and obtaining permits for new developments and redevelopments. Typically, Sistema-Hals develops or redevelops these sites which, upon completion, are then either leased (and owned as investment properties) or sold to occupiers or investors, which in some cases are identified prior to the commencement of development. While tenants and potential buyers of projects can be identified prior to commencing construction, binding pre-sale or pre-leasing contracts are not standard for the Russian real estate development market, particularly in Moscow where the developer only receives ownership upon completion. Therefore, parties often enter into non-binding memoranda of understanding prior to completion.

In Moscow, upon completion of development, we generally own, directly or indirectly, the structures we have developed but not the actual land on which the structures are situated. With few exceptions, land in Moscow is owned by the City of Moscow. Unlike in other parts of Russia, where the sale and lease of land are governed only by the Federal Land Code, land in the City of Moscow is also subject to a separate regulatory regime administered by the City of Moscow and set forth in the Moscow Law on Land Use and Construction in the City of Moscow dated May 14, 2003, or the Moscow Land Law. Pursuant to the Moscow Land Law, the majority of land in Moscow is occupied pursuant to lease agreements between owners of the structures on the land and the City. These leases are typically granted for a term of 25 to 49 years and are subject to renewal rights. They are granted by the City on the basis of an auction or tender, typically in exchange for either an upfront payment or ongoing consideration in the form of periodic lease payments. Renewal rights remain largely untested to date given the fact that most existing leases remain unexpired and are decades away from expiration. Should the Moscow City Government in the future adopt the Federal Land Code, current lessees of land will be able to acquire ownership to such land.

Currently, during the development phase, site and structure entitlements are determined according to an investment contract between the City of Moscow and developers (unless there are previously established ownership or land lease rights). Pursuant to such investment contract, ownership certificates for the structures and a land lease agreement for the land will be delivered upon completion of the development in accordance with such investment contract. In certain cases, particularly in respect of residential developments, investment contracts require a certain portion of the projects to be transferred to the City upon completion.

As of December 30, 2004, our most significant real estate investment properties and development projects were valued by Cushman & Wakefield Healey & Baker, or C&WH&B, an independent real estate appraiser with significant experience in the Moscow market. As of December 30, 2004, the aggregate market value of these assets as determined by C&WH&B was $316.3 million. As many of these properties and development projects are not 100% owned by us, not all of such aggregate market value can be attributed to our consolidated group. In addition, the valuation represents the aggregate of the current values attributable to the individual properties and should not be regarded as a valuation of the portfolio as a whole in the context of a sale as a single lot. Details of the valuation methodology and the assumptions used by C&WH&B are set forth in the valuation report signed by C&WH&B included as Appendix A to this offering memorandum. We urge you to read this valuation report in its entirety. In summary, for development projects, the income approach was used in determining the current value of the project. Under the income approach, the residual value of a property under development or held for future development is the net present value of all future income streams less the net present value of all future costs. Future incomes are assessed based on current returns for completed projects of a similar nature in the market adjusted to reflect the expected completion date for the particular project and anticipated future trends in rents and/or sales prices. Where possible a review of comparable sales was made as a check on the reasonableness of the income approach. For investment properties, the income and sales comparative approaches were utilized. For a description of the properties valued, see Appendix A, as well as "—Portfolio and Development Pipeline" below. These values were obtained assuming an unleveraged return on investment of between 15% and 30%, which, to the extent such projects are developed and financed by Sistema in accordance with the assumptions made by C&WH&B, will accrue to us. These projects are at various stages of development and the market value ascribed to these projects above may not be realized. See "Risk Factors—Risks Relating to Our Business—Risks Relating to Our Real Estate Business—We may be unable to successfully identify, acquire, develop, operate or dispose of real estate projects, which could have a material adverse effect on our business and results of operations."

Certain assumptions and methodologies used by C&WH&B include, among others, the following: (i) no provision is made for cost of any debt financing that may be used or expenses of acquisition or realization; (ii) properties will be fully let; (iii) each valuation does not consider any effect of multiple properties being developed concurrently or released to the market together; (iv) any required variations will be granted by landlords in cases where the planned development differs from that anticipated by the land lease; and (v) any required governmental consents will be obtained on acceptable terms. In addition, C&WH&B relied on certain information supplied by us without independent verification.

Strategy

Our real estate strategy is two-pronged: (i) continue to develop, redevelop and build profitable projects on our current sites or sites to be sourced by us in the future through our extensive network of market contacts and (ii) redevelop those properties in our significant real estate holdings that are no longer fully used by our operations. We aim to create a diversified and balanced portfolio comprised of shorter-term projects to be developed for sale and longer-term properties, which will be leased and held for investment purposes. Our strategic objective is to increase our share in the Moscow real estate market, taking a lead in major segments of the market, including large shopping and entertainment centers, Class A office premises, elite and other housing, cottages and land-development.

While Moscow is our primary focus, we will actively take advantage of promising business opportunities in other major cities, such as St. Petersburg, and in underdeveloped regional markets in Russia, Ukraine, Kazakhstan and the Baltic countries.

As long-term bank financing is difficult to obtain in Russia, especially at the initial stages of development, our typical financial strategy is to internally fund 30-40% of total development costs at the beginning of a project, whether the cost is for land acquisition, architectural and engineering design, construction permits or initial construction. As the project progresses, our aim is to attract external financing from banks and other financial partners.

To secure stable long-term financing, we plan to attract investments from domestic and foreign investors and investment funds and, potentially, to set up a mutual investment fund (similar to a REIT in the United States) for Russian investors to invest in the real estate market.

Management and Employees

Our real estate division currently consists of over 30 companies, comprised of both service companies and project companies that own specific projects. All of these companies are operated and managed by Sistema-Hals.

The following table sets forth the average number of employees in our real estate business for the years ended December 31, 2001, 2002 and 2003:

Year	Real estate business employees average for the year ended December 31,	% increase/(decrease) over prior year
2001	840	6%
2002	776	(8)%
2003	836	8%

Felix Evtushenkov has served as the chief executive officer of Sistema-Hals since November 2003. From 2000-2003, he served as the Vice-President for Strategy and Marketing at Sistema-Hals. Mr. Evtushenkov is the son of Vladimir Evtushenkov, our President and controlling shareholder.

George Barbashin has served as the chief financial officer of Sistema-Hals since December 2003. From 2000-2003, he worked as a specialist in, and then as Deputy Head of, the Capital Raising Department of Sistema. Mr. Barbashin was transferred to Sistema-Hals in May 2003, where he initially headed the Capital Raising Department and was thereafter promoted to chief financial officer. Mr. Barbashin has a doctorate in economics.

Portfolio and Development Pipeline

The following table sets forth certain information relating to our major properties and development projects that were valued by C&WH&B. For information relating to certain MGTS properties that were also valued by C&WH&B, see "—Development Projects—MGTS Properties." Additional information on these properties may be found in the valuation report prepared by C&WH&B included in Appendix A. Certain information set forth in the table contains current estimates and projections related to projects that are not completed and may only be at the early stages of development. Such estimates and projections can change in the future. See "Risk Factors—Risks Relating to Our Business—Risks Relating to Our Real Estate Business—We may be unable to successfully acquire, develop or operate new properties, which could have a material adverse effect on our business and results of operations."

Property	Estimated market value (on 100% equity basis), $ mln[1]	Sistema Beneficial Ownership Interest[2]	Type	Estimated GBA, sq.m.[3]	Estimated Completion Date	Status of Project	Estimated cost to complete, $ mln[3]	Current Estimated Objectives
Completed Projects Held for Investment								
Hals-Tower, Moscow	26.2	100%	Class B offices	12,200	2001	Rented out 100% occupancy; 8 years remaining under a land lease agreement	N/A	Own to lease
Serebryany Bor-1, Moscow	11.7	43.5%[4]	Cottages	4,400	2003	Rented out 59% occupancy; 41 years remaining under a land lease agreement	N/A	Own to lease
Development Properties Office								
Mokhovaya 13, Moscow	13.4	100%	Class A offices	15,900	2005	Completing reconstruction of existing building; began construction of new building	14.0	Own to occupy
Pokrovka 40, Moscow	12.5	100%	Hotel and Class A office complex	24,300	2006	Construction underway	19.9	Hotel to sell; offices own to lease
Nastasyinsky vl. 7, Moscow	14.7	46%[5]	Automatic phone switching station and offices	8,200	2005	Construction of building structure completed; engineering works in progress	4.3	Sell (building has been pre-sold)
Former Sport Hotel, Leninsky pr-t, 90/2, Moscow	32.0	50%[6]	Hotel, office and retail complex	420,000	2008	Developing architectural concept	290.0	Hotel to sell; retail and offices own to lease
Pekin Hotel, Moscow	49.2	N/A[7]	Hotel, office and retail complex	109,100	2007	Awaiting approval of architectural concept	113.0	Own to lease
Retail								
Detsky Mir, Teatralny pr-d 5, Moscow	28.9	75%[8]	Retail	79,800	2007	Obtaining approvals for redevelopment/extension; developing construction documentation	97.0	Own to lease
NIIDAR, 1st Bukhvostova str., Moscow	31.7	37.5%	Retail, office and residential complex	475,000	2011	Developing architectural concept	410.0	Residential to sell; offices and retail own to lease
Pulkovskoye shosse, St. Petersburg	14.7	100%[6]	Retail	80,000	2006	Land purchased; conducting feasibility study	32.0	Own to lease

Property	Estimated market value (on 100% equity basis), $ mln[1]	Sistema Beneficial Ownership Interest[2]	Type	Estimated GBA, sq.m.[3]	Estimated Completion Date	Status of Project	Estimated cost to complete, $ mln[3]	Current Estimated Objectives
Residential								
Krestovki River Emb., St. Petersburg	2.0	100%[6]	Upscale housing	30,000	2007	Developing architectural concept	23.0	Sell
Cottages								
Avrora, Moscow Region	31.0	100%[6]	Cottages	93 ha	2005	Commenced construction	19.7	Sell
Trudovaya, Moscow Region	14.9	43.5%[4]	Cottages	17,900	2005	Completing construction	6.6	Own to lease
Serebryany Bor-2, Moscow	4.2	43.5%[4]	Cottages	5,000	2006	Developing architectural concept	4.4	Own to lease
Zdravnitsa, Moscow Region	2.1	43.5%[4]	Cottages	16,600	2007	Developing architectural concept	17.5	Own to lease

(1) As estimated by C&WH&B. See Appendix A.

(2) For uncompleted projects, represents the current estimated beneficial ownership interest in the completed project, unless otherwise noted. In some cases, our beneficial ownership in the completed property may differ from the current estimates.

(3) GBA means gross building area.

(4) Owned through our 43.5% beneficial ownership stake in Mosdachtrest, a company in which we have a majority voting interest. Our ownership interest in Mosdachtrest is calculated based on shares owned by us, as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP (FIN 46). Excluding the ownership interests of these affiliated companies, our beneficial ownership interest in Mosdachtrest would be lower by 7.3%.

(5) Owned by our subsidiary MGTS.

(6) Owned through our 100% stake in Sistema-Hals. Our ownership interest in Sistema-Hals is calculated based on shares owned by us, as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP (FIN 46R). Excluding the ownership interests of these affiliated companies, our beneficial ownership interest in Sistema-Hals would be lower by 1.1%.

(7) Our ownership interest in the completed project has not yet been finalized because we have not yet entered into an investment contract with the City of Moscow. We currently own a 90% stake in the company that has been designated by the City of Moscow to develop the project.

(8) Owned through our 75% stake in Detsky Mir. Our ownership interest in Detsky Mir is calculated based on shares owned by us, as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP (FIN 46). Excluding the ownership interests of these affiliated companies, our beneficial ownership interest in Detsky Mir would be lower by 4.5%.

The following table sets forth certain information relating to selected other real estate projects in our pipeline that were not valued by C&WH&B. Certain information set forth in the table contains current estimates and projections related to projects that are not completed and may only be at the early stages of development. Such estimates and projections can change in the future. See "Risk Factors—Risks Relating to Our Business—Risks Relating to Our Real Estate Business—We may be unable to successfully acquire, develop or operate new properties, which could have a material adverse effect on our business and results of operations."

Property	Sistema Ownership Interest[1]	Type	Estimated GBA, sq.m.[2]	Estimated Completion Date	Status	Other information
Selected Other Pipeline Projects not Valued by C&WH&B						
Leningradsky pr-t 39, Moscow	100%[3]	Office center	52,500	2006	Obtaining final approvals; construction works expected to commence in 2005	
B.Tatarskaya 35, Moscow	100%	Office center	100,000	2009	Developing architectural concept and conducting feasibility study	
Kazan TRK	50%	Retail	23,000	2005	Commenced construction	
Krasnoyarsk TRK	100%[3]	Retail	15,000	2005	Developing architectural concept	
Kuntsevo, Moscow	51%[4]	Panel housing	601,000	2005-2010	Completing construction on 17,940 sq.m. in 2004	
		Non-standard/ Upscale housing	375,000	2005-2010	Completed construction on 43,325 sq.m.	
Petrovski Ostrov, St. Petersburg	57%[5]	Upscale housing	47,000	2007	Developing architectural concept	
Rochdelskaya 22, Moscow	90%	Upscale housing	16,100	2007	Developing architectural concept	
Michurinsky 39, Moscow	100%[3]	Upscale housing	40,000	2006	Developing architectural concept	
Dnepropetrovskaya 25, Moscow	100%[3]	Upscale housing	24,400	2006	Developing architectural concept	
Nahimovski 4, Moscow	100%[3]	Upscale housing	44,500	2007	Developing architectural concept	
Barvikha, Moscow Region	43.5%[6]	Cottages	3,000	2005	Commenced construction	12 two-story cottages averaging 250 sq.m. approximately 7 km from Moscow

Property	Sistema Ownership Interest[1]	Type	Estimated GBA, sq.m.[2]	Estimated Completion Date	Status	Other information
Klen, Moscow Region	60%[7]	Cottages and hotel	4,200	2006	Developing architectural concept	Apartment hotel with 40 cottages available for short-term rent and a 10-room hotel located 50 km west of Moscow on a 4 hectare land plot
Zhoukovka -2, Moscow Region . . .	100%	Cottages	12,500	2006	Developing architectural concept	54 two-story cottages averaging 200-260 sq.m. in a prestigious Moscow suburb
Zhoukovka -3, Moscow Region . . .	100%	Cottages	14,000	2006	Developing architectural concept	61 two-story cottages averaging 200-260 sq.m. in a prestigious Moscow suburb

(1) For uncompleted projects, represents the current estimated beneficial ownership interest in the completed project, unless otherwise noted. In some cases, our beneficial ownership in the completed property may differ from the current estimates.

(2) GBA means gross building area.

(3) Owned through our 100% stake in Sistema-Hals. Our ownership interest in Sistema-Hals is calculated based on shares owned by us, as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP (FIN 46). Excluding the ownership interests of these affiliated companies, our beneficial ownership interest in Sistema-Hals would be lower by 1.1%.

(4) Owned through our 51% stake in Kuntsevo-Invest, which holds an investment contract with the City of Moscow. Our entire ownership interest in Kuntsevo Invest is calculated based on shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP (FIN 46R).

(5) Our subsidiary Sistema Hals Severo Zapad, in which we have a 76% ownership interest, will be entitled to 75% of the property.

(6) Owned through our 43.5% beneficial ownership stake in Mosdachtrest, a company in which we have a majority voting interest. Our ownership interest in Mosdachtrest is calculated based on shares owned by us as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP (FIN 46). Excluding the ownership interests of these affiliated companies, our beneficial ownership interest in Mosdachtrest would be lower by 7.3%.

(7) Owned through our 60% stake in Mikron. Our ownership interest in Mikron is calculated based on shares owned by us as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP (FIN 46). Excluding the ownership interests of these affiliated companies, our beneficial ownership interest in Mikron would be lower by 1.5%.

Completed Projects held for Investment

We own the following completed projects for investment purposes:

Hals-Tower was completed by Sistema in 2001. The building is a multi-tenanted Class B office building located in downtown Moscow. As of September 30, 2004, occupancy was 100% and annualized contractual rental income (net of VAT and reimbursable expenses) equaled approximately $5 million. The key tenants are Sistema Telecom, Raiffeisenbank, Japan Airlines and Scandinavian Airlines. We own 100% of the building and occupy the underlying land pursuant to a land lease agreement with the City of Moscow, for which we pay approximately $21,000 per annum. Approximately eight years remain under the land lease agreement.

Serebryany Bor-1 was completed by Mosdachtrest, a company in which Sistema-Hals has a 43.5% beneficial ownership interest, in 2003. The compound consists of 36 residential units totaling 4,369 sq.m. located in a prestigious area of Moscow, 18 of which are rented mainly to executives of multinational companies and Russian high net worth individuals. Rental rates range from approximately $400-$600 per sq.m. per annum (net of VAT) for a majority of the units. Approximately 41 years remain under land lease agreements with the City of Moscow for which we pay a total approximately $500 per annum.

Development Projects

Our projects are in various stages of construction and development as described in more detail below. The main stages of a development in Moscow include:

- preparing a feasibility study;
- sourcing the project site;
- preparing architectural designs;
- concluding an investment contract between the City of Moscow and the developer stating the main rights and obligations of each party with respect to the project;
- performing construction works; and
- lease of the property or sale to third parties.

For a description of some of the authorizations and certifications required during the stages of development, see "Regulation—Real Estate—Construction and Development."

Office Building Development Projects

Mokhovaya 13. We are in the process of renovating a seven-story building and constructing a new eight-story building in downtown Moscow with a view of the Kremlin and Manezh Square. The two buildings will have GBA of approximately 15,900 sq.m., including space for underground car parking for 53 cars and approximately 500 sq.m. planned for elite boutiques. Construction began in 2003, and the project is expected to be completed by the end of 2005. The existing building is classified as an "architectural monument of federal importance" and, as such, all construction works relating to this building require prior governmental approval. We are currently an investor in this project pursuant to an investment contract with the City of Moscow that will entitle us to receive full ownership of the building upon completion. As of September 30, 2004, approximately 44 years remained under the land lease agreement with the City. Upon completion, we plan to occupy the entire office portion of the buildings, which will be used as our corporate headquarters.

Pokrovka 40. We are in the process of constructing a Class A office building and a three-star hotel on a land plot of 0.6 hectares located in downtown Moscow. We intend to sell the hotel and to own to lease the office building. The GBA will be approximately 24,300 sq.m., including a 168-room hotel of 9,500 sq.m. and office space of 14,800 sq.m. The underground area will consist of 122 parking spaces. Construction on this project commenced in the fourth quarter of 2003 and we plan to complete this project in the first quarter of 2006.

Nastasyinsky vl. 7. We are in the process of constructing a building to be used as an automatic phone switching station, as well as an office building. We estimate that the reconstructed building will comprise approximately 8,200 sq.m. and have 42 parking spaces. Construction of the building structure is complete, with work on the building façade and engineering works still in progress. We plan to complete this project during the second quarter of 2005, and the building has been pre-sold to a third party for $24.6 million (contingent upon certain conditions, including the completion of the building and our obtaining the necessary permits). MGTS currently owns this building and has a short-term land lease valid for the expected construction period.

Former Sport Hotel, Leninsky pr-t 90/2. We plan to build a hotel and an office and retail complex in southwest Moscow. We estimate the GBA of the hotel and complex will comprise approximately 420,000 sq.m., including 20,000 sq.m. for offices, 40,000 sq.m. for retail space, 35,000 sq.m. for restaurant and leisure space, 40,000 sq.m. for public areas, a hotel tower comprising 73,000 sq.m. (with 350 rooms) and an office tower comprising 122,000 sq.m. We have demolished the existing structure on the property and are currently developing a preliminary architectural concept for the complex. We intend to sell the hotel portion of this project and to retain ownership and management of the retail and office complex. We plan to complete this project in 2008. The complex will be owned by a project company in which we have a 50% stake.

Pekin Hotel. We plan to build a retail and office complex for rent in downtown Moscow on a land plot of about two hectares. The project includes the obligation to renovate an existing, well-known three-star hotel, the Pekin Hotel, also located on the land plot. We estimate the GBA of the complex will be approximately 109,100 sq.m., comprising approximately 9,000 sq.m. and 35,000 sq.m. of leasable retail and office space, respectively, in the new buildings. The complex will also include 648 parking spaces for rent. The renovation of the Pekin Hotel will upgrade it into Moscow's 14th four-star hotel with 22,000 sq.m. of hotel space and 339 rooms. The architectural concept for the project is currently pending approval. We plan to complete this project in 2007. Our subsidiary OJSC Beijing Invest, in which we have a 90% ownership stake, is an investor in this project pursuant to a December 2002 resolution of the Moscow City Government providing for the conclusion of an investment contract for the site development between the City and Beijing Invest. The exact ownership of the newly built properties is not yet determined, but will be based on the approved architectural concept. The term of the land lease agreement with the City has not yet been determined.

Retail Development Projects

The following is a description of several retail projects we are currently developing:

Teatralny Proezd 5, Detsky Mir. We plan to renovate Detsky Mir's flagship department store, located on Lubyanka Square in Moscow, and convert it into a modern shopping and entertainment complex. The GBA of the building is expected to increase from 57,568 sq.m. to approximately 79,800 sq.m., and will include approximately 38,700 sq.m. of leasable retail space and 400 parking spaces. The average rent is expected to be $600-$690 per sq.m. for retail space. We are currently obtaining preliminary approvals and developing construction documentation. We plan to complete this project during the second half of 2007. Our subsidiary, Detsky Mir, owns this building.

NIIDAR, 1st Bukhvostova str. We plan to build a technological park, an office complex, a retail complex and housing in northeastern Moscow. The 11.4 hectare land plot is leased by NPK NIIDAR, in which RTI-Systems, the management company for our radio-technology business, has a 37.5%

ownership interest and a controlling voting interest. There are currently 35 buildings on the land plot, most of which are former industrial premises owned by NPK NIIDAR. The GBA of the existing buildings is 144,100 sq.m. and, according to preliminary architectural plans, the GBA of the technology park will be approximately 85,000 sq.m., the office complex will be approximately 200,000 sq.m., the retail complex will be approximately 60,000 sq.m. and the housing complex will be approximately 130,000 sq.m. We have received approvals for the preliminary architectural concept of the complex and are currently obtaining the necessary legal and administrative permits for construction. We plan to complete this project in 2011. We intend to sell the residential portion of this project and to retain ownership and management of the retail complex, office complex and technology park.

Pulkovskoye shosse. We plan to build a retail complex with a GBA of 80,000 sq.m. and 3,500 parking spaces, on a land plot along Pulkovskoye shosse in southern St. Petersburg. The project is currently in the design and development stage, and construction is expected to begin in the second quarter of 2005. The project is expected to be completed in 2006. We have acquired the 12.6 hectare land plot where the developments will be located.

Elite Residential Development Projects

Krestovki River Embankment. We plan to build 30,000 sq.m. of elite housing on the Krestovki River Embankment in central St. Petersburg. The Krestovki River Embankment is considered a prestigious area among St. Petersburg residents and numerous foreign embassies and individual luxury cottages are located there. The site is easily accessible by private or public transport and is a 10-minute drive from Nevsky Prospect, St. Petersburg's main thoroughfare. The housing project will consist of 160 apartments and 240 underground parking spaces, which we intend to sell. We are currently in the process of developing the architectural concept for this project and obtaining lease rights to the land on which the housing will be located. We plan to complete this project in 2007.

As further described under "Regulation—Real Estate—Land," most entities holding rights to permanent use in land must re-register their rights as a lease or freehold by January 1, 2006.

Cottages and Land Development Projects

We currently have a number of cottage projects at various stages of development presented below. Cottages in Russia are typically detached two- or three-storey homes constructed of brick or wood. These homes are usually located on land plots averaging 0.2-0.4 hectares in size and situated in city suburbs.

A significant number of our cottages and land development projects are carried out by our subsidiary, Mosdachtrest. Mosdachtrest is a leading owner and lessor of rental cottages in Moscow and Moscow's suburbs. Sistema-Hals beneficially owns 43.5% of Mosdachtrest, the Moscow City Property Department beneficially owns 36%, making it the second largest shareholder, with the balance of the shares being held by a number of investors. As of September 30, 2004, Mosdachtrest held title to 16.9 hectares of land, had the right of permanent use of 226 hectares of land, maintained long-term lease rights to 39 hectares of land and maintained lease rights expiring in 2009 to five hectares in Moscow and its suburbs. The lease rights include rights to 39 hectares of land parcels in Serebryany Bor, a prestigious location for luxury cottages and a 30 minute drive from the Kremlin. Mosdachtrest is planning a rights issue pursuant to which we will have the option to subscribe to all shares not subscribed to by the other shareholders and thereby potentially allow us to increase our stake in the company.

Avrora. We have acquired rights to a 93 hectare land plot approximately 20 km north of Moscow on which we plan to build local infrastructure, including a yacht club, and sell 147 land plots of approximately 0.5 hectares each for individual cottage construction. The site has access to a canal. We own 100% of this project through Sistema-Hals, which owns the land plot. Construction of infrastructure is expected to be completed in 2005.

Trudovaya. Planned for completion in the first half of 2005, Trudovaya (Forestville) is a compound with 89 two-story cottages averaging 200 sq.m., each located 17 km north of Moscow on a 15.5 hectare land plot. The compound is owned by Mosdachtrest, which has the right of permanent use of the land plot. Construction is currently being completed, and Mosdachtrest will retain ownership and rent out the property upon its completion.

Construction of Trudovaya was undertaken without all of the required planning permissions and there is a risk that the project may be halted by local authorities. We are currently working to obtain the outstanding permissions and expect to receive them following the completion of construction. Mosdachtrest had invested $13.8 million in this project as of September 30, 2004, and expects to invest an additional $6.6 million through completion.

Serebryany Bor-2. Planned for completion in 2006, Serebryany Bor-2 is a compound with 25 two-story cottages averaging 200 sq.m. located in a prestigious area of Moscow on a 3.2 hectare land plot. The compound is owned by Mosdachtrest, which has approximately 41 years remaining on its land lease agreement with the City of Moscow. The architectural concept for this project is currently being developed. Mosdachtrest will retain ownership over and rent out the property upon its completion.

Zdravnitsa. Planned for completion in 2007, Zdravnitsa is expected to be a compound with 83 two-story cottages averaging 200 sq.m., each located 17 km west of Moscow on a 16.9 hectare land plot. The compound will be owned by Mosdachtrest, which currently owns the land plot. The architectural concept for this project is currently being developed. Mosdachtrest will retain ownership over and rent out the property upon its completion.

MGTS Properties

MGTS owns over 200 telephone exchanges, and the upcoming replacement of outdated analog equipment with modern digital equipment is expected to free up approximately 80% of the space in the exchanges. Most of these properties are located in commercially attractive areas in Moscow and represent significant redevelopment and refurbishment potential into Class A and B offices, retail or residential properties. In a first stage, we have identified 13 properties listed in the table below to redevelop over the next three years. MGTS has received permission from the City of Moscow to renovate these properties. We expect that a majority of these properties will be sold following their renovation. As of December 30, 2004, C&WH&B valued these properties at $27.4 million. As we own a 46% beneficial interest in MGTS, not all of this value can be attributed to our consolidated group. Additional details on the properties and main valuation assumptions can be found in Appendix A.

Property	Estimated market value (on 100% equity basis), $ mln[1]	Plot area, sq.m.	Current GBA, sq.m.	Planned GBA, sq.m.	Type	Rent/Sell
2 Novy Arbat Street	5.1	1,500	11,100	11,100	Retail, office	Rent
1-3, 5 Bakuninskaya Street	1.6	3,500	11,200	13,600	Office	Rent
20 B. Balkansky Pereulok	1.0	2,400	4,400	4,400	Office	Rent
6 Broshevsky Pereulok	0.4	1,900	4,600	4,600	Office	Rent
5 Vsevolozhsky Pereulok	2.3	2,300	5,200	6,200	Office	Rent
30A B. Gruzinskaya Street	1.0	2,300	4,600	5,400	Office	Rent
19 Daev Pereulok	2.3	2,900	6,500	6,500	Office	Rent
1 1st Dubrovskaya Street	4.5	5,900	7,600	30,000	Office	Rent
5/2 Milyutinsky Pereulok	2.4	3,800	6,900	5,700	Office	Rent
Nastasyinsky vl. 7, Bldg. 1	2.0	4,200	2,900	3,000	Office	Rent
5/2 Pokrovsky Boulevard	1.4	1,800	3,900	3,900	Office	Rent
11 Rogozhsky Val Street	2.2	5,900	4,800	41,000	Office, residential	Rent, sell
5 Stolyarny Pereulok	1.3	4,200	6,400	6,500	Office	Rent

(1) As estimated by C&WH&B. See Appendix A.

Property Management

Our property management business includes the management of offices, retail and entertainment complexes and cottages. We currently have 26,300 sq.m. under property management, of which 19,600 sq.m. relates to our or our subsidiaries' properties and projects.

Capital Expenditures

We have a substantial pipeline of potential real estate projects, which we may invest in during 2005 to 2006 and beyond. However, the real estate business is flexible, and we consider investments on a project-by-project basis. Each project will compete for capital with other investment opportunities. We currently expect that our real estate development projects in Russia will require investments of approximately $1,150 million during 2005 and 2006, which includes the renovation of Detsky Mir's flagship store. We expect that Sistema will provide about 30% of this amount, or $345 million, with the remaining amount secured from outside investors, partners and banks.

Market and Competition

The property development process in Russia is complex and bureaucratic. Many foreign developers who have been successful in other parts of the world have been less successful in Russia. Russian laws and regulations regarding property rights, purchase and sale agreements, construction permits, unique construction and environmental and safety standards often conflict with one another. Development is further complicated by bureaucratic hurdles and by the substantial burdens imposed on developers by municipalities. In addition, Russia often lacks modern design and construction equipment or such equipment tends to not be in compliance with local standards and, as a result, real estate development suffers.

Despite these challenges, most segments of the real estate market in Russia are prospering and, according to Stiles and Riabokobylko, in most segments, demand significantly exceeds supply.

Commercial office space

At the beginning of 2004, there were approximately 3.25 million sq.m. of Class A and Class B office space in the Moscow market, according to Stiles and Riabokobylko. New construction in 2004 is expected to have added approximately 397,000 sq.m., of which approximately 35% will be classified as Class A office space. Stiles and Riabokobylko estimates that the supply of international-quality office space in Moscow will reach 4.5 million sq.m. by the end of 2005 and is expected to increase to 6.4 million sq.m. by the end of 2007, or nearly double, as compared to 2003.

The annual vacancy rate for international-quality office space fell slightly to 6.6% in 2003 from 6.7% in 2002. Class A vacancy rates were significantly lower than average, and stood at 3.9% in 2003, compared to 2.5-4.0% in 2002, depending on city location and building quality, according to Stiles and Riabokobylko. The vacancy rate at prime buildings was often below 0.5%, according to Stiles and Riabokobylko.

The commercial property market is fragmented, with many small developers having only one or two projects. Sistema-Hals' main competitors in the office sector are Enka (Turkey), Capital Group (Moscow) and KV-Engineering (Moscow).

Retail space

The Russian retail real estate market has evolved significantly since the early 1990s. In 2001 and 2002, Moscow experienced unprecedented growth in the retail sector as companies such as IKEA, Metro, Auchan and Spar entered the market. According to Stiles and Riabokobylko, approximately 15 shopping centers opened in Moscow in 2003, adding approximately 235,000 sq.m. of retail space. Stiles and Riabokobylko has estimated that there was more than 1.2 million sq.m. of retail space in Moscow by the end of 2004, and will be 1.7-1.8 million sq.m. by the end of 2005. The overall vacancy rate in shopping centers in the City of Moscow decreased to 2% in 2003 from 3-5% in 2002, according to Stiles and Riabokobylko. However, in prominent modern shopping centers, the vacancy rates are lower at approximately 0.5% and Moscow's average occupancy rate for modern retail centers at the end of 2003 exceeded 97%, according to Stiles and Riabokobylko.

Strong competition in the retail property market is expected over the next few years, as a number of major international operators enter the Russian market. We believe the retail property market has great potential as a result of increasing disposable incomes among Russians and the ongoing reduction of retail street vendors.

Housing

In 2003, 36.5 million sq.m. of housing was constructed in Russia, with Moscow accounting for 4.7 million sq.m. according to the Federal Agency on Construction, or Gosstroi, and the Moscow City Government. The Moscow City Government estimates that new construction will add another 5 million sq.m. of housing in Moscow during 2004.

Housing is divided into three categories: typical (panel) housing, non-standard housing and business class and elite housing. According to Moscow City Government estimates, half of the housing to be built in Moscow in 2004 will be panel housing. Of the remaining 50%, 170,000 sq.m. will be elite housing according to Blackwood Real Estate Agency. Panel housing, representing the largest housing category, is relatively inexpensive housing and built from prefabricated cement blocks using a few standard designs. Panel housing can be rapidly built, but is generally considered to be of a low quality.

As demand shifts towards higher quality housing, more and more panel housing construction has moved to the suburbs of Moscow. In Moscow, the majority of individual housing projects are considered business-class housing with an average price of $2,000 per sq.m. Elite housing is heavily concentrated in a few districts within the Garden Ring, such as Ostozhenka, Plyuschiha, Patriarshie

Prudy and Zamoskvorechye, with average prices generally ranging from $3,000 to $11,000 per sq.m. and higher. According to Blackwood Real Estate Agency, the average price in the first half of 2004 was $6,300 per sq.m. This segment of the market continues to enjoy steady demand and continual increases in prices.

Currently, there is less housing per capita in Moscow than in other large European cities. Moscow averages 21 sq.m. per inhabitant, as compared to an average in Europe of 28-36 sq.m. These figures indicate that a further increase in housing construction in Moscow can be expected. At the same time, as income grows, we expect the preferred housing form to shift to higher quality categories, resulting in a higher growth rate for non-standard and elite housing.

The housing development sector tends to be dominated by large, well-known developers, including Russian companies ST-Group, KRT, Capital Group, Don Stroi, Inteko, Krost and Konti. Competition among these companies is strong.

Cottages and land development

Since 1998, developers in Russia's cottage-construction industry have refocused their marketing strategy on the growing Russian middle class. Approximately 15,000 individual houses are commissioned annually in the Moscow region, according to the Russian Realtors' Guild. More than 80% of these houses are built by individual owners with the help of small construction companies and seasonal workers.

In contrast to Soviet style "dachas" constructed mainly for seasonal occupation, modern cottage compounds are built for year-round occupation with all the necessary infrastructure. Professional developers specialize in the construction of modern cottage compounds. A cottage compound is generally developed based on a unique design concept and with similar styles for all properties within the compound. The growth of this market is restricted by the limited availability of individual mortgage financing and the lack of adequate infrastructure outside of Moscow.

Land development is potentially the most profitable segment in the real estate market due to demand for luxury accommodation and the recent liberalization of land legislation and regulations in Russia. Land development generally involves the purchase of a plot of land, constructing the necessary infrastructure and, finally, the sale of smaller land plots to individuals to build cottages.

The major players in the land development market are real estate agencies investing in their own cottage compounds and Russian financial industrial groups including Inkom Nedvizimost, MIEL, Sapsan, FK Nikoil and Absolute Bank.

Logistics complexes

The logistics complex segment is among the newest and most dynamic segments in the Moscow real estate market, and we intend to enter this segment in the future. According to Colliers International, there are approximately 700,000 sq.m. of logistics complex developments in Moscow and the Moscow region, including approximately 270,000 sq.m. of international quality warehousing. More than 50% of all facilities were custom-built, and approximately 70% of the existing quality stock is owned by logistics operators, according to Colliers International.

Property management

Growth in the real estate market leads to growth in the property management services market. As a result, a number of developers, real estate agencies and other companies offering property management services have emerged.

The average property management fee for retail and office properties is $100 per sq.m. per year, and we estimate that the total potential market for property management services in Moscow is approximately $485 million per year.

Management companies are split into three groups:

- International: Hines, Jones Lang LaSalle, Zander, Crown Relocations, Hanscom, Sawatsky;
- Russian: Gostinny Dvor, ITC, Gorod, Primeks; and
- State-owned: Affairs Management of the President of the Russian Federation, Finance and Facility Management of the Moscow Government, Administrative and Facility Management Units.

Retail

Overview

Our retail business, referred to as the Detsky Mir Group, comprises Detsky Mir Center and Detsky Mir, their subsidiaries and related companies. Detsky Mir, or "Children's World," was established in 1954 as a state-owned retailer of children's apparel, footwear, toys and accessories. We have a 100% ownership interest in Detsky Mir Center, which is primarily involved in the retail sale of children's goods. We have a 75% ownership interest in Detsky Mir, which owns and manages some of our retail real estate properties in Moscow. We also own the Detsky Mir trademark.

The Detsky Mir Group is the largest retailer in the Russian children's goods market in terms of revenues, and among the most recognized brands in Russia. The Detsky Mir Group had revenues of $55.5 million for the year ended December 31, 2003 and $51.0 million for the nine months ended September 30, 2004. For the same periods, its retail revenues were $49.4 million and $45.3 million, respectively. Detsky Mir's flagship store in Moscow, located within walking distance of the Kremlin, has a total area of 57,568 sq.m. Retail area in the store comprises approximately 33,329 sq.m. in total, of which we operate 8,500 sq.m., making it one of the largest children's department stores in Europe.

Business Description

Detsky Mir Center is our principal retail operator and also provides retail business management for the Detsky Mir Group. The principal business activity of Detsky Mir Center is the sale of children's goods, including apparel, toys, footwear and accessories. Detsky Mir Center also coordinates marketing and product strategy, financial and IT policy, chain store openings, purchasing and logistics, as well as brand support and development.

Detsky Mir Center buys goods from over 600 suppliers through contracts with local importers, wholesalers and well-known international manufacturers of children's goods. Approximately 80% of all goods purchased by Detsky Mir Center are imported.

As of September 30, 2004, we operated nine stores with a total retail area of 21,719 sq.m.

The following table lists the properties used by our retail operations as of September 30, 2004.

Location	Gross area (sq.m.)	Retail area (sq.m.)	Date opened	Revenue for the year ended December 31, 2003[1]	Revenue for the nine months ended September 30, 2004[1]
				(Amounts in millions)	
Detsky Mir, Moscow[2]	14,500	8,500	1954	$32.7	$24.5
Detsky Mir MEGA, Moscow region	4,285	3,600	Oct 2003	2.0	4.5
Detsky Mir Gol'ianovo, Moscow	1,254	1,002	Dec 2003	0.4	1.2
Detsky Mir Bibirevo, Moscow	2,262	1,864	Feb 2004	—	1.9
Detsky Mir Mar'ino, Moscow	1,028	840	Mar 2004	—	1.2
Detsky Mir Tambov, Tambov	1,646	1,093	Dec 2002	0.9	1.1
Vasilievsky Ostrov, St. Petersburg	1,030	720	Sept 2004	—	—
Dom Igroushki, Moscow	7,300	1,600	1986	3.8	2.7
Bauland, Moscow	6,900	2,500	1995	9.6	8.2
Karacharovo Warehouse, Moscow[2]	30,000	N/A	1959	N/A	N/A

(1) Revenue from retail operations only. Detsky Mir also derived $6.1 million and $5.7 million in rental revenue from third parties for the year ended December 31, 2003 and the nine months ended September 30, 2004, respectively.

(2) Property owned by Detsky Mir and leased by Detsky Mir Center.

Strategy

Our retail strategy is to continue expanding our presence in Russia to take advantage of the absence of nationwide retail chains for children's goods by opening a number of new Detsky Mir retail outlets in Moscow and other large Russian cities, continuing to improve our retail format and refurbishing our existing flagship store in central Moscow. In terms of product range, we plan to continue offering a broad selection of children's toys, clothes, shoes and accessories targeted at middle-income families. We also plan to open several discount stores to compete with specialized open air markets.

Our retail chain development will be divided into three stages to be executed between now and 2012. In the first stage, to be completed by the end of 2005, we plan to open up to 15 new stores in Moscow and the most populous Russian cities, including St. Petersburg, Samara and Krasnodar. In the second stage, to be undertaken in 2006 and 2007, we plan to open up to 50 new stores in Russian cities with over one million inhabitants, as well as up to five specialized discount stores in Moscow. We also plan during this period to commence a franchising program to take advantage of Detsky Mir's strong brand and well-developed retail methodology. As part of this program, Detsky Mir Group will offer potential franchisees with sufficient retail space and successful retail experience the right to use the Detsky Mir trademark and retail technology for an initial payment of approximately $50,000 and up to 5% of the franchise store's net revenues. In the third stage, to be undertaken in 2008-2012, we plan to open up to 65 new stores and up to eight additional discount stores in towns with over 300,000 inhabitants. See "—Capital Expenditures" below for a description of our expected capital requirements relating to this investment program.

In line with our franchising strategy, we expect our outlets to have unified retail formats, appearance and design. We intend to centralize marketing, assortment planning and selection, purchasing, merchandising, human resources and logistics activities for our stores under one legal entity. We also plan to further improve our inventory management and information management systems.

We plan to attract more customers to our flagship store in Moscow, which we intend to renovate and convert into a modern shopping and entertainment center to maximize our rental income and increase the efficiency of the building. In particular, we plan to expand retail, entertainment, and food court areas, create additional parking spaces, modernize the engineering systems, provide a new image for the building and add diversity to the retail mix. See "Business—Real Estate" above for a description of this renovation project, which will be undertaken by our real estate business. We will close our flagship store during the period of renovation, which is expected to take place during 2005 through 2007. During this time, we expect to relocate and continue to sell its inventory at an alternative store location in Moscow.

Capital Expenditures

Our decisions to make capital expenditures in our Retail Segment will be highly dependent on the development of our retail business. Investments in developing new stores will be evaluated on a store-by-store basis. In order to implement the development plan described above in Russia, we will require investments of approximately $50 million and financing for our working capital of approximately $30 million in 2005-2007. We expect to receive a portion of this total from third-parties and the remaining financing from Sistema.

We estimate the renovation of the flagship store will additionally cost approximately $122 million, of which $85 million will be used through 2006. These renovation costs are included in our estimated capital expenditures for our real estate business. We are currently negotiating with EBRD to provide approximately $80 million debt financing for this project, and expect to start the renovation in early 2005. The project is expected to be completed in the second half of 2007.

Management and Employees

The following table sets forth the average number of employees in our retail business for the years ended December 31, 2001, 2002 and 2003:

Year	Retail business employees average for the year ended December 31,	% increase/(decrease) over prior year
2001	1,465	4%
2002	1,599	9%
2003	1,658	4%

Approximately 150 of our retail business employees are members of the "Detsky Mir" trade union.

Sergei Kushakov has served as the chief executive officer of Detsky Mir Center since 2003. From 2002-2003, he served as the chief executive officer of Detsky Mir Trade House CJSC. From 1997-2002, he served as the Chief Accountant of Sistema. Mr. Kushakov has a PhD in Economics.

Market and Competition

We estimate the size of the Russian children's goods market to be approximately $3.3 billion, of which Moscow accounts for 39%, or $1.3 billion. This estimate is based on annual spending on children's goods, which varies considerably throughout Russia. According to a December 2002 issue of Expert business magazine, consumers in Moscow spent approximately $500 per child per year, while in other cities with over one million inhabitants this figure was approximately $250 to $300 per child per year. According to the Federal Service of State Statistics, or Goskomstat, children under 16 years of age constituted 18% of Russia's total population in 2002, or more than 26.1 million.

The Russian market is divided into two segments: high-priced goods are sold mainly in stores, while low-priced goods are typically sold in open-air markets. In Moscow, there is additional competition from specialized children's fairs that have developed over the last few years, as well as from supermarkets and department stores, which offer children's apparel and footwear, often in the discounted price segment.

According to our estimates, the children's goods market is growing at a rate of at least the growth rate of the general retail market in Russia, which was 23.5% in 2003, according to Noble Gibbons. Economic recovery and higher personal disposable incomes are the main growth factors, enhanced by growing birth rates.

The Russian children's goods market is very fragmented and consists of a large number of independent retailers, according to Expert business magazine. According to Comcon-Group, in Moscow, specialized open-air children's goods markets accounted for over 60% of children's goods sales in 2002, organized retail outlets, like Detsky Mir, accounted for around 30%, and the remaining 10% was divided between kiosks and other points of sale. Outside of Moscow, about 80% of sales occurred at unspecialized open-air markets and small-scale retail outlets, and the remaining 20% occurred at old Soviet-style children's goods stores, according to the December 2002 issue of Expert business magazine.

Our main competitors are children's goods open-air markets and fairs, hypermarkets, and, more recently, specialized chains focusing on the premium end of the market, such as Kenguru, Mothercare and Benetton. These chains typically offer a limited selection of high-quality children's merchandise at high prices. The open-air markets are characterized by lower prices and a wider selection of children's goods but offer a lower quality of service and limited shopping convenience, according to Expert business magazine. We foresee growing competition from hypermarket chains, such as Ramstore, which sell children's goods at affordable prices to the growing middle-market segment. We believe Detsky Mir compares favorably to its major competitors because of its well-established brand name, wide selection of high quality children's merchandise at moderate prices, shopping convenience and high quality service. We expect that traditional retail growth will be higher than for open-air markets and fairs because of consumer preferences for higher quality and a more convenient shopping experience.

Media

Overview

Our media business operates in four main divisions: pay-TV, advertising, print distribution and other media, which includes a number of secondary companies that operate in other segments such as publishing, film production and radio broadcasting.

Business Description

Following a strategic review of our media assets in 2003, we are primarily focused on developing distribution platforms and content for pay-TV and multi-media services initially in Moscow and subsequently in other parts of Russia. This new focus adheres to our strategy of applying our limited financial and managerial resources to build businesses into market leaders with the potential to create substantial value for us and our shareholders.

The table below sets forth our ownership stake and minority interests in our main subsidiaries in our media business as of December 31, 2004.

Company	Beneficial ownership[1]	Voting interest[2]
Sistema Mass Media	90%	90%
Concern SMM	100%	100%
Print distribution		
Nasha Pressa	90%	100%
Metropress	36%	40%
Stolichnaya Pressa	90%	100%
Advertising		
RA Maxima	78%	80%
TV-Project	46%	51%
Pay-TV		
Sistema Multimedia	90%	100%
Kosmos TV	50%	50%

(1) "Beneficial ownership" represents the percentage of ownership interests of the relevant entity that are beneficially owned by Sistema directly or indirectly, based on Sistema's proportionate ownership of the relevant entity through its consolidated subsidiaries.

(2) "Voting interest" represents the percentage of ownership interests of the relevant entity which Sistema or any of its consolidated subsidiaries has the power to vote.

Pay-TV. In 2003, in a series of transactions with Metromedia International Group (USA), we acquired a 50% stake in Kosmos TV, the first pay-TV service in Moscow operating since 1991. Russian Television and Radio Broadcasting Network controls the other 50%. We currently do not consolidate Kosmos TV. Kosmos TV uses MMDS technology for broadcasting and covers Moscow and Moscow's suburbs. It offers over 70 channels, the best selection among pay-TV services in Moscow, as well as a range of subscription packages starting from $11 per month. As of September 30, 2004, Kosmos TV had approximately 38,000 subscribers.

Other businesses. We consider our newspaper publishing, news print distribution, film production and radio broadcasting businesses as non-core segments, and do not plan significant investments into these businesses. However, we will seek out partnerships with other financial investors or media companies to develop certain projects and to exit these businesses profitably over time. These other media businesses had combined revenues of $35.2 million in 2003 and $28.9 million for the nine months ended September 30, 2004.

Our print distribution division includes a wholesale distributor and two retail operators. We estimate that our companies controlled approximately 17% of the wholesale print distribution market in Moscow in 2003. We also own interests in several outdoor advertising companies and in the Maxima advertising agency, which offers a full range of advertising services such as marketing strategy, creative strategy, media planning, media buying and promotions.

Strategy

We are currently developing four segments of our pay-TV project:

Multimedia pay-TV services in Moscow. We plan to launch through our subsidiary, Sistema Multimedia, a pay-TV and video over DSL service utilizing MGTS' ADSL network, which can potentially deliver ADSL services to up to four million residential customers. Our strategy is to become a leader in pay-TV in Moscow by offering high-quality service at affordable prices. The new service will have a wide selection of approximately 25 Russian and 50 international channels, broadband Internet access, interactive services like pay-per-view and video-on-demand, interactive games and e-commerce services. We also plan to produce a number of proprietary thematic channels. We plan to integrate Kosmos TV's subscriber base into this new service platform, which we currently plan to launch in the first quarter of 2005.

In March 2004, MGTS, MTU-Intel and Sistema Mass Media signed a framework agreement that regulates the relationship between these companies in connection with the launch of our new pay-TV service. As of September 2004, we have together developed the technical procedures for accessing MGTS' ADSL network, customer service, and billing. Sistema Multimedia and MGTS plan to finalize the commercial terms of their partnership during the first quarter of 2005.

Pay-TV services in regions. We plan to acquire pay-TV companies in selected regions of Russia as well as to develop partnerships with regional operators in order to distribute our pay-TV content. As we do not own modern telecommunications networks suitable for TV broadcasting outside of Moscow, we will not be able to provide the full range of interactive and multimedia services in the regions. However, our products in the regions will include multichannel TV with exclusive thematic channels. We believe that regional expansion is important for developing a national pay-TV network as well as providing a broad platform for distribution of our content.

Internet and e-commerce. We plan to develop a platform of e-commerce services available through the Internet and interactive TV. We are one of the largest Internet access providers in Moscow. See "Business—Telecommunications" above for a description of our Internet business. We plan to add Internet and e-commerce services to our pay-TV packages in order to provide optional interactive services to our subscribers.

Content production and distribution. We believe that programming and interactive features are key for the success of our pay-TV project. Most of the thematic channels currently available on pay-TV in Russia are international channels lacking local content in the Russian language. We believe that the development and distribution of local Russian-language thematic channels will be one of the key selling points for our pay-TV service. To develop this programming, we plan to build partnerships with international and local production companies. Together with our partners, we will aim to develop up to 10 thematic channels such as movie channels and automobile, travel, cooking and fishing-themed channels, during 2005-2007. We also plan to sell this programming to other pay-TV companies in Russia and abroad. We do not expect to make significant expenditures for licensing premium or exclusive content from third parties.

We believe we have a number of competitive advantages that support our pay-TV and multi-media services development strategy:

- *Dominant position in Moscow's communications market.* Our subsidiaries, MGTS and Comstar UTS, have access to virtually 100% of the households in the City of Moscow. Their modern network infrastructure, combined with advances in video-over-DSL technology, allows us to offer pay-TV and interactive services to our existing telecommunications customers without substantial capital investment in the infrastructure.

- *Substantial synergies with our telecommunications division.* Through our telecommunications division, we collect bills from over 11 million customers based in Moscow and the Moscow region. Access to this customer base allows us to effectively segment our targeted subscriber base and reduce the time and cost required to market our newly launched services.

- *Ability to provide voice telephony, broadband and pay-TV services in a bundled package.* Our broadband and pay-TV services will be delivered though the fixed network of MGTS, and we will have the ability to offer pay-TV, broadband and voice services in a bundled package under one brand.

- *Investment in proprietary content.* We fully recognize the importance of proprietary content targeted at local consumer tastes for the success of our pay-TV project. We believe that in a market such as Moscow, with 16 free-to-air TV channels, the ability to provide Russian content is a key competitive advantage. We plan to develop four thematic channels by the time we launch our new multimedia pay-TV service in early 2005, and plan to launch five additional channels in the next 12 months. We further plan to enter into partnerships with leading international media groups in order to develop tailor-made premium content for Russian audiences.
- *Limited competition.* We believe that the market for pay-TV and interactive entertainment services is still in its early stages of development in Russia, and that our strong platform in Moscow will allow us to become a leading pay-TV operator in Russia.

Capital Expenditures

Our capital expenditure program in our pay-TV business will be success-based and driven by market developments. Our pay-TV business in Russia is expected to require investments of approximately $140 million from 2005 through 2008, subject to the evolution of demand for our pay-TV services. We expect that Sistema will provide about half of this amount, or $70 million, with the remaining amount secured from outside investors, partners and vendors.

Management and Employees

The following table sets forth the average number of employees in our media business for the years ended December 31, 2001, 2002 and 2003.

Year	Media business employees average for the year ended December 31,	% Increase/(decrease) over prior year
2001	708	63%
2002	584	(18)%
2003	935	60%

Alexander Leiviman is the General Director of our media business and has also served as a member of our Board of Directors since 1993. See "Management" for additional information regarding Mr. Leiviman.

Nikolay Repin serves as our media business First Deputy General Director in charge of media projects. He joined MTU-Inform in 1997 as the Director of Internet Technologies, and served as the chief executive officer of MTU-Intel from 2000-2003. Mr. Repin was nominated as one of the best telecommunication managers in Russia in 2000 by Kompania magazine, and was included in the IT Top 100 ranking in 2001 and 2002 by iOne.ru.

Sergey Klyutchenkov has served as our media division's First Deputy General Director in charge of the press and distribution businesses since August 2003. From 2001-2003, he served as the chief executive officer of our Metro newspaper. Mr. Klyutchenkov was nominated for the "Media Manager of Russia" award, as one of the best media managers in Russia in 2001, 2002, and 2003.

Market and Competition

The pay-TV market remains underdeveloped in Russia compared with other rapidly developing service industries like wireless telecommunications. According Comcon research, as of July 2004, 3.2 million households in Russia were regular subscribers of cable TV services and 0.44 million households had satellite dishes. Based on Comcon's data and 2002 Russian census estimates, we estimate that up to 6% and 0.8% of Russian households were regular subscribers of cable TV services and/or had satellite dishes, respectively, as of July 2004.

The pay-TV market has two segments: basic service and premium service. Basic service usually has a relatively small number of channels, typically ranging from 15 to 20, and no premium content such as exclusive sport and movie channels. The typical monthly ARPU of these subscribers is approximately $2-$4, according to Zenith Optimedia.

Premium service typically includes over 50 international and local channels, including premium content such as exclusive sport, movie and adult channels. NTV-Plus, a DTH (direct to home) satellite operator that covers mainly the European part of Russia, is the only national premium service operator. In Moscow, premium service is also available via our subsidiary Kosmos TV, an MMDS operator; Divo TV, an MMDS and cable operator; and Comcor TV, a cable operator. Many local utilities also charge residents a regulated, nominal fee for access to up to 16 free-to-air channels via local cable. We do not consider this segment to be part of the pay-TV market.

The pay-TV market is highly fragmented, with most operators offering their services in only one city. We believe that similar to other industries, such as telecommunications, consolidation in the pay-TV industry is imminent. We expect that NTV-Plus, Divo TV and Comcor TV will be the main competitors of our pay-TV project in Moscow. In the regions, we expect to compete with local pay-TV operators and with NTV-Plus. NTV-Plus offers over 50 channels including news, movies, sports, children, music and adult content. It reports approximately 300,000 subscribers, and the subscription fee ranges from $18 to $42 per month. The service is available in the European part of Russia and in certain other CIS countries via satellite dish. Coverage, exclusive sporting events and movie content are the main competitive advantages of NTV-Plus. For example, certain sporting events like UEFA Champions League football, NHL hockey and tennis are available in Russia exclusively on NTV-Plus.

Divo TV offers service in certain parts of Moscow over MMDS radio antennas and via the analog cable of Mostelecom. It offers about 40 channels and the subscription fee ranges from $10 to $25 per month. Divo TV was the first pay-TV operator in Russia that offered pay-per-view service. According to Vedomosti, Divo TV is estimated to have 20,000 subscribers.

Comcor TV is owned by Moscow ÑableCom Corporation. The service is available in Moscow via the HFC network. Comcor TV offers high-speed Internet access in addition to pay-TV services. The monthly subscription fee starts from $9 for pay-TV service and $15 for Internet access. Comcor TV also provides a social package of free-to-air channels. According to Moscow CableCom, as of September 30, 2004, the total number of households reached totaled 197,563, and it had 8,985 pay-TV subscribers, 63,090 free-to-air service subscribers and about 16,814 Internet service subscribers.

Other Businesses

Our Other Businesses Segment include interests in travel services, international operations, radio and space technology, pharmaceuticals and biotechnology, as well as the operations of our parent company.

Travel Services. Our travel services division consists of Intourist, a Moscow-based tour operator. Intourist is one of the leading Russian providers of travel and leisure services and operates its business through 40 Russian and five foreign subsidiaries. Revenues of our travel services division were $62.1 million and $75.4 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively. The division had an operating loss for the year ended December 31, 2003 in the amount of $1.9 million, and operating income of $0.9 million for the nine months ended September 30, 2004.

International Operations. We beneficially own interests in real estate properties located in the Czech Republic, Spain, Croatia and elsewhere. Our international operations revenue and operating income for the year ended December 31, 2003 and for the nine months ended September 30, 2004, were immaterial.

Radio and Space Technology. Our radio and space technology division consists of Concern RTI-Systems and its subsidiaries and affiliates. This division is primarily involved in the design and production of radars and radar systems, space control systems and telecommunications equipment for both governmental agencies and corporate clients. Our radio and space technology division revenue was $29.2 million and $14.2 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively. Our operating income for the year ended December 31, 2003 and for the nine months ended September 30, 2004 was $1.4 million and $0.5 million, respectively.

Pharmaceuticals and Biotechnology. Our subsidiary Medical Technological Holding Company, or MTH, manufactures and sells pharmaceuticals, medicine-related products and medical equipment. At present, MTH is working on projects to produce infusion solutions, one-shot infusion systems, diagnostic test systems, vaccines and genetic engineering products. Our pharmaceuticals and biotechnology division revenue was $4.4 million and $4.1 million for the year ended December 31, 2003 and for the nine months ended September 30, 2004, respectively. Our operating loss for the year ended December 31, 2003 and for the nine months ended September 30, 2004 was $2.0 million and $0.5 million, respectively.

MANAGEMENT

Management

Our directors and executive officers and their respective ages and positions are as follows:

Name	Age	Position
Evgeny G. Novitsky	46	Chairman of the Board
Vladimir P. Evtushenkov	56	President and Director
Dmitry L. Zubov	50	Deputy Chairman of the Board
Vyacheslav V. Kopiev	50	Deputy Chairman of the Board
Stanislav V. Emelyanov	75	Director
Alexander Y. Goncharuk	48	Director
Mechislav V. Klimovich	57	Director
Evgeniy A. Kurgin	57	Director
Vladimir S. Lagutin	57	Director
Alexander L. Leiviman	55	Director
Nikolai V. Mikhailov	67	Director
Alexander I. Gorbatovsky	50	Director
Sergei A. Drozdov	33	Director and First Vice-President, Corporate Property
Alexei N. Buyanov	35	First Vice-President, Finance
Levan S. Vasadze	33	First Vice-President, Strategy

Evgeny G. Novitsky has served as the Chairman of our Board of Directors since January 2005. As a matter of Russian law, the Chairman of the Board of Directors is a non-executive position. Mr. Novitsky served as our President from 1995 until January 2005 and has served as our Director since 1995. Prior to 1995, Mr. Novitsky was the chairman of the board of directors of I.V.K. CJSC, a Russian information technology company. In addition, Mr. Novitsky serves as the chairman of the board of directors of three companies (Sistema Telecom, CSC OJSC, Concern RTI-Systems OJSC) and as a member of the management board of ECU GEST Holding S.A. All of these companies are affiliated with us.

Vladimir P. Evtushenkov has served as our President since January 2005. Mr. Evtushenkov also serves as our Director. From 1993 until 1995 he served as our President and served as the Chairman of our Board of Directors from January 1994 to January 2005. From 1993 until 2000, he was the chairman of the board of directors of MKNT OJSC. In addition, Mr. Evtushenkov serves as a member of the board of directors of OJSC Sistema Mass Media and ECU GEST Holding S.A., both of which are affiliated with us.

Dmitry L. Zubov has served as the Deputy Chairman of our Board of Directors since 1999. During 1998 and 1999, he served as a director of ABN-Sistema OJSC and PromKhimInvest CJSC. Between 1996 and 1997, he served as the deputy chairman of the board of directors of Moseximbank. Mr. Zubov currently serves as the chairman of the board of directors of Region JSC and is a member of the boards of directors of six additional companies (Detsky Mir, Detsky Mir Center, Sistema-Hals, Project-Construction Union "Sistema Hals," Medical Technologies MTH CJSC and Olympiyskaya Sistema CJSC). All of these companies are affiliated with us.

Vyacheslav V. Kopiev has served as our Director since 2001. In September 2003, Mr. Kopiev was appointed Deputy Chairman of our Board of Directors. He was our Vice-President from 1997 to 2000 and our Senior Vice-President from 2000 to September 2003. Prior to 1997, he was a deputy chairman of the Russian-British Chamber of Commerce and Trade. In addition, Mr. Kopiev serves as the chairman of the board of directors of four companies (Concern Media Center "SMM," Sistema Mass Media, Rosbalt Information Agency CJSC and Literaturnaya Gazeta). He also serves on the boards of directors of nine additional companies (Concern Radio Center, Maxima Advertising Agency, Olympiyskaya Sistema CJSC, Region JSC, Intourist, Narodnoye Kino ZAO, Sistema Mass Media, "TV Stolitsa" OJSC and TV Center OJSC). Most of these companies are affiliated with us.

Stanislav V. Emelyanov has served as our Director since 1997. Since 1993, he has been the head of the Institute of System Analysis of the Russian Academy of Science.

Alexander Y. Goncharuk has served as our Director since 1998. In 1998 and in 2002-2003, he served as the chairman of the board of directors of MTS. He also served as the deputy chairman of the board of directors of MTS during 1997 and from January 1999 through June 1999. From 1995 until 1998, Mr. Goncharuk served as our Vice-President. From 1998-2003, Mr. Goncharuk served as the president of Sistema Telecom. In addition, Mr. Goncharuk currently serves as the chairman of the boards of directors of four companies (Elaks OJSC, Elion OJSC, NIIME and Mikron OJSC and Sitronics ZAO) and is a member of the boards of directors of four additional companies (Sistema Telecom, MTS, MGTS and OJSC CSC). All of these companies are affiliated with us. Since July 2003, Mr. Goncharuk has served as the general director of OJSC CSC.

Mechislav V. Klimovich has served as our Director since 1998. He also served as the general director of Sistema-Hals from May 2002 until August 2003. From 1999 until 2002, Mr. Klimovich was the president of Sistema-Invest and, in 2002, he served as our First Vice-President. From 1996 until 1999, he headed the Municipal Borrowings Committee of the Moscow City Government and, from 1994 until 1996, he was the head of Moscow's Property Fund. In addition, Mr. Klimovich serves on the boards of directors of 11 additional companies (Detsky Mir, Detsky Mir Center, Sistema-Hals, Landshaft, Concern RTI-Systems OJSC, Sistema-Inventure ZAO, Intourist-Hotel-Group OJSC, Mosdachtrest, OJSC Beijing Invest, SK "Olympiysky" OJSC and Sistema KOFFOR OJSC). Most of these companies are affiliated with us.

Evgeniy A. Kurgin has served as our Director since 2000. He was our Vice-President from 1997 until August 2003. From 1992 until August 2003, he also served as the general director of ROSNO. In addition, Mr. Kurgin serves on the boards of directors of ROSNO OJSC, ROSNO-MC, MTH CJSC, Orgsintez-1 CJSC and Medical Technologies CJSC. All of these companies are affiliated with us. From 2003 until 2004, Mr. Kurgin served as president of the Russian Union of Car Insurance. Since 2004, he has served as the general director of Medical Technologies CJSC.

Vladimir S. Lagutin has served as our Director since 2001. He also served as the general director of MGTS from 1995 to 2003. In addition, Mr. Lagutin serves as the chairman of the board of directors of three companies (MTS, MGTS and ZAO Comstar) and serves on the boards of directors of two additional companies (Sistema Telecom and CSC OJSC). All of these companies are affiliated with us. Since July 2003, Mr. Lagutin has served as the general director of Sistema Telecom.

Alexander L. Leiviman has served as our Director since 1993 and was the Deputy Chairman of our Board of Directors from 1993 until 1998. From 1993 until 1996, he was our Vice-President and from 1999 until 2002, he was our First Vice-President. From 1996 until 1997, he also served as the president of Sistema-Invest CJSC. From 1998 until 2002, Mr. Leiviman served as a director of MTS. From 1997 until 1999, he served as the president of Intourist and currently serves as the chairman of the board of directors of five companies (Concern Radio-Center, Maxima Advertising Agency, Gazeta Metro, Film Studio "Zolotoy Vek" OOO and ZAO Sistema-International IG). In addition, Mr. Leiviman serves on the boards of directors of seven companies (Sistema Telecom, Sistema Mass Media, Intourist, ZAO Narodnoye Kino, New Line of Stars Studio OOO, ZAO "TV Project" and "TV Stolitsa" OJSC). Most of these companies are affiliated with us. Mr. Leiviman also serves on the management board of ECU GEST Holding S.A. and, since September 2003, has served as general director of OJSC Sistema Mass Media.

Nikolai V. Mikhailov has served as our Director since 2001. From 1996 until 1997, he was a Deputy Secretary of the Security Council of the Russian Federation. From 1997 until 2001, he served as a First

Deputy Minister of Defense of the Russian Federation. In 2001, he served as a Counselor to the Chairman of our Board of Directors. Mr. Mikhailov currently serves on the boards of directors of five companies (Concern RTI-Systems OJSC, Business Informatization System ZAO, Kamov OJSC, NII Stali OJSC and Sistema Venture OJSC). Most of these companies are affiliated with us.

Alexander I. Gorbatovsky has served as our Director since August 2004 and currently serves as the chairman of the board of directors of MMZ No. 3 (OJSC). From 1993 until 1997, he served as the general director of Kedr-M JSC and from 1997 until 2002 as the president of Sistema-Neft.

Sergei A. Drozdov has served as our Director and First Vice-President since 2002. From 1998 until 2002, he also served as a vice-president of Sistema-Invest. In addition, Mr. Drozdov serves as the chairman of the boards of directors of Detsky Mir, Reestr OJSC, Detsky Mir Center and NII Stali OJSC and on the boards of directors of eight companies (Sistema Telecom, MGTS, CSC OJSC, ZAO Sistema-International IG, Medical technology MTH CJSC, Olympiyskaya Sistema ZAO, Intourist-Hotel-Group OJSC and M-Consult CJSC). Most of these companies are affiliated with us.

Alexei N. Buyanov has served as our First Vice-President since September 2002. From 1996 until 1998, he served as a vice-president of Sistema-Invest CJSC and from 1998 until 2002, he served as a vice-president of MTS. In addition, Mr. Buyanov serves on the boards of directors of 13 companies (ECU GEST Holding S.A., MTS, ROSNO, Sistema Telecom, CSC OJSC, MBRD, East-West United Bank S.A., ZAO Invest-Svyaz-Holding, Sistema Hals, Alliance-ROSNO Asset Management OJSC, Sistema Finance S.A., Sistema Capital S.A. and Sistema Holding Limited. Most of these companies are affiliated with us.

Levan S. Vasadze has served as our First Vice-President since 2000. From 1998 until 2000, he served as our Vice-President. Prior to 1998, he served as the managing director of Aton Capital Group. In addition, Mr. Vasadze has served as the chairman of the board of directors of ROSNO since 2001. He also serves on the boards of directors of seven additional companies (Sistema Telecom, MGTS, Comstar, CSC, Sistema-Hals, Detsky Mir Center and Sistema-International IG). All of these companies are affiliated with us.

The business address of each of our directors is 10, Leontievsky pereulok, Moscow 125009, Russian Federation.

Remuneration of Directors

The aggregate amount of remuneration paid by us to our Directors as a group for services as Directors of Sistema during the year ended December 31, 2003 was approximately $582,753 in salary and $633,385 in bonuses. Directors are also provided with medical insurance and company cars upon request.

Stock Bonus and Option Plans

Sistema

We will establish a share bonus plan and share option plan for our officers, directors and key employees. When we establish such plans, we will set aside our shares in an amount not exceeding 3% of our outstanding common shares.

MTS Stock Bonus and Option Plan

Among our subsidiaries, only MTS has a stock bonus plan and stock option plan for selected officers, key employees and key advisors. Directors, key employees and key advisors received 3,587,987 shares of MTS' common stock under the stock bonus plan during September 2000. In addition, 9,966,631 shares of MTS' common stock were allocated for MTS' stock option plan and options have been granted to MTS directors and key employees in each of 2001, 2002, 2003 and 2004 under this plan. Under this plan, board members and key employees, upon being granted stock options, have the right to purchase shares of MTS' common stock or, in lieu of shares, receive a cash award equal to the difference between the price per share fixed in the option agreement and the market price per share of MTS' common stock on the date of exercise.

Employees

The average number of employees of the group totaled approximately 41,920, 49,150 and 56,050 for the years ended December 31, 2001, 2002 and 2003, respectively, comprised of employees of our material subsidiaries and our parent company.

TRANSACTIONS WITH AFFILIATES

Notris LLC

We and certain of our affiliates have entered into securities transactions with Notris LLC, an entity controlled by Mr. Drozdov, one of our directors:

- On November 28, 2001, Notris sold 2,197,000 shares, representing approximately 10% of the share capital of Detsky Mir, to Sistema for $73,405. Notris had purchased these shares for $73,450 on July 2, 2001 from Sistema-Market.
- On March 1, 2002, Notris purchased 2,798 shares, representing approximately 0.2% of the share capital of Vyksunsk Metallurgical Plant, from MKNT & Co., a former wholly owned subsidiary of ours that was merged into Sistema in November 2001, for $233,782. On September 20, 2002, Notris sold these shares to Reestr OJSC, our consolidated subsidiary, for $148,337.
- On March 1, 2002, Notris purchased 5,461 shares, representing approximately 1% of the share capital of Gas-Service OJSC, a gas-utility company, from MKNT & Co. for $233,701. MKNT & Co. had purchased these shares for $1,166,634 in June 1998.
- On March 1, 2002, Notris purchased 4,000 shares, representing approximately 0.1% of the share capital of Kondopoga, a paper processing plant in Karelia, for $80,411 from MKNT & Co. MKNT & Co. had purchased these shares for $401,411 in June 1998. On July 21, 2003, Notris sold these shares to Reestr OJSC for approximately $82,000.
- On October 10, 2002, Notris purchased 19 shares, representing approximately 19% of the share capital of Telecom-900, from Invest-Svyaz-Holding for $6,900,000. Invest-Svyaz-Holding had purchased these shares for $6,270,000 on September 13, 2001.
- On April 22, 2003, Notris sold 300 shares, representing approximately 93.8% of the share capital of NTR Region OJSC to Sistema for $4,884.
- On June 26, 2003, Notris entered into an agreement with Intourist to repay an outstanding loan provided in the amount of $40,585 by Notris on February 11, 2003. Under the agreement, $2,136 of the loan was repaid by the contribution of 1,501 shares, representing 3.3% of the share capital of Reestr OJSC. The remainder of the loan was repaid in cash.
- On July 21, 2003, Notris sold 79,145 shares, representing approximately 0.1% of the share capital of Krasnoyarsky Shinnyi Zavod OJSC to Reestr OJSC for $15,126.
- On September 15, 2003, Notris sold 20 shares, representing approximately 20% of the share capital of Absolut JSC to Laminea JSC for $978.
- On November 13, 2003, Notris purchased 20,502 shares, representing approximately 25.5% of the share capital of Severnoye OJSC from Sistema-Neft OJSC for $543,376.
- On February 5, 2004, Notris purchased 24,999 shares, representing approximately 5.6% of the share capital of Reestr OJSC from R-Brok JSC for $37,180.

Notris has also entered into loan transactions with several of our consolidated subsidiaries. Since January 1, 2000, Notris obtained several interest-free loans from our consolidated subsidiaries in amounts ranging from $79,849 to $4,887,840. All of the loans were paid in full when due. We began to consolidate Notris LLC as of January 1, 2004.

PromTorgCenter CJSC

We and certain of our affiliates have entered into transactions with PromTorgCenter CJSC, an entity controlled by Andrey Ryabov, a director of several of our consolidated subsidiaries:

- On September 24, 2001, PromTorgCenter purchased 3,751,881 shares representing approximately 4% of the share capital of ROSNO from Sistema for $574,268. Sistema had purchased these shares for $987,915 on October 19, 1998.
- On September 24, 2001, PromTorgCenter sold 1,875,940 shares, representing approximately 2% of the share capital of ROSNO, to Mr. Leiviman, one of our directors, for $286,399 and another 1,875,941 shares, representing approximately 2% of the share capital of ROSNO, to Mr. Novitsky, the Chairman of our Board of Directors, for $287,869. PromTorgCenter had purchased these shares for $574,268 from Sistema on September 24, 2001.
- On April 10, 2001, PromTorgCenter sold 22,060 shares, representing approximately 100% of the share capital of CJSC Concel, our subsidiary, to Sistema for $756,256. PromTorgCenter had acquired these shares on February 2001 from Elion, our subsidiary, in exchange for 4,354,725 shares, representing 6% of share capital, of OAO Promradtechbank.
- On February 3, 2003, Reestr OJSC issued 63,134 new shares, representing approximately 14.2% of its share capital, to PromTorg Center for approximately $89,000.
- On April 24, 2003, PromTorgCenter sold 100 shares, representing less than 0.01% of the share capital of Detsky Mir Center, to us for approximately $44,000. PromTorgCenter had acquired these shares on July 2, 2001 from Sistema-Market, our consolidated subsidiary, for approximately $390.
- On June 30, 2003, PromTorgCenter purchased 200 shares, representing approximately 2% of the share capital of Leasing Company Promleasing OJSC from Promradtechbank OJSC for $65.
- On September 18, 2003, PromTorgCenter sold 300 shares, representing approximately 10% of the share capital of Mobilniye Telematichiskiye Sistemy Pozitsionirovaniya OJSC for $978.
- On November 13, 2003, PromTorgCenter sold 12,000 shares, representing 14.4% of the share capital of Severnoye OJSC to Sistema-Neft OJSC for $904,878.
- On November 17, 2003, PromTorgCenter sold 420 shares, representing approximately 4.2% of the share capital of Sistema-Neft OJSC for $420,000 to ECU GEST HOLDING S.A.
- On December 5, 2003, PromTorgCenter purchased 655,000 shares, representing approximately 0.01% of the share capital of IzhMash OJSC from Lastea-ART JSC for $385,814.
- On August 12, 2004, PromTorgCenter purchased 10 promissory notes of Sky-Link from MBRD for $16,838,712.

PromTorgCenter has also entered into loan transactions with several of our consolidated subsidiaries. PromTorgCenter obtained several interest free loans from our consolidated subsidiaries in amounts ranging from $88,244 to $10,378,217. All of the loans were paid in full when due. We began to consolidate PromTorgCenter CJSC as of January 1, 2004.

ROSNO

During the nine-month period ended September 30, 2004, ROSNO repurchased 3.4% of its outstanding shares from Mr. Kurgin, one of our directors, for the total cash consideration of $5.6 million.

Detsky Mir

In 2001 and 2002, Detsky Mir entered into contracts for children's shoe supplies with an entity in which Sergei Kiselyov, a former director of Detsky Mir, has a 70% interest. The amounts paid under these contracts in 2001 and 2002 were $1,722,060 and $3,794,845, respectively.

In 2000, 2001 and 2002, Detsky Mir Center, a subsidiary of Detsky Mir, entered into contracts for children's toys with an entity in which Mr. Kiselyov has a 70% interest. The amounts paid under these contracts in 2000, 2001 and 2002 were $812,990, $1,884,120 and $1,696,234, respectively.

MBRD

In January 2000, Mr. Evtushenkov, Mr. Novitsky, Mr. Zubov, Mr. Leiviman and Mr. Goncharuk, our directors, and Victor Bolshakov, president of Sistema International, purchased in brokerage transactions promissory notes of MKNT & Co. at an aggregate purchase price of $1,260,788. In April 2000, these individuals sold these promissory notes to MBRD for an aggregate consideration of $1,188,755. The total face value of these notes was $1,260,788.

MTU-Inform/MTU-Intel

In July and August 2000, Mr. Lagutin, Semen Rabovsky and Said Alimbekov sold 1,320,000 shares, representing 14% of the share capital of P-Com, to MTU-Inform and 660,000 shares, representing 7% of the share capital of P-Com, to MTU-Intel for an aggregate consideration of $9,167,400. Mr. Lagutin is one of our directors. Mr. Rabovsky is the general director of Comstar UTS and a director of several of our subsidiaries. Mr. Alimbekov is a general director of MTU-Inform and a director of several of our subsidiaries. Mr. Lagutin, Mr. Rabovsky and Mr. Alimbekov were founders of P-Com.

Sistema-Invest

In September 2001, Mr. Novitsky and Mr. Leiviman sold shares of ROSNO to Sistema-Invest for a total consideration of $2,348,913. Mr. Novitsky and Mr. Leiviman had purchased these shares for $574,268 in September 2001.

Landshaft

Several of our directors have purchased parcels of real property from Landshaft. This real property was acquired by Landshaft in 2000 and had been developed for resale. In 2001, Mr. Evtushenkov, Mr. Novitsky, Mr. Leiviman, Mr. Goncharuk, Mrs. Zubova, a relative of Mr. Zubov, Mr. Arbiev, Mr. Gorbatovsky, one of our directors, Mrs. Kurgina, a relative of Mr. Kurgin, Mr. Klimovich, one of our directors, Mrs. Turkun, a relative of Mr. Kopiev, one of our directors, and Mr. Sidorov, the president of MTS, purchased parcels of property from Landshaft for an aggregate consideration of $1,076,796.

For additional information regarding related party transactions see Note 31 to our audited consolidated financial statements.

Other

As of the date of this offering memorandum, there were no outstanding loans granted by any member of the group to members of the Board of Directors of Sistema and no guarantees provided by any member of our group for their benefit.

PRINCIPAL AND SELLING SHAREHOLDERS

The following table sets forth information regarding the beneficial ownership of our shares as of the date of this offering memorandum and as adjusted to reflect the offering and the exercise of the overallotment option in full:

Beneficial owner	Shares Beneficially Owned Before the Offering		Shares Offered	Shares Beneficially Owned After the Offering		Shares Offered Pursuant to the Over-Allotment Option	Shares Beneficially Owned After the Offering Assuming Exercise of Over-Allotment Option	
	Number	Percent		Number	Percent		Number	Percent
Vladimir P. Evtushenkov[(1)]	6,320,125	78.03%	4,612	6,315,513	65.45%	25,832	6,289,681	65.18%
Alexander L. Leiviman[(2)]	393,750	4.86%	7,364	386,386	4.00%	41,236	345,150	3.58%
Evgeny G. Novitsky[(3)]	393,750	4.86%	7,364	386,386	4.00%	41,236	345,150	3.58%
Alexander I. Gorbatovsky[(5)]	275,625	3.40%	6,264	269,361	2.79%	35,079	234,282	2.43%
Alexander Y. Goncharuk[(4)]	236,250	2.92%	6,137	230,113	2.38%	34,363	195,750	2.03%
Dmitry L. Zubov[(5)]	157,500	1.94%	3,580	153,920	1.60%	20,045	133,875	1.39%
Vyacheslav I. Inozemtsev	118,125	1.46%	2,685	115,440	1.20%	15,034	100,406	1.04%
Stanislav K. Arbiev	78,750	0.97%	1,790	76,960	0.80%	10,023	66,937	0.69%
Mechislav V. Klimovich[(5)]	78,750	0.97%	1,790	76,960	0.80%	10,023	66,937	0.69%
Victor E. Bolshakov	39,375	0.49%	895	38,480	0.40%	5,011	33,469	0.35%
Nikolay V. Mikhailov[(5)]	8,000	0.10%	182	7,818	0.08%	1,018	6,800	0.07%
GDR Holders	—	—	—	1,592,663	16.50%	—	1,831,563	18.98%
Total	8,100,000	100.00%	42,663	9,650,000	100.00%	238,900	9,650,000	100.00%

(1) Mr. Evtushenkov is our President and a member of our Board of Directors. Of his ownership stake, a portion is held by Zelnik Holdings Limited, a company 100% owned by Mr. Evtushenkov. Zelnik Holdings is also a Selling Shareholder in the offering.

(2) Mr. Leiviman is a member of our Board of Directors and is the general director of Sistema Mass Media.

(3) Mr. Novitsky is the Chairman of our Board of Directors.

(4) Mr. Goncharuk is a member of our Board of Directors and the general director of CSC.

(5) Member of our Board of Directors.

None of our shareholders has voting rights different from any other holders of our shares. Based on our share register, we believe we are not directly or indirectly owned or controlled by another corporation or government, and that there are no arrangements the operation of which may result in a change of control.

Changes in Shareholders' Equity

The following table sets forth, as of the date of this offering memorandum, the changes in our share capital that have occurred within the past three years.

Date	Means of issue	Number of shares issued	Issue price per share	Expenses of issuance charged to subscriber	Amount of increase	Issued share capital	Number of ordinary shares in issue
May 7, 2001	Closed subscription	6	$69.79	n/a	$ 419	$ 170,591	6
December 3, 2001	Conversion (split)	8,100,000	n/a	n/a	n/a	$ 170,591	8,100,000
August 25, 2004	Conversion (nominal value increase)	8,100,000	n/a	n/a	$24,919,239	$25,089,830	8,100,000

None of the Directors or their affiliated parties has any options with respect to our shares.

DESCRIPTION OF SHARE CAPITAL AND CERTAIN REQUIREMENTS OF RUSSIAN LEGISLATION

We describe below our registered common shares, the material provisions of our charter in effect on the date of this offering memorandum and certain requirements of Russian legislation.

Our Purpose

Article 2 of our charter provides that our primary purpose is to earn profit by conducting entrepreneurial activity.

Description of Share Capital

General

Pursuant to our charter, we have the right to issue registered common shares, preferred shares and other securities provided for by the legislation of the Russian Federation with respect to securities.

Under Russian legislation, charter capital refers to the aggregate nominal value of the issued and outstanding shares. Currently, we have an issued capital of 729,000,000 rubles, represented by 8,100,000 common shares (each with a nominal value of 90 rubles) fully paid, issued and outstanding. In addition, we are allowed by our charter to issue 1,550,000 common shares (authorized shares), each with a nominal value of 90 rubles, which are being issued in connection with this offering. No preferred shares are authorized or outstanding. Preferred shares may only be issued if amendments have been made to our charter pursuant to a resolution of the general meeting of shareholders.

We are an open joint stock company with fewer than 1,000 holders of voting shares for purposes of certain provisions of the Joint Stock Companies Law described below. We will continue to have fewer than 1,000 holders of voting shares for purposes of these provisions immediately following our initial public offering, as the Depositary will be considered under Russian law as the holder of all of the Shares represented by the GDRs.

Rights Attaching to Common Shares

Holders of our common shares have the right to vote at all shareholder meetings. As required by the Joint Stock Companies Law and our charter, all of our common shares have the same nominal value and grant identical rights to their holders. Each fully paid common share, except for treasury shares, gives its holder the right to:

- freely transfer the shares without the consent of other shareholders;
- receive dividends;
- participate in shareholders' meetings and vote on all matters of shareholders' competence;
- transfer voting rights to its representative on the basis of a power of attorney;
- through participation in general meetings of shareholders, elect and dismiss members of the Board of Directors and the review commission;
- if holding, alone or with other holders, 2% or more of the voting stock, within 30 days after the end of our fiscal year, make proposals for the annual shareholders' meeting and propose candidates to the Board of Directors and the review commission;
- if holding, alone or with other holders, 10% or more of the voting stock, demand from the Board of Directors the calling of an extraordinary shareholders' meeting or an unscheduled audit by the review commission;

- demand, in the following circumstances, the repurchase by us of all or some of the shares owned by such holder, as long as the holder voted against or did not participate in the voting on the decision approving the following action:
  - decisions with respect to a reorganization;
  - the approval by shareholders of a major transaction, as defined under Russian law; and
  - the amendment of our charter in a manner that limits shareholders' rights;
- upon liquidation, receive a proportionate amount of our property after our obligations to our creditors are fulfilled;
- have free access to certain company documents, receive copies for a reasonable fee and, if holding alone or with other holders, 25% or more of the voting stock, have free access to accounting documents and minutes of the management board meetings; and
- exercise other rights of a shareholder provided by our charter, Russian legislation and decisions of shareholders' meetings approved in accordance with its competence.

Preemptive Rights

Our charter provides existing shareholders with a preemptive right to purchase shares or convertible securities during an open subscription in an amount proportionate to their existing shareholding. In addition, the Joint Stock Companies Law provides shareholders with a preemptive right to purchase shares or convertible securities during a closed subscription if the shareholders voted against or did not participate in the voting on the decision approving such subscription. The preemptive right does not apply to a closed subscription to existing shareholders, provided that each such shareholder may acquire a whole number of shares or convertible securities being placed in an amount proportionate to their existing holdings of such securities.

Dividends

The Joint Stock Companies Law and our charter set forth the procedure for determining the dividends that we distribute to our shareholders. According to our charter, we may declare dividends based on our first quarter, six month, nine month or annual results. Dividends are recommended to a shareholders meeting by a majority vote of the Board of Directors, and approved by the shareholders meeting by a majority vote. A decision on quarterly, six month and nine month dividends must be taken within three months of the end of the respective quarter; a decision on annual dividends must be taken at the annual general shareholders meeting. The dividend approved at the shareholders meeting may not be more than the amount recommended by the Board of Directors. Dividends are distributed to holders of our shares as of the record date for the shareholders meeting approving the dividends. See "—General Meetings of Shareholders—Notice and Participation" below. Dividends are not paid on treasury shares, as defined under Russian law.

The Joint Stock Companies Law allows dividends to be declared only out of net profits calculated under Russian accounting standards and as long as the following conditions have been met:

- the charter capital of the company has been paid in full;
- the value of the company's net assets is not less (and would not become less as a result of the proposed dividend payment) than the sum of the company's charter capital, the company's reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred shares of the company;
- the company has repurchased all shares from shareholders having the right to demand repurchase; and
- the company is not, and would not become as the result of the proposed dividend payment, insolvent.

Distributions to Shareholders on Liquidation

Under Russian legislation, the liquidation of a company results in its termination without the transfer of rights and obligations to other persons as legal successors. Our charter allows us to be liquidated by a three-quarters majority vote of a shareholders meeting or by a court order.

Following a decision to liquidate the company, the right to manage our affairs would pass to the liquidation commission which, in the case of voluntary liquidation, is appointed by a 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 which may 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:

- individuals owed compensation for injuries or deaths;
- employees;
- secured creditors;
- federal and local governmental entities claiming taxes and similar payments to the budgets and non-budgetary funds; and
- other creditors in accordance with Russian legislation.

The Federal Law on Insolvency (Bankruptcy) provides for a somewhat different order of priority of creditors' claims in the event of insolvent liquidation.

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
- payments to holders of common 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 bear only the risk of loss of their investment. This may not be the case, however, when one person or entity is capable of determining decisions made by another person or entity. The person or entity capable of determining such decisions is deemed an "effective parent." The person or entity whose decisions are capable of being so determined is deemed an "effective subsidiary." The effective parent bears joint and several responsibility for transactions concluded by the effective subsidiary in carrying out these decisions if:

- this decision-making capability is provided for in the charter of the effective subsidiary or in a contract between such persons; and
- the effective parent gives binding instructions to the effective subsidiary.

Accordingly, 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, you will not be personally liable for our debts or those of our effective subsidiaries unless you control our business.

In addition, an effective parent is secondarily liable for an effective subsidiary's debts if an effective subsidiary becomes insolvent or bankrupt resulting from the action or inaction of an effective parent. This is the case no matter how the effective parent's ability to determine decisions of the effective subsidiary arises, such as through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent that 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 losses.

Charter Capital Increase

We may increase our charter capital by issuing new shares, or increasing the nominal value of already issued shares using the company's net income.

Generally, a decision to increase the charter capital by issuing additional shares or increasing the nominal value of issued shares requires a majority vote of a shareholders' meeting. In addition, the issuance of shares above the number of authorized and non-issued shares provided in our charter necessitates a charter amendment, which requires a three-quarters majority vote of a shareholders meeting.

The Joint Stock Companies Law requires that newly issued shares be sold at market value, except in limited circumstances where (1) existing shareholders exercise a preemptive right to purchase shares at not less than 90% of the price paid by third parties, or (2) fees of up to 10% are paid to intermediaries, in which case the fees paid may be deducted from the price. The price may not be set at less than the nominal value of the shares. The Board of Directors and an independent appraiser value any in-kind contributions for new shares.

Russian securities regulations set out detailed procedures for the issuance and registration of shares of a joint stock company. These procedures require:

- prior registration of a share issuance with the Federal Service for the Financial Markets;
- public disclosure of information relating to the share issuance; and
- following the placement of the shares, registration and public disclosure of the results of the placement of shares.

Our shareholders approved the issuance of shares for the offering on September 1, 2004, and the issuance of shares was registered under Russian securities laws on December 30, 2004. We will, after the closing of the offering, comply with all other applicable filing requirements.

Capital Decrease; Share Buy-Backs

The Joint Stock Companies Law does not allow a company to reduce its charter capital below the minimum charter capital required by law, which is 100,000 rubles for an open joint stock company. Our charter requires that any decision to reduce our charter capital, whether through a repurchase and cancellation of shares or a reduction in the nominal value of the shares, be made by a majority vote of a shareholders meeting. Additionally, within 30 days of a decision to reduce our charter capital, we must issue written notice to our creditors and publish this decision. Our creditors would then have the right to demand, within 30 days of publication or receipt of our notice, repayment of all amounts due to them, as well as compensation for damages.

The Joint Stock Companies Law allows our shareholders or our Board of Directors to authorize the repurchase of up to 10% of our shares in exchange for cash. The repurchased shares must be resold at market price within one year of their repurchase or the shareholders must decide to cancel such shares and decrease the charter capital.

The Joint Stock Companies Law allows us to repurchase our shares only if, at the time of repurchase:

- our charter capital has been paid in full;
- we are not and would not become, as a result of the repurchase, insolvent;
- the value of our net assets is not less (and would not become less, as a result of the proposed repurchase) than the sum of our charter capital, the reserve fund and the difference between the liquidation value and par value of our issued and outstanding preferred shares; and
- we have repurchased all shares from shareholders having the right to demand repurchase of their shares under legislation protecting the rights of minority shareholders, as described immediately below.

Russian legislation and our charter provide that our shareholders may demand the repurchase of all or some of their shares so long as the shareholder demanding such repurchase voted against or did not participate in the voting on the decision approving any of the following actions:

- decisions with respect to a reorganization;
- the approval by shareholders of a major transaction, as defined under Russian law; and
- the amendment of our charter in a manner that limits shareholders' rights.

We may spend up to 10% of our net assets calculated under Russian accounting standards for a share redemption demanded by shareholders. If the value of shares in respect of which shareholders have exercised their right to demand repurchase exceeds 10% of our net assets, we will repurchase shares from each such shareholder on a pro rata basis.

Registration and Transfer of Shares

Russian legislation requires that a joint stock company maintain a register of its shareholders. Ownership of our registered common shares is evidenced solely by entries made in such register. Any of our shareholders may obtain an extract from our register certifying the number of shares that such shareholder holds. OJSC Reestr maintains our shareholder register.

The purchase, sale or other transfer of shares is accomplished through the registration of the transfer in the shareholder register, or the registration of the transfer with a licensed Russian depositary if shares are held by such depositary. The registrar or depositary may not require any documents in addition to those required by Russian legislation in order to transfer 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, may be challenged in court.

Reserve Fund

Russian legislation requires that each joint stock company 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. Our charter provides for a reserve fund of 5% of our charter capital, funded through mandatory annual transfers of at least 5% of our statutory net profits until the reserve fund has reached the 5% requirement.

General Meetings of Shareholders

Procedure

The powers of a shareholders meeting are set forth in the Joint Stock Companies Law and in our charter. A shareholders meeting may not decide issues that are not included in the list of its competence by the Joint Stock Companies Law and our charter. Among the issues which the shareholders have the exclusive power to decide are:

- charter amendments;
- reorganization or liquidation;
- election and removal of the members of the Board of Directors;
- determination of the number, nominal value and type of authorized shares and rights granted by such shares;
- changes in the company's charter capital;
- appointment and removal of an external auditor and the members of the company's review commission and counting commission;
- approval of certain interested party transactions and major transactions;
- distribution of profits; and
- redemption by the company of issued shares in cases provided for by the Joint Stock Companies Law.

Voting at a shareholders meeting is generally on the principle of one vote per common share, with the exception of the election of the Board of Directors, which is done through cumulative voting. Decisions are generally passed by a majority vote of the holders of voting stock present at a shareholders meeting. However, Russian law requires a three-quarters majority vote of the holders of voting stock present at a shareholders meeting to approve the following:

- charter amendments;
- reorganization or liquidation;
- major transactions involving assets in excess of 50% of the balance sheet value of the assets of a company;
- determination of the number, nominal value and type of authorized shares and the rights granted by such shares;
- repurchase by the company of its issued shares;
- any issuance of shares or securities convertible into common shares by closed subscription; or
- issuance by open subscription of common shares or securities convertible into common shares, in each case, constituting 25% or more of the number of issued and outstanding common shares.

The quorum requirement for our shareholders meeting is met if shareholders (or their representatives) accounting for more than 50% of the issued voting shares are present. If the 50% quorum requirement is not met, another shareholders meeting with the same agenda may (or, in the case of an annual meeting, must) be scheduled and the quorum requirement is satisfied if shareholders (or their representatives) accounting for at least 30% of the issued voting shares are present at that meeting.

The annual shareholders meeting must be convened by the Board of Directors between March 1 and June 30 of each year, and the agenda must include the following items:

- determination of the number and election of members of the Board of Directors;
- approval of the annual statutory report, balance sheet and profit and loss statement;
- approval of distribution of profits, including approval of annual dividends, if any;

- approval of an independent auditor for statutory accounts; and
- approval of the review commission.

The shareholders meeting also approves compensation for members of our Board of Directors. A shareholder or group of shareholders owning in the aggregate at least 2% of the issued voting shares may introduce proposals for the agenda of the annual shareholders meeting and may nominate candidates for the Board of Directors and the review commission. Any agenda proposals or nominations must be provided to the company no later than January 30.

Extraordinary shareholders meetings may be called by the Board of Directors on its own initiative, or at the request of the review commission, the independent auditor of the statutory accounts or a shareholder or group of shareholders owning in the aggregate at least 10% of the issued voting shares as of the date of the request.

A general meeting of shareholders may be held in a form of a meeting or by absentee ballot. The form of a meeting contemplates the adoption of resolutions by the general meeting of shareholders through the attendance of the shareholders or their authorized representatives for the purpose of discussing and voting on issues on the agenda, provided that if a ballot is mailed to shareholders for participation at a meeting convened in such form, the shareholders may complete and mail the ballot back to the company without personally attending the meeting. A general meeting of the shareholders by absentee ballot contemplates the determination of shareholders' opinions on issues on the agenda by means of a written poll.

The following issues cannot be decided by a shareholders' meeting by absentee ballot:

- election of directors;
- election of the review commission;
- approval of a company's independent auditor for statutory accounts; and
- approval of the annual report, balance sheet, profit and loss statement under Russian law, and any distributions of profits, including approval of annual dividends, if any.

Notice and Participation

All shareholders entitled to participate in a general shareholders meeting must be notified of the meeting, whether the meeting is to be held in direct form or by absentee ballot, no less than 20 days prior to the date of the meeting, and such notification shall specify the agenda for the meeting. However, if reorganization is an agenda item, shareholders must be notified at least 30 days prior to the date of the meeting, and if it is an extraordinary shareholders meeting to elect the Board of Directors by cumulative vote, shareholders must be notified at least 50 days prior to the date of the meeting. Only those items that were set out in the agenda may be voted upon at a general shareholders meeting.

The list of persons entitled to participate in a general shareholders meeting is compiled on the basis of data in our shareholders register on the date established by the Board of Directors, which date may neither be earlier than the date of adoption of the board resolution to hold a general shareholders meeting nor more than 50 days before the date of the meeting (or, in the case of a shareholders meeting to elect the Board of Directors by cumulative vote, not more than 65 days before the date of the meeting).

The right to participate in a general shareholders' meetings may be exercised by a shareholder as follows:

- by personally participating in the discussion of agenda items and voting thereon;

- by sending an authorized representative to participate in the discussion of agenda items and to vote thereon;
- by absentee ballot; or
- by delegating the right to fill out the absentee ballot to an authorized representative.

Board of Directors

Our charter provides that our entire Board of Directors must be elected at each annual general shareholders meeting and that our 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 voting shares held by such shareholder multiplied by the number of persons to be elected to our Board of Directors, and the shareholder may give all such votes to one candidate or spread them between two or more candidates. Before the expiration of their term, the directors may be removed as a group at any time without cause by a majority vote of a shareholders meeting.

The Joint Stock Companies Law requires all joint stock companies to have at least a five-member board of directors, at least a seven-member board of directors for a joint stock company with more than 1,000 holders of voting shares, and at least a nine-member board of directors for a joint stock company with more than 10,000 holders of voting shares. Only natural persons (as opposed to legal entities) are entitled to sit on the board. Members of the board of directors are not required to be shareholders of the company. The actual number of directors is determined by the company's charter or by a decision of the shareholders' meeting. Our charter provides that the number of members on our Board of Directors is determined by the shareholders. Currently, our Board of Directors consists of 13 members.

The Joint Stock Companies Law generally prohibits the board of directors from acting on issues that fall within the exclusive competence of the general shareholders meeting. Our Board of Directors has the power to direct the general management of the company, and to decide the following issues:

- determination of our business priorities, including approval of major investment projects, financial and business plans, budgets and investment programs;
- convening annual and extraordinary shareholders meetings, except in certain circumstances specified in the Joint Stock Companies Law;
- setting a date, time and place for the shareholders meeting;
- approval of the agenda of the shareholders meeting and determination of the record date for shareholders entitled to participate in a shareholders meeting;
- placement of our bonds and other securities, except in certain circumstances specified in our charter;
- determination of the price of our property and of our securities to be placed or repurchased, as provided for by the Joint Stock Companies Law;
- repurchase of our shares, bonds and other securities in certain cases provided for by the Joint Stock Companies Law;
- formation of our executive bodies, including appointment of the president, and early termination of their powers and the establishment of their compensation;
- recommendations in respect of the amount of a dividend and the payment procedure;

- recommendations in respect of the amount of remuneration and compensation to be paid to the members of our review commission and on the fees payable for the services of an independent auditor;
- the use of our reserve fund and other funds;
- the creation of branches and representative offices;
- approval of internal documents, except for those documents whose approval falls within the competence of the company's shareholders or president;
- approval of major and interested party transactions in the cases provided for by the Joint Stock Companies Law;
- the increase of our charter capital by issuing additional shares within the limits of the authorized charter capital, except in certain circumstance specified in our charter;
- approval of decisions on share issuances and of the prospectus relating to such share issuances, as well as of reports on the results of such share issuances;
- decision on our participation in other organizations, with the exception of participation in holding companies, commercial or industrial groups, or other associations of commercial entities, where shareholders' vote is required by our charter;
- approval of our share registrar; and
- other issues, as provided for by the Joint Stock Companies Law and our charter.

Our charter generally requires a majority vote of the directors present for an action to pass, with the exception of actions for which Russian legislation requires a unanimous vote or a majority vote of the disinterested and independent directors, as described herein. A board meeting is considered duly assembled and legally competent to act when a majority of the number of directors provided for in our charter are present.

Interested Party Transactions

Under the Joint Stock Companies Law, certain transactions defined as "interested party transactions" require approval by disinterested directors or shareholders of the company. "Interested party transactions" include transactions involving a member of the board of directors or a member of any executive body of the company, any person that owns, together with any affiliates, at least 20% of a company's issued voting stock or any person who is able to direct the actions of the company, if that person, or that person's spouse, parents, children, adoptive parents or children, brothers or sisters or affiliates, is:

- a party to, or beneficiary of, a transaction with the company, whether directly or as a representative or intermediary;
- the owner of at least 20% of the issued voting shares 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 the board of directors 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.

The Joint Stock Companies Law requires that an "interested party transaction" by a company with more than 1,000 shareholders be approved by a majority vote of the independent directors of the company who are not interested in the transaction. An "independent director" is a person who is not, and within the year preceding the decision was not, the general director, a member of any executive body or an affiliate of the company. Additionally, such person's spouse, parents, children, adoptive parents or children, brothers or sisters may not occupy positions in the executive bodies of the company. For companies with 1,000 or fewer shareholders, an interested party transaction must be approved by a majority vote of the directors who are not interested in the transaction if the number of these directors is sufficient to constitute a quorum.

Approval by a majority of shareholders who are not interested in the transaction is required if:

- the value of such transaction or a number of interrelated transactions is 2% or more of the balance sheet value of the company's assets determined under Russian accounting standards;
- the transaction or a number of interrelated transactions involves the issuance, by subscription, of voting shares or securities convertible into voting shares, or secondary market sale of such securities, in an amount exceeding 2% of the company's issued voting stock;
- 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.

Approval by a majority of shareholders who are not interested in the transaction may not be required for an interested party transaction if such transaction is substantially similar to transactions concluded by the company and the interested party in the ordinary course of business before such party became an interested party with respect to the transaction.

The approval of interested party transactions is not required in the following instances:

- the company has only one shareholder that simultaneously performs the functions of the executive body of the company;
- all shareholders of the company are deemed interested in such transactions;
- the transactions arise from the shareholders executing their preemptive rights to purchase newly issued shares of the company;
- the transactions arise from the repurchase, whether mandatory or not, by the company of the issued shares; or
- where the company is merging with another company, when the latter owns more than three-fourths of the voting capital stock of the company.

Major Transactions

The Joint Stock Companies Law defines a "major transaction" as a transaction, or a series of transactions, involving the acquisition or disposal, or a possibility of disposal, of property having a value of 25% or more of the balance sheet value of the assets of a company as determined under Russian accounting standards, with the exception of transactions completed in the ordinary course of business or transactions involving the placement of common shares or securities convertible into common shares. Major transactions involving assets ranging from 25% to 50% of the balance sheet value of the assets of a company require unanimous approval by all members of the board of directors or, failing to receive such approval, a simple majority vote of a shareholders meeting. Major transactions involving assets in excess of 50% of the balance sheet value of the assets of a company require a three-quarters majority vote of a shareholders meeting.

Change in Control

Anti-takeover Protection

Russian legislation requires that any person that intends, either individually or together with its affiliates, to acquire 30% or more (including, for such purposes, the shares already owned by this person or its affiliates) of the common shares of a company having more than 1,000 holders of common shares must give at least 30, but no more than 90, days' prior written notice to the company. Additionally, the Joint Stock Companies Law provides that a person acquiring either individually, or together with its affiliates, 30% or more (including, for such purposes, the shares already owned by this person or its affiliates) of the common shares of a company with more than 1,000 holders of common shares, within 30 days of acquiring the shares, must offer to buy all of the common shares or securities that are convertible into common shares of that company at a market price which shall not be lower than the weighted average price of the common shares over the six months before the date of acquisition. These requirements also apply to any acquisitions of each subsequent 5% or more of the issued common shares of a company by a person already holding (together with its affiliates) over 30% of the issued common shares of such company. If the acquirer fails to observe these requirements, it will be limited to voting only those shares it purchased in compliance with these requirements. The requirement to make a buyout offer of securities may be waived in a company's charter or by a resolution adopted by a majority vote of a shareholders meeting, excluding the votes of the person (and its affiliates) acquiring shares. New Russian securities regulations strongly discourage listed companies from waiving the buyout offer requirement, and regulators have advised Russian companies to abandon any waiver of this requirement by July 1, 2005. Our charter does not contain a waiver of this requirement.

Approval of the Russian Federal Antimonopoly Service

Pursuant to Russian antimonopoly legislation, transactions exceeding a certain amount, involving companies with a combined value of assets that (under Russian accounting standards) exceeds a certain threshold or companies registered as having more than a 35% share of the market in a particular commodity, and which would result in a shareholder (or a group of affiliated shareholders) holding more than 20% of the voting capital stock of the company must be approved in advance by the Federal Antimonopoly Service.

Because the rights of beneficial owners of our GDRs may not be recognized under Russian law, the Depositary may be required to obtain such approval for deposits of our Shares that would exceed 20% of our voting capital stock, and for any subsequent deposits.

Exchange Controls

The Federal Law on Currency Regulation and Currency Control, which came into effect on June 18, 2004, empowers the government and the Central Bank of Russia to regulate and restrict certain foreign currency operations, including certain types of payments in foreign currency, operations involving foreign securities (including GDRs) and domestic securities (including our common shares), as well as certain types of settlements in rubles between residents and non-residents of Russia. As the new regulatory regime is very recent and untested, it is currently unclear how it will be applied in practice. In particular, it remains uncertain whether it will be more or less restrictive than the prior laws and regulations it replaced.

Capital Import and Export Restrictions

Pursuant to the Federal Law on Currency Regulation and Currency Control, the government and the Central Bank of Russia have the power to restrict, in particular, the following operations:

- investments (not involving the acquisition of securities) by Russian residents into participatory interests in joint ventures with foreign investors or acquired from foreign investors;
- the acquisition of Russian securities by foreign investors and foreign securities by Russian investors;
- the grant or receipt of loans and credits between residents and non-residents of Russia; and
- payments for export-import transactions with settlement over 180 days (and in limited cases, from three to five years) following completion.

Restrictions that can be introduced include:

- a requirement to perform the operations listed above through special bank accounts with authorized Russian banks (the "requirement to use a special account"); and
- a requirement to deposit in a special non-interest bearing account with an authorized Russian bank (the "reservation requirement"), prior to the performance of the operations listed above, a monetary sum of:
  - up to 100% of the amount of the foreign currency operation in question for a period of time not exceeding 60 days; or
  - up to 20% of the amount of the foreign currency operation in question for a period of time not exceeding one year.

As of the date hereof, the requirement to use a special account has been introduced in respect of acquisitions of Russian securities by foreign investors and foreign securities by Russian investors and in respect of the grant or receipt of loans and credits between residents and non-residents of Russia. In particular, the following operations are subject to the requirement to use special accounts:

- the receipt by residents of Russia of foreign currency loans and credits with maturities of less than three years granted by non-residents of Russia;
- the acquisition of foreign securities (such as GDRs) by Russian investors; and
- the acquisition of Russian securities (such as our shares) by foreign investors.

As of the date hereof, the reservation requirement has been introduced, in particular, in respect of:

- the receipt by residents of Russia of foreign currency loans and credits with maturities of less than three years in the amount of 3% of the loan/credit for one year; and
- the acquisition of foreign securities (such as GDRs) by Russian investors in the amount of 50% of the sum paid for the securities for 15 days.

While restrictions imposed on foreign currency operations are currently limited in scope, the statutory powers of the government and the Central Bank of Russia enable them to:

- increase the amount and/or time period of the reservation requirements; and/or
- extend the reservation requirements and other restrictions to other types of foreign currency operations envisaged by the Federal Law on Currency Regulation and Currency Control.

Additionally, Russian companies must repatriate 100% of their receivables from the export of goods and services (with a limited number of exceptions covering, in particular, certain types of secured financing) and convert 10% of export receivables in foreign currency into rubles within seven days of the date on which they were received. Furthermore, certain types of cross-border operations are required to be performed only in rubles, including, for example, transactions with domestic securities, such as our shares, between residents and non-residents of Russia.

Restrictions on the Remittance of Dividends, Interest or Other Payments to Non-residents

The Federal Law on Foreign Investments in the Russian Federation of July 9, 1999 specifically guarantees foreign investors the right to repatriate their earnings from Russian investments. However, the Russian exchange control regime may materially affect your ability to do so.

Ruble dividends payable on the Shares may be paid to the Depositary or its nominee and converted into U.S. dollars by the Depositary for distribution to owners of GDRs without restriction. However, the ability to convert rubles into U.S. dollars is also subject to the availability of U.S. dollars in Russia's currency markets. Although there is an existing market within Russia for the conversion of rubles into U.S. dollars, including the interbank currency exchange and over-the-counter and currency futures markets, the further development of this market is uncertain. At present, there is no market for the conversion of rubles into foreign currencies outside of Russia and no viable market in which to hedge ruble and ruble-denominated investments.

Notification of Foreign Ownership

Foreign persons registered as individual entrepreneurs in Russia 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. The procedure for notifying the Russian tax authorities by foreign companies that are not registered with the Russian tax authorities at the time of their share acquisitions is unclear. Other than this notification requirement, there are no requirements or restrictions with respect to the foreign ownership of our shares.

DESCRIPTION OF THE GLOBAL DEPOSITARY RECEIPTS

Deutsche Bank Trust Company Americas has agreed to act as the depositary for the GDRs. The Depositary's principal New York offices are located at 60 Wall Street, New York, New York 10005, United States and its principal London offices are located at Winchester House, 1 Great Winchester Street, London EC2N 2DB, United Kingdom. In this summary we use the term "GDRs" to refer to the Rule 144A GDRs and to the Regulation S GDRs. GDRs are represented by certificates that are commonly known as "Global Depositary Receipt Certificates" or "GDR Certificates." The GDRs we are selling in the United States are referred to and will be issued as Rule 144A GDR and the GDRs we are selling outside the United States are referred to and will be issued as the Regulation S GDRs. GDRs represent ownership interests in securities, cash or other property on deposit with the Depositary.

The Depositary has appointed Deutsche Bank Ltd. as the custodian for the safekeeping of the securities, cash or other property on deposit (hereinafter, the Custodian). The Custodian's principal office is at 4 Shepkina Street, Moscow 129090, Russia.

We have appointed the Depositary pursuant to two separate deposit agreements, one for the Rule 144A GDRs (hereinafter, the Rule 144A Deposit Agreement) and one for the Regulation S GDRs (hereinafter, the Regulation S Deposit Agreement). Copies of the Deposit Agreements are available for inspection by any holder of the GDRs at the principal offices of the Depositary during business hours. This is a summary description of the material terms of the GDRs and of your material rights as an owner of the GDRs. Please remember that summaries by their nature lack the precision of the information summarized and that the rights and obligations of an owner of GDRs will be determined by reference to the terms of the applicable Deposit Agreement and not by this summary.

Fifty GDRs represents the right to receive one Share on deposit with the Custodian. Each GDR will also represent the right to receive cash or any other property received by the Depositary or the Custodian on behalf of the owner of the GDR but that has not been distributed to the owners of GDRs because of legal restrictions or practical considerations.

If you become an owner of GDRs, you will become a party to the applicable Deposit Agreement and therefore will be bound by its terms and by the terms of the GDR Certificate that represents your GDRs. The applicable Deposit Agreement and the GDR Certificate specify our rights and obligations as well as your rights and obligations as owner of GDRs and those of the Depositary. As a GDR owner you appoint the Depositary as your attorney-in-fact, with full power to delegate, to act on your behalf and to take any and all actions contemplated in the applicable Deposit Agreement, to adopt any and all procedures necessary to comply with applicable laws and to take such action as the Depositary in its sole discretion may deem necessary or appropriate to carry out the purposes of the applicable Deposit Agreement.

Presently, you may hold your GDRs only through a brokerage or safekeeping account. As such, you must rely on the procedures of your broker or bank to assert your rights as GDR owner. Please consult with your broker or bank to determine what those procedures are. When we refer to "you," we assume the reader owns GDRs and will own GDRs at the relevant time. When we refer to a "holder" we assume the person owns GDRs and such person's agent (*i.e.*, broker, custodian, bank or trust company) is the holder of the applicable GDR.

No temporary Master GDRs or other temporary documents of title have been or will be issued.

Registration of Placement Report

Prior to the receipt by the Depositary of written notice from us that the placement report with respect to the newly issued Shares being offered by us has been registered with the Federal Service for the Financial Markets, the GDRs shall be deemed to be issued on a provisional basis and you will not be able to withdraw the Shares underlying your GDRs and will not be able to instruct the Depositary to exercise voting rights with respect to the Shares that underlie your GDRs. See "Risk Factors—You will not be able to withdraw the Shares underlying the GDRs prior to the registration of a placement report for newly issued Shares, and the failure to register this placement report could result in the offering being withdrawn and newly issued Shares underlying the GDRs being cancelled" and "Escrow of Proceeds and Registration of Placement Report."

Distinctions between Rule 144A GDRs and Regulation S GDRs

The Rule 144A GDRs and the Regulation S GDRs are similar in many ways but are different primarily on account of the requirements of the U.S. securities laws. The Rule 144A GDRs are "restricted securities" under the U.S. securities laws and as such are subject to limitations on their issuance, transfer and cancellation. The Regulation S GDRs are not *per se* "restricted securities" under the U.S. securities laws, but we have imposed certain contractual restrictions on the Regulation S GDRs in an effort to prevent the transfer of Regulation S GDRs in violation of the U.S. securities laws.

The differences between the Regulation S GDRs and the Rule 144A GDRs and the restrictions imposed on the Rule 144A GDRs and the Regulation S GDRs cover primarily the following:

- The venue for trading the GDRs in the United States: the Rule 144A GDRs may be traded in PORTAL among QIBs.
- The restrictions on the transfers, deposits and withdrawals of the Shares represented by the GDRs. See "—Transfer Restrictions."
- The eligibility for book-entry transfer. See "—Settlement and Safekeeping."
- Special restrictions on deposits and withdrawals apply to our affiliates. See "—Ownership of GDRs by our affiliates" below.

These distinctions and the requirements of the U.S. securities laws may require us and the Depositary to treat the Regulation S GDRs and the Rule 144A GDRs differently at any time in the future. There can be no guarantee that holders of Rule 144A GDRs will receive the same entitlements as holders of Regulation S GDRs and vice versa.

Settlement and Safekeeping

Rule 144A GDRs

The Depositary has made arrangements with DTC to act as securities depository for the Rule 144A GDRs. All Rule 144A GDRs issued in the offering will be registered in the name of Cede & Co. (DTC's nominee). One Master Rule 144A GDR Certificate will represent all Rule 144A GDRs that will be issued to and registered in the name of Cede & Co. Transfers of ownership interests in Rule 144A GDRs are to be accomplished by entries made on the books of DTC and participants in DTC acting on behalf of Rule 144A GDR owners. Owners of Rule 144A GDRs will not receive certificates representing their ownership interests in the Rule 144A GDRs, except in the event that a successor securities depository cannot be appointed.

DTC may discontinue providing its services as securities depository with respect to the Rule 144A GDRs at any time by giving reasonable notice to the Depositary. Under such circumstances and in the event a successor securities depository cannot be appointed, individual Rule 144A GDR Certificates representing the applicable number of Rule 144A GDRs held by each owner of Rule 144A GDRs will be printed and delivered to the relevant Rule 144A GDR owners.

Regulation S GDRs

The Depositary has made arrangements with Euroclear and Clearstream to act as securities depositories for the Regulation S GDRs. All Regulation S GDRs issued in the offering will be registered in the name of BT Globenet Nominees Limited, as nominee for the common depositary for Euroclear and Clearstream. One Master Regulation S GDR will represent all Regulation S GDRs issued to and registered in the name of BT Globenet Nominees Limited. Euroclear and Clearstream will hold the Regulation S GDRs on behalf of their participants (any such participant of Euroclear or Clearstream, a "Participant"), and, transfers will be permitted only within Euroclear and Clearstream in accordance with usual rules and operating procedures of the relevant system. Transfers of ownership interests in Regulation S GDRs are to be accomplished by entries made on the books of Euroclear and Clearstream and of participants in Euroclear and Clearstream, acting in each case on behalf of Regulation S GDR owners. Owners of Regulation S GDRs will not receive certificates representing their ownership interests in the Regulation S GDRs, except in the event that use of the Euroclear and Clearstream book-entry system for the Regulation S GDRs is discontinued.

If at any time Euroclear or Clearstream, as the case may be, ceases to make its respective book-entry settlement systems available for the Regulation S GDRs, we and the Depositary will attempt to make other arrangements for book-entry settlement. If alternative book-entry settlement arrangements cannot be made, the Depositary will make available Regulation S GDRs in physical certificated form.

Transfer Restrictions

The GDRs may be reoffered, resold, pledged or otherwise transferred only in compliance with the U.S. securities laws and are subject to the following restrictions:

Restrictions upon the transfer of GDRs

Rule 144A GDRs	Regulation S GDRs
The Rule 144A GDRs may be reoffered, resold, pledged or otherwise transferred only:	Regulation S GDRs may be reoffered, resold, pledged or otherwise transferred only:
(i) outside the United States in accordance with Regulation S;	(i) outside the United States in accordance with Regulation S;
or	or
(ii) to a QIB in a transaction meeting the requirements of Rule 144A;	(ii) to a QIB in a transaction meeting the requirements of Rule 144A;
or	or
(iii) pursuant to Rule 144 under the Securities Act, if available;	(iii) pursuant to Rule 144 under the Securities Act, if available;
or	or
(iv) pursuant to an effective registration statement under the Securities Act.	(iv) pursuant to an effective registration statement under the Securities Act.

Please also see "—Ownership of GDRs by our affiliates" below.

Restrictions upon deposit of Shares

Rule 144A GDRs

Shares will be accepted for deposit under the Rule 144A Deposit Agreement only if delivered by, or on behalf of, a person that is:

(i) not Sistema or an affiliate of Sistema or a person acting on behalf of Sistema or an affiliate of Sistema;

and

(ii) a QIB or a person outside the United States that is not a U.S. person (as defined in Regulation S).

Regulation S GDRs

Shares will be accepted for deposit under the Regulation S Deposit Agreement only if delivered by, or on behalf of, a person that is:

(i) not Sistema or an affiliate of Sistema or a person acting on behalf of Sistema or an affiliate of Sistema;

and

(ii) not in the business of buying or selling securities, or if such person is in the business of buying or selling securities, such person did not acquire the Shares to be deposited from Sistema or an affiliate of Sistema;

and

(iii) is a person outside the United States that is not a U.S. person (as defined in Regulation S).

Shares withdrawn from deposit under the Rule 144A Deposit Agreement will not be accepted for deposit pursuant to the Regulation S Deposit Agreement unless such shares are not and may not be deemed to be "restricted securities" within the meaning of Rule 144(a)(3) under the Securities Act.

Please also see "—Ownership of GDRs by our affiliates" below.

Restrictions upon the withdrawal of Shares

Rule 144A GDRs

So long as the placement report has been registered with the Federal Service for the Financial Markets as described under "—Registration of Placement Report" below, Shares may be withdrawn from the Rule 144A Deposit Agreement only by:

(i) a person other than a U.S. person (as defined in Regulation S) outside the United States who will be the beneficial owner of the Shares upon withdrawal;

or

(ii) a QIB who

(a) has sold the Rule 144A GDRs to another QIB in a transaction meeting the requirements of Rule 144A, or to a person other than a U.S. person (as defined in Regulation S) outside the United States in accordance with Regulation S,

or

(b) will be the beneficial owner of the Shares and agrees to observe the transfer restrictions applicable to Rule 144A GDRs in respect of the Shares so withdrawn.

Regulation S GDRs

So long as the placement report has been registered with the Federal Service for the Financial Markets as described under "—Registration of Placement Report" below, Shares may be withdrawn from the Regulation S Deposit Agreement by the holders of Regulation S GDRs.

Please also see "—Ownership of GDRs by our affiliates" below.

We may restrict transfers of the Shares where such transfer might result in ownership of Shares exceeding the limits applicable to the Shares under applicable law or our charter. We may also restrict transfers of the GDRs where such transfer may result in the total number of Shares represented by the GDRs owned by a single holder or beneficial owner to exceed any such limits. We may, in our sole discretion, but subject to applicable law, instruct the Depositary to take action with respect to the ownership interest of any holder or beneficial owner in excess of the limits set forth in the preceding sentence, including but not limited to, the imposition of restrictions on the transfer of GDRs, the removal or limitation of voting rights or the mandatory sale or disposition on behalf of a holder or beneficial owner of the Shares represented by the GDRs held by such holder or beneficial owner in excess of such limitations, if and to the extent such disposition is permitted by applicable law and our charter.

The registration of transfer of GDR certificates in particular instances may be refused, or the registration of transfers generally may be suspended, during any period when the transfer books of the Depositary, us, the registrar or the Russian share registrar are closed, or if any such action is deemed necessary or advisable by us or the Depositary, in good faith, at any time or from time to time because of any requirement of law, any government or governmental body or commission or any securities exchange on which the GDRs or Shares are listed, or under any provision of the Deposit Agreements or provisions of, or governing, the Shares, or any meeting of our shareholders or for any other reason.

The Depositary may close the transfer books with respect to GDR certificates, at any time or from time to time, when deemed necessary or advisable by it in good faith in connection with the performance of its duties hereunder, or at our reasonable request.

Dividends and Distributions

As a holder, you generally have the right to receive the distributions we make on the securities deposited with the Custodian. Your receipt of these distributions may be limited, however, by practical considerations and legal limitations. Holders will receive such distributions under the terms of the Deposit Agreements in proportion to the number of GDRs held as of a specified GDR record date, which the Depositary will use reasonable efforts to establish as close as possible to the record date set by us for the Shares.

Distributions of Cash

Whenever we make a cash distribution in respect of securities on deposit with the Custodian, we will deposit the funds with the Custodian. Upon receipt of confirmation from the Custodian of the deposit of the requisite funds, the Depositary will arrange for the funds to be converted into U.S. dollars and for the distribution of the U.S. dollars to the holders, if in the reasonable judgment of the Depositary it is practicable and lawful. See "—Foreign Currency Conversion" below for actions the Depositary is entitled to take if conversion, transfer and distribution cannot be so made by the Depositary.

The amounts distributed to holders will be net of the fees, expenses, taxes and governmental charges payable by holders under the terms of the Deposit Agreements. The Depositary will apply the same method for distributing the proceeds of the sale of any property (such as undistributed rights) held by the Custodian in respect of the securities on deposit.

Distributions of Shares

Whenever we make a free distribution of Shares in respect of the Shares on deposit with the Custodian, we will deposit the applicable number of Shares with the Custodian. Upon receipt of confirmation of such deposit from the Custodian, the Depositary will either distribute to holders new GDRs representing the Shares deposited or modify, to the extent permissible by law, the GDR-to-Shares ratio, in which case each GDR you hold will represent rights and interests in the additional Shares so deposited. Only whole new GDRs will be distributed. Fractional entitlements will be sold and the proceeds of such sale will be distributed as in the case of a cash distribution.

The distribution of new GDRs or the modification of the GDR-to-Shares ratio upon a distribution of Shares will be made net of the fees, expenses, taxes and governmental charges payable by holders under the terms of the Deposit Agreements. In order to pay such taxes or governmental charges, the Depositary may sell all or a portion of the new Shares so distributed.

No such distribution of new GDRs will be made if it would violate U.S. law (*i.e.*, the U.S. securities laws) or if it is not operationally practicable. If the Depositary does not distribute new GDRs as described above, it may sell the Shares received and will distribute the proceeds of the sale as in the case of a distribution of cash. The Depositary will hold and/or distribute any unsold balance of such property in accordance with the provisions of the applicable Deposit Agreement.

Distributions of Rights

Whenever we intend to distribute rights to purchase additional Shares, we will give timely prior notice to the Depositary and state whether or not we wish such rights to be made available to you. If we wish such rights to be made available to you, we will assist the Depositary in determining whether it is lawful and reasonably practicable to distribute rights to purchase additional GDRs to holders.

The Depositary will establish procedures to distribute rights to purchase additional GDRs to holders and to enable such holders to exercise such rights only if the Depositary has received our request to make such distribution in a timely manner, and the Depositary shall have determined that it is lawful and reasonably practicable to make the rights available to holders of GDRs, and we have provided all of the documentation contemplated in the applicable Deposit Agreement (such as opinions to address the lawfulness of the transaction). You will have to pay fees, expenses, and any taxes and other governmental charges to subscribe for the new GDRs upon the exercise of your rights. The Depositary is not obligated to establish procedures to facilitate the distribution and exercise by holders of rights to purchase new Shares other than in the form of GDRs.

The Depositary will not distribute the rights to you if:

- we do not request that the rights be distributed to you in a timely manner, or we request that the rights not be distributed to you; or
- we fail to deliver satisfactory documents to the Depositary; or
- it is not reasonably practicable to distribute the rights.

The Depositary will sell the rights that are not exercised or not distributed if such sale is lawful and reasonably practicable in a riskless principal capacity, at such place and upon terms (including public and private sale) as it may deem practicable. The proceeds of such sale will be distributed to holders as in the case of a cash distribution. If the Depositary is unable to sell the rights, it will allow the rights to lapse.

The Depositary shall not be responsible for (i) any failure to determine whether it may be lawful or practicable to make such rights available to holders in general or to you in particular, (ii) any foreign exchange exposure or loss incurred in connection with any sale or exercise, or (iii) the content of any materials forwarded to the holders on behalf of the Company in connection with the rights distribution. There can be no assurance that holders in general or you in particular will be given the opportunity to exercise rights on the same terms and conditions as the holders of Shares or to exercise such rights.

Elective Distributions

Whenever we intend to distribute a dividend payable at the election of shareholders either in cash or in additional Shares, we will give timely prior notice thereof to the Depositary and will indicate whether we wish the elective distribution to be made available to you. In such case, we will assist the Depositary in determining whether such distribution is lawful and reasonably practicable.

The Depositary will make the election available to you only if it has received timely prior notice from us, if it is reasonably practicable and if we have provided all of the documentation contemplated in the applicable Deposit Agreement. In such case, the Depositary will establish procedures to enable you to elect to receive either cash or additional GDRs, in each case as described in the Deposit Agreements.

If the election is not made available to you, you will, to the extent permitted by law, receive either cash or additional GDRs, depending on what a shareholder in Russia would receive upon failing to make an election, as more fully described in the corresponding Deposit Agreement.

There can be no assurance that holders of GDRs or beneficial interests therein generally, or you in particular, will be given the opportunity to receive elective distributions on the same terms and conditions as the holders of the Shares.

Other Distributions

Whenever we intend to distribute property other than cash, Shares or rights to purchase additional Shares, we will timely notify the Depositary in advance and will indicate whether we wish such distribution to be made to you. If so, we will assist the Depositary in determining whether such distribution to holders is lawful and reasonably practicable.

If the Depositary has received timely prior notice from us, it is reasonably practicable to distribute such property to you and if we have provided all of the documentation contemplated in the Deposit Agreements, the Depositary will distribute the property to the holders in a manner it deems practicable.

The distribution will be made net of fees, expenses, taxes and governmental charges payable by holders under the terms of the Deposit Agreements. In order to pay such taxes and governmental charges, the Depositary may sell all or a portion of the property received.

The Depositary will *not* distribute the property to you and will sell the property if:

- we do not request that the property be distributed to you or we do not make such request in a timely manner or we ask that the property not be distributed to you;
- we fail to deliver satisfactory documents to the Depositary; or
- the Depositary determines that all or a portion of the distribution to you is not lawful or reasonably practicable.

The proceeds of any such sale will be distributed to holders as in the case of a cash distribution. If the Depositary is unable to sell such property, the Depositary may dispose of such property in any way it deems reasonably practicable under the circumstances.

Redemption

Whenever we decide to redeem any of the securities on deposit with the Custodian, we will timely notify the Depositary in advance. If the Depositary has received timely prior notice from us, determined that such redemption is practicable and received from us all of the documentation contemplated in the Deposit Agreements, the Depositary will mail notice of the redemption to the holders.

The Custodian will be instructed to surrender the Shares being redeemed against payment of the applicable redemption price. The Depositary will convert the redemption funds received into U.S. dollars upon the terms of the Deposit Agreements and will establish procedures to enable holders to receive the net proceeds from the redemption upon surrender of their GDRs to the Depositary. (See "—Foreign Currency Conversion" below for actions the Depositary is entitled to take if conversion, transfer and distribution of funds by the Depositary is not practicable or lawful.) You will have to pay fees and charges of, and the expenses incurred by, the Depositary, and any taxes upon the redemption of your GDRs. If less than all GDRs are being redeemed, the GDRs to be redeemed will be selected by lot or on a *pro rata* basis, as the Depositary may determine.

Changes Affecting Shares

The Shares held on deposit for your GDRs are subject to change from time to time. For example, there may be a change in nominal or par value, a split-up, cancellation, consolidation or reclassification of such Shares or a recapitalization, reorganization, merger, consolidation or sale of assets affecting us.

If any such change were to occur, any securities which shall be received by the Depositary or the Custodian in exchange for, or in conversion, replacement or otherwise in respect of, such Shares shall, to the extent permitted by law, be treated as new Shares under the Deposit Agreements, and the GDR certificates shall, subject to the terms of the Deposit Agreements and applicable law, evidence the GDRs representing the right to receive such replacement securities. The Depositary in such circumstances may with our approval, and shall if we so request and provide the Depositary a satisfactory opinion of counsel that such action is not in violation of applicable laws or regulations, execute and deliver additional GDR certificates to you or make appropriate adjustments in its records, or call for the exchange of your existing GDRs for new GDRs. If the Depositary may not lawfully distribute such securities to you, the Depositary may with our approval sell such securities and distribute the net proceeds to you as in the case of a cash distribution, and shall do so if we so request and provide the Depositary a satisfactory opinion of counsel that such action is not in violation of applicable laws or regulations.

The Depositary shall not be responsible for (i) any failure to determine that it is lawful or practicable to make such securities available to holders of GDRs in general or to you in particular, (ii) any foreign exchange exposure or loss incurred in connection with such sale, or (iii) any liability to the purchaser of such securities.

Issuance of GDRs upon Deposit of Shares

Subject to limitations set forth in the Deposit Agreements and the GDRs, the Depositary may create GDRs on your behalf if you or your broker deposit Shares with the Custodian. The Depositary will deliver these GDRs to the person you indicate only after you pay any applicable issuance fees and any charges and taxes payable for the transfer of the Shares to the Custodian and you provide the applicable deposit certification. Your ability to deposit Shares and receive GDRs may be limited by U.S. and Russian legal considerations applicable at the time of deposit.

The Depositary will refuse to accept Shares for deposit whenever it is notified in writing by us that such deposit would result in any violation of applicable laws, including ownership restrictions under Russian laws. The Depositary will also refuse to accept certain Shares for deposit under the Rule 144A Deposit Agreement if notified in writing that the Shares are listed on a U.S. securities exchange or quoted on a U.S. automated inter-dealer quotation system, unless accompanied by evidence satisfactory to the Depositary that any Shares presented for deposit are eligible for resale pursuant to Rule 144A. The Depositary may also, upon receipt of notice from us, limit at any time the number of Shares accepted for deposit under the terms of the Deposit Agreements so as to eliminate or minimize any requirements that may be imposed on us, the Depositary or the GDR facilities existing under the terms of the Deposit Agreements under Russian laws, rules, regulations, or administrative decisions or pronouncements.

The issuance of GDRs may be delayed until the Depositary or the Custodian receives confirmation that all required approvals have been given and that the Shares have been duly transferred to the Custodian. The Depositary will only issue GDRs in whole numbers.

When you make a deposit of Shares, you will be responsible for transferring good and valid title to the Depositary, as evidenced by documents satisfactory to the Depositary or the Custodian. As such, you will be deemed to represent and warrant that:

- the Shares are duly authorized, validly issued, fully paid, non-assessable and legally obtained;

- all preemptive (and similar) rights, if any, with respect to such Shares have been validly waived or exercised;
- you are duly authorized to deposit the Shares;
- the Shares presented for deposit are free and clear of any lien, encumbrance, security interest, charge, mortgage or adverse claim;
- in the case of a deposit of Shares under the Regulation S Deposit Agreement, the Shares are not, and the Regulation S GDRs issuable upon such deposit will not be, "Restricted Securities" (as defined in the Regulation S Deposit Agreement), except in the case of deposits of a kind described in "—Ownership of GDRs by our affiliates" below;
- the Shares presented for deposit have not been stripped of any rights or entitlements;
- the Shares are not subject to any unfulfilled requirements of Russian law; and
- except as provided in the Deposit Agreements and summarized under "—Ownership of GDRs by our affiliates" below, you are not, and you shall not become while holding GDRs, one of our affiliates.

If any of the representations or warranties are incorrect in any way, we and the Depositary may, at your cost and expense, take any and all actions necessary to correct the consequences of the misrepresentations.

When you deposit Shares to receive Rule 144A GDRs, you will be required to provide the Depositary with a deposit certification stating, inter alia, that:

- you acknowledge that the Shares and the Rule 144A GDRs have not been and will not be registered under the Securities Act or with any securities regulatory authority in any state or other jurisdiction in the United States;
- you are not an affiliate of Sistema and you are not acting on behalf of Sistema or one of its affiliates;
- you are (i) a QIB or (ii) a person (other than a U.S. person, as defined in Regulation S) outside the United States and acquired or have agreed to acquire and will acquire the Shares to be deposited outside the United States; and
- you agree, as the owner of the Rule 144A GDRs, to offer, sell, pledge and otherwise transfer the Rule 144A GDRs or the Shares represented by the Rule 144A GDRs in accordance with the applicable U.S. state securities laws and only:
  - to a QIB in a transaction meeting the requirements of Rule 144A; or
  - outside the United States to a person (other than a U.S. person, as defined in Regulation S) outside the United States in accordance with Regulation S; or
  - in accordance with Rule 144 under the Securities Act, if available; or
  - pursuant to an effective registration statement under the Securities Act.

A copy of the form of deposit certification for Rule 144A GDRs is attached to the Rule 144A Deposit Agreement and may be obtained from the Depositary upon request.

When you deposit Shares to receive Regulation S GDRs, you will be required to provide the Depositary with a deposit certification stating, inter alia, that:

- you acknowledge that the Shares and the Regulation S GDRs have not been and will not be registered under the Securities Act or with any securities regulatory authority in any state or other jurisdiction in the United States;
- you are not an affiliate of Sistema and you are not acting on behalf of Sistema or one of its affiliates;
- you are, or at the time the Shares are deposited you will be, the beneficial owner of the Shares and the GDRs to be issued upon deposit of such Shares;
- you are a person (other than a U.S. person, as defined in Regulation S) outside the United States and acquired or have agreed to acquire and will acquire the Shares to be deposited outside the United States; and
- you are not in the business of buying and selling securities or, if you are in such business, you did not acquire the Shares presented for deposit from us or any of our affiliates.

A copy of the form of deposit certification for Regulation S GDRs is attached to the Regulation S Deposit Agreement and may be obtained from the Depositary upon request.

Withdrawal of Shares Upon Cancellation of GDRs

The GDRs representing Shares offered and sold pursuant to the terms of this offering memorandum have been issued by the Depositary on a provisional basis until the Federal Service for the Financial Markets registers the placement report. Until the Federal Service for the Financial Markets registers the placement report, the GDRs representing such Shares will not be eligible for cancellation and withdrawal of underlying Shares. The Depositary will refuse to honor any GDR cancellation requests until such time as we have informed the Depositary in writing that the Federal Service for the Financial Markets has registered the placement report. See "—Registration of Placement Report" above. Thereafter and until the Shares being sold by us can be traded on the RTS Stock Exchange and the Moscow Stock Exchange, when you cancel your GDRs and deliver them to the Depositary, you will receive Shares being sold by the Selling Shareholders, and only if all such Shares shall have been withdrawn will you receive Shares being sold by us, irrespective of how you acquired your GDRs.

Subject always to the withdrawal of deposited property being permitted under applicable laws and the terms of the applicable Deposit Agreement, as a holder you will be entitled to present your GDRs to the Depositary for cancellation and then receive the corresponding number of underlying Shares at the Custodian's offices. Your ability to withdraw the Shares may be limited by U.S. and Russian law considerations applicable at the time of withdrawal.

In order to withdraw the Shares represented by your GDRs, you will be required to pay to the Depositary the fees for cancellation of GDRs and any charges and taxes payable upon the transfer of the Shares being withdrawn and you will be required to provide to the Depositary the applicable withdrawal certification. You assume the risk for delivery of all funds and securities upon withdrawal. Once cancelled, the GDRs will not have any rights under the corresponding Deposit Agreement.

If you hold a GDR registered in your name, the Depositary may ask you to provide proof of identity and genuineness of any signature and such other documents as the Depositary may deem appropriate before it will cancel your GDRs. The withdrawal of the Shares represented by your GDRs may be delayed until the Depositary receives satisfactory evidence of compliance with all applicable laws and regulations. Please keep in mind that if GDRs representing fractional securities are presented for cancellation, the Depositary shall be entitled to sell such fractional securities and remit the proceeds of such sale to you net of fees, expenses, charges and taxes.

When you request the withdrawal of the Shares represented by your Rule 144A GDRs, you will be required to provide the Depositary with a withdrawal certification stating, *inter alia*, that:

(A) you acknowledge that the Shares represented by your Rule 144A GDRs have not been and will not be registered under the Securities Act or with any securities regulatory authority in any state or other jurisdiction in the United States; and

(B) you certify that:

  (1) you are a QIB, acting for your own account or for the account of one or more other QIBs, who is the beneficial owner of the Rule 144A GDRs presented for cancellation; and

    (a) either:

      - you have sold or agreed to sell the Shares to a person (other than a U.S. person, as defined in Regulation S) outside the United States in accordance with Regulation S;
      - you have sold or agreed to sell the Shares to a QIB in a transaction meeting the requirements of Rule 144A; or
      - you will be the beneficial owner of the Shares upon withdrawal and:
        - you (or the person on whose behalf you are acting) will sell the Shares only to another QIB in a transaction meeting the requirements of Rule 144A; to a person (other than a U.S. person, as defined in Regulation S) outside the United States in accordance with Regulation S; in accordance with Rule 144, if available; or pursuant to an effective registration statement under the U.S. Securities Act; and
        - you will not deposit the Shares in any depositary receipts facility that is not a "restricted" depositary receipts facility;

OR

  (2) you are a person (other than a U.S. person, as defined in Regulation S) located outside the United States and acquired or agreed to acquire the Shares outside the United States and will be the beneficial owner of the Shares upon withdrawal.

Holders of Regulation S GDRs are not required to provide the Depositary with a withdrawal certification under the Regulation S Deposit Agreement, except in the case of an exchange of Rule 144A GDRs for sale of Regulation S GDRs by one of our affiliates. See "—Ownership of GDRs by our affiliates" below.

Proofs, Certificates and Other Information

You may be required (i) to provide to the Depositary and the Custodian proof of citizenship or residence, taxpayer status, payment of all applicable taxes or other governmental charges, exchange control approvals, legal or beneficial ownership of GDRs, compliance with all applicable laws and the terms of the Deposit Agreements, and (ii) to execute certifications and to make representations and warranties and to provide such other information and documentation as the Depositary or the Custodian may deem necessary or proper or as we may reasonably require by written request to the Depositary consistent with its obligations under the Deposit Agreements. The Depositary may withhold the execution or delivery or registration of transfer or cancellation of any GDR certificate, or the distribution or sale of any dividend or distribution of rights, until such proof or other information is filed or such certifications are executed, or such representations are made, or such other documentation or information is provided, in each case, to the Depositary's and our reasonable satisfaction.

Ownership of GDRs by Our Affiliates

We permit our affiliates to deposit Shares against the issuance of Rule 144A GDRs, so long as they satisfy the requirements, including delivery of the requisite certifications to the Depositary, of the Rule 144A Deposit Agreement. We also permit our affiliates to exchange their Rule 144A GDRs for Regulation S GDRs solely to allow them to sell their GDRs in transactions meeting the requirements of Regulation S, so long as each exchanging affiliate delivers the requisite certifications to the Depositary and otherwise satisfies the requirements of the Deposit Agreements. We do not otherwise permit our affiliates to deposit Shares against the issuance of Regulation S GDRs unless they certify to the Depositary that they have sold or irrevocably agreed to sell the Regulation S GDRs to be issued in respect of the Shares so deposited in a transaction meeting the requirements of Regulation S, and deliver the other requisite certifications to the Depositary.

The requirements for such deposits and exchanges of GDRs by our affiliates are more fully described in the Deposit Agreements.

Voting Rights

As a holder, you generally have the right under the Deposit Agreements to instruct the Depositary to exercise the voting rights for the Shares represented by your GDRs other than when such GDRs shall be deemed to be issued on a provisional basis. See "—Registration of Placement Report" above. The voting rights of holders of Shares are described in "Description of Share Capital and Certain Requirements of Russian Legislation."

Upon our timely written request, and provided no U.S. or English legal prohibitions (including the rules of the London Stock Exchange) exist, the Depositary will distribute to you any notice of shareholders' meetings or solicitation of consents or proxies from holders of Shares received from us together with information explaining how to instruct the Depositary to exercise the voting rights of the Shares represented by the GDRs.

If the Depositary timely receives voting instructions from a holder of GDRs in the manner specified by the Depositary, it will endeavor—insofar as practicable and permitted under applicable law, the provisions of the applicable Deposit Agreement, our charter and the terms of our Shares—to vote or cause the Custodian to vote the Shares represented by the holder's GDRs in accordance with such voting instructions. Russian securities regulations expressly permit a Depositary to split the vote of Shares registered in its name in accordance with the instructions from GDR holders. However, because the Depositary does not have express statutory authority to split the vote with respect to the Shares in accordance with instructions from GDR holders, and given the untested nature of such securities regulations, the Depositary may refrain from voting at all unless all GDR holders have instructed it to vote the shares in the same manner. Consequently, you may have significant difficulty in exercising voting rights with respect to the underlying Shares. See "Risk Factors—Risks Related to our GDRs and the Trading Market—Your voting rights with respect to the shares represented by our GDRs are limited by the terms of the Deposit Agreements for our GDRs and relevant requirements of Russian law."

Neither the Depositary nor the Custodian will, under any circumstances, exercise any discretion as to voting, vote any number of Shares other than an integral number thereof or vote Shares in a manner that would be inconsistent with any applicable law, and neither the Depositary nor the Custodian will vote, attempt to exercise the right to vote, or in any way make use of for purposes of establishing a quorum or otherwise, the Shares except pursuant to and in accordance with instructions from holders of the GDRs. If the Depositary timely receives voting instructions from a holder of GDRs which fail to specify the manner in which the Depositary is to vote the Shares represented by such holder's GDRs, the Depositary will deem the holder to have instructed the Depositary not to vote the Shares with respect to the items for which no instruction was given.

Notwithstanding anything else contained in the Deposit Agreements, the Depositary shall not have any obligation to take any action with respect to any meeting, or solicitation of consents or proxies, of holders of the Shares if the taking of such action would violate U.S. or English laws, including the rules of the London Stock Exchange. The Company has agreed in the Deposit Agreements that it shall not establish internal procedures that would prevent the Depositary from complying with, or that are inconsistent with, the terms and conditions of the section of the Deposit Agreements which deals with voting.

Please note that the ability of the Depositary to carry out voting instructions may be limited by practical, legal and regulatory limitations and the terms of the securities on deposit. We cannot assure you that you will receive voting materials in time to enable you to return voting instructions to the Depositary in a timely manner. Securities for which no voting instructions have been received from GDR holders will not be voted. See "Risk Factors—Risks Related to our GDRs and the Trading Market—Your voting rights with respect to the shares represented by our GDRs are limited by the terms of the Deposit Agreements for our GDRs and relevant requirements of Russian law."

Fees and Charges

Service	Fees
Issuance of GDRs*	Up to $0.05 per GDR issued
Cancellation of GDRs	Up to $0.05 per GDR cancelled
Distribution of cash dividends or other cash distributions	Up to $0.02 per GDR held
Distribution of GDRs pursuant to stock dividends, free stock distributions or exercise of rights	Up to $0.05 per GDR issued
Distribution of securities other than GDRs or rights to purchase additional GDRs	Up to $0.05 per Share (or Share equivalent) distributed
Annual Depositary Services Fee	Annually up to $0.02 per GDR held at the end of each calendar year except to the extent of any cash dividend fee charged during such calendar year
Transfer of GDRs	$1.50 per GDR certificate presented for transfer
Inspection of share Register	Up to $0.01 per GDR held as of the applicable record date to cover expenses incurred by the Depositary, the Custodian or their respective agents in connection with the inspection of the share register maintained by the share registrar, *provided that* such fee will be charged to any GDR holder not more frequently than once in any calendar year

* No fee shall be incurred or charged in connection with the deposit of Shares in the initial offering.

As a GDR holder you will also be responsible to pay the following charges incurred by the Depositary:

- taxes (including applicable interest and penalties) and governmental charges;
- fees for the transfer and registration of Shares charged by the share registrar (*i.e.*, upon deposit and withdrawal of Shares);
- fees and expenses incurred for converting foreign currency into U.S. dollars and compliance with exchange control regulations;
- expenses for cable, telex and fax transmissions and for delivery of securities; and
- fees and expenses incurred in connection with the delivery or servicing of Shares on deposit.

We have agreed to pay certain other charges and expenses of the Depositary. Note that the fees and charges you may be required to pay may vary over time and may be changed by us and by the Depositary. You will receive prior notice of such changes.

Amendments and Termination

We may agree with the Depositary to modify the Deposit Agreements at any time without your consent. We undertake to give holders 30 days' prior notice of any modifications that would materially prejudice any of their substantial rights under the Deposit Agreements or that shall impose or increase fees or charges (other than charges in connection with foreign exchange control regulations and taxes and other governmental charges, delivery expenses and such other expenses). We will not consider to be materially prejudicial to your substantial rights, among other things, any modifications or supplements that are reasonably necessary for the GDRs to be settled solely in book-entry form, in each case without imposing or increasing the fees and charges you are required to pay. In addition, we may not be able to provide you with prior notice of any modifications or supplements that are required to accommodate compliance with applicable provisions of law.

You will be bound by the modifications to the Deposit Agreements if you continue to hold your GDRs after the modifications to the applicable Deposit Agreements become effective.

The Deposit Agreements cannot be amended to prevent you from withdrawing the Shares represented by your GDRs. Notwithstanding any such restriction on amendments or supplements to the Deposit Agreements, we and the Depositary may at any time amend or supplement the Deposit Agreements or the GDR Certificates in order to comply with mandatory provisions of applicable laws, rules or regulations, and such amendments or supplements may become effective before notice thereof is given to holders or within any other period required to comply with such laws, rules or regulations.

We have the right to direct the Depositary to terminate the Deposit Agreements. Similarly, the Depositary may in certain circumstances on its own initiative terminate the Deposit Agreements. In addition, the Depositary may resign, with such resignation to take effect upon the earlier of 90 days notice or the acceptance of appointment by a successor depositary, or we may remove the Depositary, with such removal to take effect upon the later of 90 days notice or the acceptance of appointment by a successor depositary, and if in either such case no successor depositary shall have accepted appointment by us, then the Depositary may terminate the Deposit Agreements. In either case, the Depositary must give notice to the holders of the GDRs at least 30 days before termination.

Upon termination, the following will occur under the Deposit Agreements:

- for a period of six months after termination, you will be able to request the cancellation of your GDRs and the withdrawal of the Shares represented by your GDRs and the delivery of all other property held by the Depositary in respect of those Shares on the same terms as prior to the termination, including the payment of any applicable taxes or governmental charges. During such six months' period the Depositary will continue to collect all distributions received on the Shares on deposit (*i.e.*, dividends) but will not distribute any such property to you until you request the cancellation of your GDRs.

- after the expiration of such six-month period, the Depositary may sell the securities held on deposit. The Depositary will hold the proceeds from such sale and any other funds then held for the holders of GDRs in an unsegregated, non-interest bearing account, without liability for interest. At that point, the Depositary will have no further obligations to holders other than to account for the funds then held for the holders of GDRs still outstanding, net of fees, expenses, taxes and governmental charges payable by holders under the terms of the Deposit Agreements.

Books of Depositary

The Depositary will maintain GDR holder records at its principal office in New York and, if no book-entry settlement system is available for the relevant GDRs, at its principal office in London as well. You may inspect such records at such office during regular business hours but solely for the purpose of communicating with other holders in the interest of business matters relating to the GDRs and the Deposit Agreements.

The Depositary will maintain facilities in New York and London to record and process the issuance, cancellation, combination, split-up and transfer of GDRs. These facilities may be closed from time to time, to the extent not prohibited by law.

Transmission of Notices to Shareholders

We will promptly transmit to the Depositary those communications that we make generally available to our shareholders. If those communications were not originally in English, we will translate them. Upon our request and at our expense, the Depositary will arrange for the mailing of copies of such communications to all GDR holders and will make a copy of such communications available for inspection at its principal offices in New York and London.

Limitations on Obligations and Liabilities

The Deposit Agreements limit our obligations and the Depositary's obligations to you. Please note the following:

- We and the Depositary are obligated only to take the actions specifically stated in the Deposit Agreements without negligence or bad faith.
- Neither we nor the Depositary, nor any of our or their respective controlling persons or agents, shall be under any obligation to appear in, prosecute or defend any action, suit or other proceeding in respect of any Shares or in respect of the GDR certificates, which in our or their respective opinion may involve us or them (as the case may be) in expense or liability, unless indemnity satisfactory to us or them (as the case may be) against all expense (including fees and disbursements of counsel) and liability be furnished as often as may be required (and no Custodian shall be under any obligation whatsoever with respect to such proceedings, the responsibility of the Custodian being solely to the Depositary).
- The Depositary disclaims any liability for any failure to carry out voting instructions, for any manner in which a vote is cast or for the effect of any vote, provided it acts without negligence and in good faith and in accordance with the terms of the Deposit Agreements.
- The Depositary disclaims any liability for any failure to determine the lawfulness or practicality of any action, for the content of any document forwarded to you on our behalf or for the accuracy of any translation of such a document, for the investment risks associated with investing

in Shares, for the validity or worth of the Shares, for any tax consequences that result from the ownership of GDRs, for the credit-worthiness of any third party, for allowing any rights to lapse under the terms of the Deposit Agreements or for the failure or timeliness of any of our notices.

- The Depositary and the Custodian disclaim any liability with respect to Russia's system of share registration and custody, including any liability in respect of the unavailability of the Shares or other deposited securities (or any distribution in respect thereof).
- The Depositary disclaims any liability for any acts or omissions made by a successor depositary whether in connection with a previous act or omission of the Depositary or in connection with any matter arising wholly after the removal or resignation of the Depositary, provided the Depositary performed its obligations as Depositary without negligence or bad faith.
- We and the Depositary will not be obligated to perform any act that is inconsistent with the terms of the Deposit Agreements.
- We and the Depositary disclaim any liability if we are prevented or forbidden from or delayed in acting on account of any law or regulation, any provision of our charter, any provision of any securities on deposit or by reason of any act of God or war or other circumstances beyond our control (including, without limitation, nationalization, expropriation, currency restrictions, work stoppage, strikes, civil unrest, acts of terrorism, revolutions, rebellions, explosions and computer failure).
- We and the Depositary disclaim any liability by reason of any exercise of, or failure to exercise, any discretion provided for in the Deposit Agreements or in our charter or in any provisions of securities on deposit.
- We and the Depositary further disclaim any liability for any action or inaction in reliance on the advice or information received from legal counsel, accountants, any person presenting Shares for deposit, any holder of GDRs or authorized representatives thereof, or any other person believed by either of us in good faith to be competent to give such advice or information.
- We and the Depositary also disclaim liability for the inability by a holder to benefit from any distribution, offering, right or other benefit which is made available to holders of Shares but is not, under the terms of the Deposit Agreements, made available to you.
- We and the Depositary may rely without any liability upon any written notice, request or other document believed to be genuine and to have been signed or presented by the proper parties.
- We and the Depositary also disclaim any liability for consequential or punitive damages for any breach of the terms of the applicable Deposit Agreement.

Indemnification

The Depositary has agreed to indemnify us and our directors, officers, employees, agents and affiliates against, and hold each of us harmless from, any direct loss, liability, tax, charge or expense of any kind whatsoever (including the reasonable fees and expenses of counsel) which may arise out of acts performed or omitted by the Depositary or the Custodian, provided, that the Custodian is a branch or subsidiary of Deutsche Bank AG at the time of such act or omission, under the Deposit Agreements due to the negligence or bad faith of the Depositary or the Custodian.

We have agreed to indemnify the Depositary, the Custodian and any of their respective directors, officers, employees, agents and affiliates against, and hold each of them harmless from, any direct loss, liability, tax, charge or expense of any kind whatsoever (including the reasonable fees and expenses of counsel) that may arise, *inter alia*, (i) out of any offer or sale of the GDRs or the Shares, (ii) out of any offering document in respect thereof, except to the extent relating to any information provided by the Depositary, or (iii) out of acts performed or omitted in accordance with the provisions of the Deposit Agreements, in any such case by the Depositary, the Custodian or any of their respective directors, officers, employees, agents and affiliates, except to the extent such loss, liability, tax, charge or expense is due to the negligence or bad faith of any of them, or by us or any of our directors, officers, employees, agents and affiliates.

Pre-Release Transactions

The Depositary may, in certain circumstances, issue GDRs before receiving a deposit of Shares or release Shares before receiving GDRs for cancellation. These transactions are commonly referred to as "pre-release transactions." The Deposit Agreements limit the aggregate size of pre-release transactions and imposes a number of conditions on such transactions (*i.e.*, the need to receive collateral, the type of collateral required, the representations required from brokers, etc.). The Depositary may retain the compensation received from the pre-release transactions.

Taxes

You will be responsible for the taxes and other governmental charges payable on the GDRs and the securities represented by the GDRs. We, the Depositary and the Custodian may deduct from any distribution the taxes and governmental charges payable by holders and may sell any and all Shares on deposit to pay the taxes and governmental charges payable by holders. You will be liable for any deficiency if the sale proceeds do not cover the taxes that are due.

The Depositary may refuse to issue GDRs, to deliver, transfer, split and combine GDRs or to release securities on deposit until all taxes and charges are paid by the applicable holder. The Depositary and the Custodian may, but are not obligated to, take reasonable administrative actions to obtain tax refunds and reduced tax withholding for any distributions on your behalf. However, you may be required to provide to the Depositary and to the Custodian proof of taxpayer status and residence and such other information as the Depositary and the Custodian may require to fulfill legal obligations. You are required to indemnify us, the Depositary and the Custodian for any claims with respect to taxes (including applicable interest and penalties thereon) based on any tax benefit obtained for you.

The Depositary is under no obligation to provide you with any information about our tax status. The Depositary shall not incur any liability for any tax consequences that may be incurred by you on account of your ownership of the GDRs, including without limitation by virtue of our tax status.

By purchasing GDRs, you agree to indemnify the Depositary, us, the Custodian and any of their or our agents, officers, employees and affiliates for, and to hold each of them and us harmless from, any claims with respect to taxes (including applicable interest and penalties thereon) arising from any tax benefit obtained for you as a GDR holder.

Disclosure of Interests

By purchasing GDRs, you agree to comply with requests from us or the Depositary pursuant to Russian law, the rules and requirements of any stock exchange on which the Shares are, or may be, registered, traded or listed, or our charter, which are made to provide information, *inter alia*, as to the capacity in which you hold or own a beneficial interest in the GDRs (and the Shares, as the case may be) and regarding the identity of any other person interested in such GDRs, the nature of such interest and various related matters, whether or not you are a holder or owner of a beneficial interest in the GDRs at the time of such request.

Foreign Currency Conversion

The Depositary will arrange for the conversion into U.S. dollars of all foreign currency received if such conversion is practicable, and it will distribute the U.S. dollars in accordance with the terms of the Deposit Agreements. You will have to pay fees and expenses incurred in converting foreign currency, such as fees and expenses incurred in complying with currency exchange controls and other governmental requirements.

The Depositary may, but is not obliged to, make any filing with any governmental authority required to obtain an approval or license necessary for any conversion of any foreign currency into or distribution of U.S. dollar funds. If the conversion of foreign currency is not practicable or lawful, or if any required approvals are denied or not obtainable at a reasonable cost or within a reasonable period, the Depositary may take the following actions in its discretion:

- Convert the foreign currency to the extent practicable and lawful and distribute the U.S. dollars to the holders for whom the conversion and distribution is lawful and practicable.
- Distribute the foreign currency to holders for whom the distribution is lawful and practicable.
- Hold the foreign currency (without liability for interest) for the applicable holders.

The Depositary will not invest the currency it cannot convert and it will not be liable for any interest thereon. If exchange rates fluctuate during a time when the Depositary cannot convert the rubles, you may lose some or all of the value of the distribution.

Governing Law and Arbitration of Disputes

Although New York law has been chosen to govern the construction and interpretation of the Deposit Agreements and the GDRs, the rights of holders of the Shares and other deposited securities and our obligations and duties in respect of such holders shall be governed by the laws of Russia (or such other jurisdiction's laws as may govern the deposited securities).

Under the terms of the Deposit Agreements owners of GDRs agree that any dispute, controversy or cause of action against us and/or the Depositary arising out of the GDRs, the Deposit Agreements, the Shares or other deposited securities will be referred to and resolved by arbitration in accordance with the rules of the London Court of International Arbitration in proceedings in London, England, as more fully described in the Deposit Agreements.

EACH PARTY TO THE DEPOSIT AGREEMENTS, INCLUDING HOLDERS AND BENEFICIAL OWNERS OF GDRs, IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY APPLICABLE LAW, ANY RIGHT IT MAY HAVE TO A TRIAL BY JURY IN ANY LEGAL PROCEEDING DIRECTLY OR INDIRECTLY ARISING OUT OF OR RELATING TO THE DEPOSIT AGREEMENTS OR THE TRANSACTIONS CONTEMPLATED UNDER THE DEPOSIT AGREEMENTS.

Russian Share Register

We have appointed OJSC Reestr as the registrar of our Shares in Russia and we have agreed to continue such appointment so long as the GDRs remain outstanding or any of the Deposit Agreements remain in force.

We have agreed in the Deposit Agreements to:

- take any and all actions reasonably necessary to ensure the accuracy and completeness of all of the information contained in the register of shareholders maintained by the share registrar;

- provide or use our reasonable efforts to cause the share registrar to provide unrestricted access by the Depositary and the Custodian to the register of shareholders regularly (and not less than monthly) so as to permit verification of the registration of Shares represented by the GDRs in the name of the Depositary or the Custodian or their respective nominees;
- use our reasonable efforts to cause the share registrar to promptly notify the Depositary (i) of any material and uncured breaches by the share registrar of the terms of the Deposit Agreements, and (ii) any time the share registrar will no longer be able materially to comply with, or has engaged in conduct that indicates it will not materially comply with, the provisions of the Deposit Agreements relating to it;
- use our reasonable efforts to cause the share registrar to promptly re-register the Shares being deposited into or withdrawn from the GDR facilities; and
- use our reasonable efforts to cause the share registrar to promptly notify the Depositary (i) of any alleged unlawful elimination of shareholders from the shareholder register (or any alleged unlawful alteration of shareholder records), (ii) of any alleged unlawful refusal to register shares, and (iii) any time the share registrar holds the Shares for its own account.

In the Deposit Agreements we have agreed to assume sole liability for:

- any act or failure to act of the share registrar (other than as a result of any act or failure to act by the Depositary or the Custodian);
- unavailability of Shares on deposit under the terms of the Deposit Agreements; and
- failure of the Depositary to make any distributions contemplated by the Deposit Agreements as a result of our actions, the actions of the share registrar (other than as a result of any act or failure to act by the Depositary or the Custodian), and actions of our agents, our charter (or other documents relating to the Shares), and any provisions of any securities we issue or distribute and any related distribution or offering.

The Depositary has agreed, for the benefit of the owners of GDRs, to confirm not less frequently than monthly, the number of Shares identified on the share register as being on deposit pursuant to the terms of the Deposit Agreements. We have agreed with the Depositary that the Custodian shall maintain in custody duplicate share extracts provided by the share registrar and that any known discrepancies between the records of the Depositary and the Custodian, on the one hand, and the records of the share registrar, on the other hand, will be brought to our attention promptly. We will use our reasonable efforts to cause the share registrar to reconcile any discrepancies and to effectuate the requisite corrections to the share register. In the event we are unable to obtain such reconciliation of records and the discrepancy exceeds 0.5% of the number of Shares identified on the records of the Depositary or the Custodian as being on deposit under the terms of any one of the Deposit Agreements, we will give notice thereof to the owners of GDRs (through the Depositary) and the Depositary shall cease issuance of new GDRs until the records have been appropriately reconciled.

Securities Act and Other Legends

Legends for Rule 144A GDRs

NEITHER THIS RULE 144A GDR CERTIFICATE, NOR THE RULE 144A GDRs EVIDENCED HEREBY, NOR THE SHARES REPRESENTED THEREBY HAVE BEEN OR WILL BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES. THE OFFER, SALE, PLEDGE OR OTHER TRANSFER OF THIS RULE 144A GDR CERTIFICATE, THE RULE 144A GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY

EACH IS SUBJECT TO CERTAIN CONDITIONS AND RESTRICTIONS. THE HOLDERS AND THE BENEFICIAL OWNERS HEREOF, BY PURCHASING OR OTHERWISE ACQUIRING THIS RULE 144A GDR CERTIFICATE AND THE RULE 144A GDRs EVIDENCED HEREBY, ACKNOWLEDGE THAT SUCH RULE 144A GDR CERTIFICATE, THE RULE 144A GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT AND AGREE FOR THE BENEFIT OF THE COMPANY AND THE DEPOSITARY THAT THIS RULE 144A GDR CERTIFICATE, THE RULE 144A GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY MAY BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY IN COMPLIANCE WITH THE SECURITIES ACT AND APPLICABLE LAWS OF THE STATES, TERRITORIES AND POSSESSIONS OF THE UNITED STATES GOVERNING THE OFFER AND SALE OF SECURITIES AND ONLY (1) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH REGULATION S UNDER THE SECURITIES ACT, (2) TO A PERSON WHOM THE HOLDER AND THE BENEFICIAL OWNER REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A UNDER THE SECURITIES ACT PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF ANOTHER QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A, (3) PURSUANT TO AN EXEMPTION FROM THE REGISTRATION REQUIREMENTS OF THE SECURITIES ACT PROVIDED BY RULE 144 UNDER THE SECURITIES ACT (IF AVAILABLE), OR (4) PURSUANT TO AN EFFECTIVE REGISTRATION STATEMENT UNDER THE SECURITIES ACT.

THE BENEFICIAL OWNER OF SHARES RECEIVED UPON CANCELLATION OF ANY RULE 144A GDR MAY NOT DEPOSIT OR CAUSE TO BE DEPOSITED SUCH SHARES INTO ANY DEPOSITARY RECEIPT FACILITY ESTABLISHED OR MAINTAINED BY A DEPOSITARY BANK, OTHER THAN A RULE 144A RESTRICTED DEPOSITARY RECEIPT FACILITY, SO LONG AS SUCH SHARES ARE "RESTRICTED SECURITIES" WITHIN THE MEANING OF RULE 144(a)(3) UNDER THE SECURITIES ACT. NO REPRESENTATION CAN BE MADE AS TO THE AVAILABILITY OF THE EXEMPTION PROVIDED BY RULE 144 UNDER THE SECURITIES ACT FOR RESALE OF THE SHARES OR THE RULE 144A GDRs.

EACH HOLDER AND BENEFICIAL OWNER, BY ITS ACCEPTANCE OF THIS RULE 144A GDR CERTIFICATE OR A BENEFICIAL INTEREST IN THE RULE 144A GDRs EVIDENCED HEREBY, AS THE CASE MAY BE, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING RESTRICTIONS.

PRIOR TO RECEIPT BY THE DEPOSITARY OF WRITTEN NOTICE FROM THE COMPANY THAT A REPORT ON THE RESULTS OF THE ISSUE OF THE SHARES ISSUED BY THE COMPANY AND PLACED IN THE INITIAL OFFERING BY THE COMPANY HAS BEEN REGISTERED WITH THE RUSSIAN FEDERAL SERVICE FOR THE FINANCIAL MARKETS, THE RULE 144A GDRs REPRESENTED HEREBY ARE ISSUED ON A PROVISIONAL BASIS. PRIOR TO RECEIPT OF SUCH NOTICE, NOTWITHSTANDING ANYTHING IN THIS RULE 144A GDR CERTIFICATE OR THE RULE 144A DEPOSIT AGREEMENT TO THE CONTRARY, THE DEPOSITARY SHALL NOT, EXCEPT AS SPECIFICALLY DESCRIBED BELOW, DELIVER ANY SHARES PURSUANT TO PARAGRAPH 2 OF THIS RECEIPT AND SECTION 2.7 OF THE RULE 144A DEPOSIT AGREEMENT AND THE DEPOSITARY SHALL NOT VOTE, OR CAUSE TO BE VOTED, SECURITIES DEPOSITED THEREUNDER, AND HOLDERS SHALL NOT BE ENTITLED TO GIVE VOTING INSTRUCTIONS, AS CONTEMPLATED BY

PARAGRAPH 19 OF THIS RECEIPT AND SECTION 4.10 OF THE RULE 144A DEPOSIT AGREEMENT.

IF A REPORT ON THE RESULTS OF ISSUANCE OF THE SHARES ISSUED BY THE COMPANY AND PLACED IN THE INITIAL OFFERING HAS NOT BEEN REGISTERED WITH THE RUSSIAN FEDERAL SERVICE FOR THE FINANCIAL MARKETS ON OR BEFORE THE DATE WHICH IS 60 DAYS AFTER THE CLOSING DATE FOR SUCH OFFERING (OR SUCH LATER DATE AS THE COMPANY, THE SELLING SHAREHOLDERS AND THE UNDERWRITERS PARTICIPATING IN THE OFFERING MAY AGREE), UPON WRITTEN NOTICE BY A REPRESENTATIVE OF THE UNDERWRITERS FOR THE INITIAL OFFERING THE PROCEEDS OF THE PLACEMENT OF THE SHARES SHALL BE RETURNED TO THE DEPOSITARY AND FROM THE TIME OF RECEIPT OF SUCH FUNDS THIS RULE 144A GDR CERTIFICATE WILL REPRESENT THE RIGHT TO RECEIVE A PROPORTIONAL INTEREST IN THE FUNDS SO RECEIVED. THE FUNDS SO RECEIVED BY THE DEPOSITARY IN ANY CURRENCY OTHER THAN U.S. DOLLARS WILL BE CONVERTED INTO U.S. DOLLARS (AT MARKET RATES THEN AVAILABLE) AND DISTRIBUTED TO HOLDERS OF RULE 144A GDRs, IN EACH CASE UPON THE TERMS OF THE RULE 144A DEPOSIT AGREEMENT. THE RULE 144A GDRs WILL BE CANCELLED BY THE DEPOSITARY UPON DISTRIBUTION OF THE PROPORTIONAL INTERESTS IN THE FUNDS SO RECEIVED, CONVERTED (IF NECESSARY) AND DISTRIBUTED TO THE HOLDER OF THIS RULE 144A GDR CERTIFICATE. THE FUNDS SO RECEIVED, CONVERTED (IF NECESSARY) AND DISTRIBUTED TO HOLDERS OF RULE 144A GDRs MAY BE LESS THAN THE PRICE AT WHICH THE RULE 144A GDRs HAVE BEEN SOLD BY THE COMPANY OR THE SELLING SHAREHOLDERS OR PURCHASED BY THE HOLDER THEREOF, AND MAY BE SUBJECT TO WITHHOLDING TAXES OR DELAYS.

IT IS EXPECTED THAT THE SHARES DEPOSITED HEREUNDER WILL BE REGISTERED ON THE SHARE REGISTER MAINTAINED BY THE RUSSIAN SHARE REGISTRAR OF THE COMPANY IN THE NAME OF DEUTSCHE BANK TRUST COMPANY AMERICAS, AS DEPOSITARY, OR ITS NOMINEE, OR OF THE CUSTODIAN, OR ITS NOMINEE. HOLDERS AND BENEFICIAL OWNERS SHOULD BE AWARE, HOWEVER, THAT RUSSIA'S SYSTEM OF SHARE REGISTRATION AND CUSTODY CREATES RISKS OF LOSS THAT ARE NOT NORMALLY ASSOCIATED WITH INVESTMENTS IN OTHER SECURITIES MARKETS. THE DEPOSITARY WILL NOT BE LIABLE FOR THE UNAVAILABILITY OF SHARES OR FOR THE FAILURE TO MAKE ANY DISTRIBUTION OF CASH OR PROPERTY WITH RESPECT THERETO AS A RESULT OF SUCH UNAVAILABILITY.

THE DEPOSITARY HAS BEEN ADVISED BY RUSSIAN COUNSEL THAT COURTS IN THE RUSSIAN FEDERATION ARE NOT REQUIRED TO RECOGNIZE OR ENFORCE JUDGMENTS OBTAINED IN THE FEDERAL COURTS OF THE UNITED STATES OF AMERICA OR THE COURTS OF THE STATE OF NEW YORK.

Legends for Regulation S GDRs

NEITHER THIS REGULATION S GDR CERTIFICATE, NOR THE REGULATION S GDRs EVIDENCED HEREBY, NOR THE SHARES REPRESENTED THEREBY HAVE BEEN OR WILL BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933, AS AMENDED (THE "SECURITIES ACT"), OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES. THE OFFER, SALE, PLEDGE OR OTHER TRANSFER OF THIS REGULATION S GDR CERTIFICATE, THE REGULATION S GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED

THEREBY EACH IS SUBJECT TO CERTAIN CONDITIONS AND RESTRICTIONS. THE HOLDERS AND THE BENEFICIAL OWNERS HEREOF, BY PURCHASING OR OTHERWISE ACQUIRING THIS REGULATION S GDR CERTIFICATE AND THE REGULATION S GDRs EVIDENCED HEREBY, ACKNOWLEDGE THAT SUCH REGULATION S GDR CERTIFICATE, THE REGULATION S GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY HAVE NOT BEEN REGISTERED UNDER THE SECURITIES ACT AND AGREE FOR THE BENEFIT OF THE COMPANY AND THE DEPOSITARY THAT THIS REGULATION S GDR CERTIFICATE, THE REGULATION S GDRs EVIDENCED HEREBY AND THE SHARES REPRESENTED THEREBY MAY BE REOFFERED, RESOLD, PLEDGED OR OTHERWISE TRANSFERRED ONLY IN COMPLIANCE WITH THE SECURITIES ACT AND APPLICABLE LAWS OF THE STATES, TERRITORIES AND POSSESSIONS OF THE UNITED STATES GOVERNING THE OFFER AND SALE OF SECURITIES.

EACH HOLDER AND BENEFICIAL OWNER, BY ITS ACCEPTANCE OF THIS REGULATION S GDR CERTIFICATE OR A BENEFICIAL INTEREST IN THE REGULATION S GDRs EVIDENCED HEREBY, AS THE CASE MAY BE, REPRESENTS THAT IT UNDERSTANDS AND AGREES TO THE FOREGOING RESTRICTIONS.

PRIOR TO RECEIPT BY THE DEPOSITARY OF WRITTEN NOTICE FROM THE COMPANY THAT A REPORT ON THE RESULTS OF THE ISSUE OF THE SHARES ISSUED BY THE COMPANY AND PLACED IN THE INITIAL OFFERING BY THE COMPANY HAS BEEN REGISTERED WITH THE RUSSIAN FEDERAL SERVICE FOR THE FINANCIAL MARKETS, THE REGULATION S GDRs REPRESENTED HEREBY ARE ISSUED ON A PROVISIONAL BASIS. PRIOR TO RECEIPT OF SUCH NOTICE, NOTWITHSTANDING ANYTHING IN THIS REGULATION S GDR CERTIFICATE OR THE REGULATION S DEPOSIT AGREEMENT TO THE CONTRARY, THE DEPOSITARY SHALL NOT, EXCEPT AS SPECIFICALLY DESCRIBED BELOW, DELIVER ANY SHARES PURSUANT TO PARAGRAPH 2 OF THIS RECEIPT AND SECTION 2.7 OF THE REGULATION S DEPOSIT AGREEMENT AND THE DEPOSITARY SHALL NOT VOTE, OR CAUSE TO BE VOTED, SECURITIES DEPOSITED THEREUNDER, AND HOLDERS SHALL NOT BE ENTITLED TO GIVE VOTING INSTRUCTIONS, AS CONTEMPLATED BY PARAGRAPH 19 OF THIS RECEIPT AND SECTION 4.10 OF THE REGULATION S DEPOSIT AGREEMENT.

IF A REPORT ON THE RESULTS OF ISSUANCE OF THE SHARES ISSUED BY THE COMPANY AND PLACED IN THE INITIAL OFFERING HAS NOT BEEN REGISTERED WITH THE RUSSIAN FEDERAL SERVICE FOR THE FINANCIAL MARKETS ON OR BEFORE THE DATE WHICH IS 60 DAYS AFTER THE CLOSING DATE FOR SUCH OFFERING (OR SUCH LATER DATE AS THE COMPANY, THE SELLING SHAREHOLDERS AND THE UNDERWRITERS PARTICIPATING IN THE OFFERING MAY AGREE), UPON WRITTEN NOTICE BY A REPRESENTATIVE OF THE UNDERWRITERS FOR THE INITIAL OFFERING THE PROCEEDS OF THE PLACEMENT OF THE SHARES SHALL BE RETURNED TO THE DEPOSITARY AND FROM THE TIME OF RECEIPT OF SUCH FUNDS THIS REGULATION S GDR CERTIFICATE WILL REPRESENT THE RIGHT TO RECEIVE A PROPORTIONAL INTEREST IN THE FUNDS SO RECEIVED. THE FUNDS SO RECEIVED BY THE DEPOSITARY IN ANY CURRENCY OTHER THAN U.S. DOLLARS WILL BE CONVERTED INTO U.S. DOLLARS (AT MARKET RATES THEN AVAILABLE) AND DISTRIBUTED TO HOLDERS OF REGULATION S GDRs, IN EACH CASE UPON THE TERMS OF THE REGULATION S DEPOSIT AGREEMENT. THE REGULATION S GDRs WILL BE CANCELLED BY THE DEPOSITARY UPON DISTRIBUTION OF THE PROPORTIONAL INTERESTS IN THE FUNDS SO RECEIVED,

CONVERTED (IF NECESSARY) AND DISTRIBUTED TO THE HOLDER OF THIS REGULATION S GDR CERTIFICATE. THE FUNDS SO RECEIVED, CONVERTED (IF NECESSARY) AND DISTRIBUTED TO HOLDERS OF REGULATION S GDRs MAY BE LESS THAN THE PRICE AT WHICH THE REGULATION S GDRs HAVE BEEN SOLD BY THE COMPANY OR THE SELLING SHAREHOLDERS OR PURCHASED BY THE HOLDERS THEREOF, AND MAY BE SUBJECT TO WITHHOLDING TAXES OR DELAYS.

IT IS EXPECTED THAT THE SHARES DEPOSITED HEREUNDER WILL BE REGISTERED ON THE SHARE REGISTER MAINTAINED BY THE RUSSIAN SHARE REGISTRAR OF THE COMPANY IN THE NAME OF DEUTSCHE BANK TRUST COMPANY AMERICAS, AS DEPOSITARY, OR ITS NOMINEE, OR OF THE CUSTODIAN, OR ITS NOMINEE. HOLDERS AND BENEFICIAL OWNERS SHOULD BE AWARE, HOWEVER, THAT RUSSIA'S SYSTEM OF SHARE REGISTRATION AND CUSTODY CREATES RISKS OF LOSS THAT ARE NOT NORMALLY ASSOCIATED WITH INVESTMENTS IN OTHER SECURITIES MARKETS. THE DEPOSITARY WILL NOT BE LIABLE FOR THE UNAVAILABILITY OF SHARES OR FOR THE FAILURE TO MAKE ANY DISTRIBUTION OF CASH OR PROPERTY WITH RESPECT THERETO AS A RESULT OF SUCH UNAVAILABILITY.

THE DEPOSITARY HAS BEEN ADVISED BY RUSSIAN COUNSEL THAT COURTS IN THE RUSSIAN FEDERATION ARE NOT REQUIRED TO RECOGNIZE OR ENFORCE JUDGMENTS OBTAINED IN THE FEDERAL COURTS OF THE UNITED STATES OF AMERICA OR THE COURTS OF THE STATE OF NEW YORK.

REGULATION

Our businesses are subject to numerous laws and regulations which are summarized below by segment.

Telecommunications

Regulation in the Russian Federation

In the Russian Federation, the federal government regulates telecommunications services. The principal law regulating telecommunications in the Russian Federation is the Federal Law on Communications, which provides, among other elements, for the following:

- licensing of telecommunications services;
- requirements for obtaining a radio frequency allocation;
- equipment certification;
- equal rights for individuals and legal entities, including foreign individuals and legal entities, to offer telecommunications services;
- fair competition;
- freedom of pricing other than pricing by companies with monopoly power; and
- liability for violations of Russian legislation on telecommunications.

The new Federal Law on Communications came into force on January 1, 2004 and replaced the law of 1995 regulating the same subject matter. The Federal Law on Communications creates a framework in which government authorities may enact specific regulations. Regulations enacted under the legislative framework in place prior to enactment of the Federal Law on Communications continue to be applied to the extent they do not conflict with the Federal Law on Communications. In the transition period before these regulations are put in compliance with the new law, it is not clear how they would interact with provisions of the new law.

The new law, which confers broad powers to the state to regulate the communications industry, including the allocation of frequencies, the establishment of fees for frequency use and the allocation and revocation of numbering capacity, significantly modifies the system of government regulation of the provision of communications services in Russia. In particular, while under the previous law the Ministry of Information Technologies and Communications issued licenses for the provision of wireless communications services at its own discretion, under the new law, licenses to provide communications services in territories where frequency and numbering capacity are limited may be issued only on the basis of a tender. In addition, the new law provides for the establishment of a "universal services reserve fund" to be funded by a levy imposed on all telecommunications service providers, including us. See "Risk Factors—Risks Relating to the Russian Federation and Ukraine—Legal Risks and Uncertainties—The implementation of the new Federal Law on Communications will impose an additional financial burden on us which may materially adversely affect our financial condition and results of operations." The new law also attempts to simplify the succession of licenses to merged or otherwise reorganized companies by instituting a license re-issuance procedure, whereas under the previous law, merged or reorganized companies were required to apply to the Ministry of Information Technologies and Communications for the issuance of a new license in such circumstances.

Another federal law which currently applies to only one of our subsidiaries, MGTS, is the Federal Law on Natural Monopolies, enacted in August 1995. The Federal Law on Natural Monopolies establishes the legal basis for federal regulation of natural monopolies, including those engaged in the communications market, and provides for governmental control over tariffs and certain activities of natural monopolies, or regulated entities. This law greatly impacts telecommunications providers that are included in the register of the natural monopolies, including their freedom to set tariffs. The Federal Law on Natural Monopolies outlines types of transactions into which a regulated entity may enter only with a prior approval of the Federal Antimonopoly Service and sets forth the general principle that regulated entities may not refuse to provide regulated services to certain types of consumers. Regulated entities are subject to continuous reporting requirements, including submitting plans for capital investments.

Regulatory authorities

The Russian telecommunications industry is regulated by several governmental agencies. These agencies, whose functions are not always clearly defined, form a complex, multi-tier system of regulation that resulted, in part, from the implementation of the Federal Law on Communications, as well as from the March 2004 large-scale restructuring of the Russian government. The system of regulation is still evolving and further changes are expected.

The Ministry of Information Technologies and Communications is the federal executive body that develops and supervises the implementation of governmental policy in the area of communications and coordinates and controls the activities of its subordinate agencies. The Ministry may issue regulations in the area of communications if authorized to do so by federal legislation (including presidential and governmental decrees).

The following bodies, each of which is subordinate to the Ministry of Information Technologies and Communications, also regulate the telecommunications industry.

The Federal Service for Supervision in the Area of Communications is a federal executive body that supervises and controls certain areas of communications and information technologies, including:

- the issuance of licenses and permissions in the area of communications and informatization;
- the registration of radio-electronic and high-frequency equipment;
- the technical supervision of networks and network equipment throughout Russia;
- the monitoring of compliance by network operators with applicable regulations, terms of their licenses and terms of the use of frequencies allocated to them; and
- the enforcement of equipment certification requirements.

The Federal Agency of Communications is a federal executive body that implements governmental policy, manages federal property and provides public services in the area of communications, including:

- the allocation of radio frequencies based on decisions taken by the State Radio Frequencies Commission and registration of such allocations;
- the allocation of numerical resources;
- the certification of equipment for compliance with technical requirements;
- the examination of electromagnetic compatibility of equipment with existing civil radioelectronic equipment; and
- the organization of tenders with respect to licenses in the sphere of communications.

The State Radio Frequencies Commission is an inter-agency coordination body acting under the Ministry of Information Technologies and Communications which is responsible for the regulation of radio frequency spectrum and develops a long-term policy for frequency allocation in the Russian Federation.

Other regulatory authorities. In addition, the Federal Antimonopoly Service supervises competition regulations and enforces the Federal Law on the Natural Monopolies and the regulations enacted thereunder. The Federal Tariffs Service regulates certain tariffs in the sphere of telecommunications, including the tariffs on the local and DLD calls by subscribers of PSTNs and installation and subscription fees. The Federal Service for Supervision in the Area of Consumer Rights Protection and Human Well-Being is responsible for the enforcement of sanitary regulations, including some authority over the location of telecommunications equipment, and supervises the compliance of companies with the regulations relating to the protection of consumer rights.

Licensing of telecommunications services and radio frequency allocation

Telecommunications licenses are issued based on the Regulations on Licensing in the Field of Telecommunications in the Russian Federation, enacted in June 1994, as amended, and, with regard to wireless telecommunications services, on the Approval of Regulations for Holding a Competitive Tender for Receipt of Licenses Associated with the Provision of Cellular Radiotelephone Services, enacted in June 1998. Under these regulations, licenses for telecommunications services were issued and renewed for periods ranging from three to fifteen years. Under the new law, effective January 1, 2004, licenses may be issued and renewed for periods ranging from three to twenty-five years. Several different licenses to conduct different communication services may be issued to one entity. Provided the licensee has conducted its activities in accordance with the applicable law and terms of the license, renewals may be obtained upon application to the Ministry of Information Technologies and Communications. Officials of the Ministry of Information Technologies and Communications have broad discretion with respect to both issuance and renewal procedures.

A company must complete a multi-stage process before the commercial launch of its communications network. A company must:

- obtain approval to use specific frequencies within the specified band from the State Radio Frequencies Commission and the Federal Agency of Communications if providing wireless telecommunications services;
- receive a license from the Federal Service for Supervision in the Area of Communications to provide communications services; and
- obtain permission from the Federal Service for Supervision in the Area of Communications for network operations. To receive this permission, a wireless telecommunications services provider must develop a frequency allocation and site plan, which is then reviewed and certified by the Federal Service for Supervision in the Area of Communications for electromagnetic compatibility of the proposed cellular network with other radio equipment operating in the license area. The Federal Service for Supervision in the Area of Communications has discretion to modify this plan, if necessary, to ensure such compatibility.

For fixed line providers, the Federal Service for Supervision in the Area of Communications examines the compliance of the fixed line network with the regulatory standards and requirements before the issuance of the permission for network operations.

Under the old Federal Law on Communications and related licensing regulations the transfer of a license, including assignment or pledge of a license as collateral, was prohibited except for transfer of licenses for the provision of wireless telecommunications services awarded through a competitive tender. Effective January 1, 2004, the prohibitions on the transfer of licenses were relaxed and in particular in case of mergers licenses may be re-issued upon application by a transferee as a new license holder following the transfer. Additionally, the Ministry of Information Technologies and Communications has declared that agreements on the provision of telecommunications services must be concluded and performed by the license holder.

If the terms of a license are not fulfilled or the service provider violates applicable legislation, the license may be suspended or terminated. Licenses may be suspended for various reasons, including:

- failure to comply with Russian law or the terms and conditions of the license;
- failure to provide services for over three months from the start-of-service date set forth in the license; and
- annulment of a frequency allocation if it results in the inability to render communications services.

In addition, licenses may be terminated for various reasons by the court, including:

- failure to remedy in a timely manner a violation that led to the suspension of the license;
- provision of inaccurate information in documents on the basis of which a license was issued; and
- failure to fulfill obligations undertaken in the process of a tender or auction.

The license may also be terminated in a number of cases, including liquidation of a license holder or failure to pay a license fee on time.

A suspension or termination of a license may be appealed in court. From time to time we receive notices of violations of licenses from the regulatory authorities, and the CDMA license for the Moscow license area of our subsidiary P-Com was temporarily suspended in October and November, 2002.

Frequencies are allocated for a maximum term of 10 years which may be extended upon the application of a frequency user. Under the new Federal Law on Communications, frequency allocations may be changed for purposes of state management, defense, security and protection of legal order in the Russian Federation with the license holder to be compensated for related losses. Further, frequency allocations may be suspended or terminated for a number of reasons, including failure to comply with the conditions on which frequency was allocated.

Also, under the new Law on Communications frequency allocations may be changed for the purposes of the state management, defense, security and protection of legal order in the Russian Federation with compensation of losses to the license holder out of such change. Further, a frequency allocation may be suspended or terminated in a number of cases, including failure to comply with conditions on which a frequency was allocated.

The following one-time license fees are payable in respect of each region covered by the license: 15,000 rubles, for services involving use of a frequency spectrum, lease of communication channels running beyond one region of Russia as well as in number of other cases specified by law; and 1,000 rubles in other cases. The license fee for a license received through a tender or auction is determined by the terms of such tender or auction.

In addition to licensing fees, a government decree enacted on June 2, 1998 requires payment of fees for the use of radio frequencies for cellular telephone services. The payment procedure was established by a government decree enacted on August 6, 1998 which requires that all wireless telecommunications services operators pay an annual fee set by the State Radio Frequencies Commission and approved by the Federal Antimonopoly Service for the use of their frequency spectrums. Additionally, as prescribed in government decree No. 223 on Reorganization of the System of State Surveillance over Telecommunications, dated April 26, 2004, operators must make monthly payments to fund supervisory services in the communications sphere. In 2004, this fee amounted to 0.3% of revenues generated from the provision of communications services. In addition, the new Federal Law on Communications contemplates an industry-wide levy to finance a supervisory arm of the Ministry of Information Technologies and Communications. See “Risk Factors—Risks Relating to the Russian Federation and Ukraine—Legal Risks and Uncertainties—The implementation of the new

Federal Law on Communications will impose an additional financial burden on us which may materially adversely affect our financial condition and results of operations.''

The new Federal Law on Communications empowers the Russian Government to determine and annually review the list of licensing conditions. Licenses also generally contain a number of other detailed conditions, including a date by which service must begin, technical standards and a schedule of the number of subscribers and percentage coverage of the licensed territory that must be achieved by specified dates. We have either commenced service by the applicable deadline or received an extension of the applicable deadline for all of our licenses.

Equipment certification

Telecommunications equipment must be certified to be used in the interconnected communications network of the Russian Federation, which includes all fixed line and wireless networks open to the public. All networks of our telecommunications subsidiaries must be certified. A government decree on Regulation of Use of Equipment in the Interconnected Telecommunications Network, enacted on August 5, 1999, gives the Ministry of Information Technologies and Communications and the Federal Antimonopoly Service the right to restrict the use of certain equipment, including equipment manufactured outside Russia, and to set the technical requirements for the equipment used in the interconnected telecommunications network. The Federal Agency of Communications issues certificates of compliance with technical requirements to equipment suppliers based on the Agency's internal review. In addition, a Presidential decree requires that licenses and equipment certifications be obtained from the Federal Security Service to design, produce, sell, use or import encryption devices. Some commonly used digital cellular telephones are designed with encryption capabilities and must be certified by the Federal Security Service.

Furthermore, certain high-frequency equipment, a list of which was approved by Government Resolution No. 539 of October 12, 2004, manufactured or used in the Russian Federation requires special permission from the Federal Service for Supervision in the Area of Communications. These permissions are specific to the entity that receives them and do not allow the use of the equipment by other parties.

A Ministry of Information Technologies and Communications decree enacted on January 14, 1997 also directs PSTN operators to give preference to Russian producers when purchasing switching equipment. PSTN operators must receive permission from the Ministry of Information Technologies and Communications in order to purchase foreign-produced equipment.

Competition, interconnection and pricing

The Federal Law on Communications requires federal regulatory agencies to encourage competition in the provision of communication services and prohibits the abuse of a dominant position to limit competition. The Federal Law on Communications provides that telecommunications tariffs may be regulated in cases provided for by legislation. Presidential Decree No. 221, enacted on February 28, 1995, on Measures for Streamlining State Regulation of Prices (Tariffs), and a government decree enacted on October 11, 2001, allow for regulation of tariffs and other commercial activities of telecommunications companies that are ''natural monopolies.'' Government Decree No. 332, dated June 30, 2004, authorized the Federal Tariffs Service to set the following tariffs for the natural monopolies in the communication market:

- installation fees;
- monthly subscription fees; and
- local call charges, including per-minute charges, if used by the operator.

In accordance with the Federal Law on the Natural Monopolies, the Federal Antimonopoly Service maintains a Register of Natural Monopolies. A telecommunications operator may be included in this register if: (1) there is no other operator providing similar services and (2) the operator is properly licensed. At present, only one of our subsidiaries, MGTS, is included in the Register of Natural Monopolies and is subject to these regulations. For a discussion of current the Federal Antimonopoly Service tariffs that apply to MGTS see "Business—Incumbent PSTN fixed line communications services—Regulated Services."

The Federal Antimonopoly Service also has certain oversight authority with regard to rates between certain regional telephone operators, long distance provider Rostelecom and wireless operators. In addition, Russian legislation requires that operators of PSTNs may not refuse to provide connections or discriminate against one operator in favor of another. However, a regional fixed line operator may charge different interconnection rates to different wireless operators. Notwithstanding the above, fixed line operators not included in the Register of Natural Monopolies, as well as wireless operators, are free to set their own tariffs.

The new Law on Communications effective January 1, 2004, provides for a special regulation of PSTN providers which together with their affiliates have not less than 25% of installed capacity or territory coverage locally or in the Russian Federation generally or have capacity to carry out transmission of not less than 25% of traffic. In particular, the new law regulates in greater detail interconnection procedures and their contracts. In addition, such PSTN providers will be included in a special register and their tariffs for connection and traffic transmission services will be regulated by the state.

Internet access and data transmission services regulation

In general, provision of Internet access and data transmission services is subject to the same regulations as the provision of other communications services, including the licensing and equipment certification requirements.

The Federal Law on Information, Information Technologies and Protection of Information, and the Federal Law on Participation in the International Information Exchange are framework laws in the Internet and data transmission market, and most of the provisions of which require further implementation through regulations enacted by governmental bodies. Among other elements, the Federal Laws on Information, Protection of Information, and Participation in the International Information Exchange provide for the following:

- an obligation of the owner of a communications network to protect the copyright and other rights of the author of the information transmitted through the network in accordance with the legislation of the Russian Federation;
- a prohibition against providing international access to certain information, including confidential information, access to which is restricted under the regulations of the Russian Federation;
- licensing of services related to, and certification of equipment used for, work with confidential and other restricted information;
- licensing of international information exchange activities related to the creation or use of governmental information resources;
- the authority of the Federal Antimonopoly Service to prevent monopolistic and anti-competitive activities in connection with international information exchange;
- liability for the distribution of corrupt or untrue foreign documentary information received by means of international exchange; and
- the authority of regulatory bodies to suspend international information exchange for up to two months in the event of any regulatory violations related to such exchange.

Numbering capacity

Historically, telephone numbering in Moscow has been based on the three-digit area code, or prefix, plus a seven-digit local code system, allowing for a theoretical total capacity of 9,999,999 telephone numbers to be allocated within any given area. In practice, a significant amount of numbers are reserved for emergency services, toll-free numbers, long distance dialing codes and other government needs, thus limiting the actual capacity. Wireless operators in Russia initially began offering wireless services in Moscow using direct Moscow numbers rented from both incumbent and alternative operators. As a result, the Moscow "095" code has become a premium feature, primarily appealing to businesses and heavy users of wireless telephony services. Despite the introduction of prefixes allocated to wireless operators, mobile numbers with the Moscow "095" code remain a premium product, and with the growth of wireless penetration in Moscow, the demand for these numbers has increased significantly. The principal means of obtaining new numbers is to buy or lease them from operators with spare capacity, such as MGTS or MTU-Inform, at premium prices. To resolve this shortage of available numbering capacity, it is expected that Moscow will be divided into two area codes, "095" (north) and "499" (south). However, this plan requires significant investment by MGTS, and may take years before it is completed. As long as "095" numbers remain in high demand, renting numbering capacity to other operators will remain a major source of revenue for operators with free capacity.

The new Law on Communications, effective January 1, 2004, regulates issues related to the numbering capacity which previously were determined at the discretion of the Ministry of Information Technologies and Communications. In particular, the new law and its implementing regulation adopted by Government Decree No. 350, dated July 13, 2004, grant the Federal Agency of Communications the right to change or withdraw the numbering capacity and sets forth various reasons for which numbering capacity withdrawals are allowed, including termination of the license, non-use of the numbering capacity during two years since the allocation of numbering capacity and non-payment on time for allocation of the numbering capacity.

Regulation in Ukraine

Regulatory Authorities

The State Department on Communications and Informatization, or SDCI (formerly the State Committee on Communications and Informatization, or SCCI), regulates the telecommunications industry largely through the issuance of regulations, establishment of requirements relating to the quality of telecommunications services and technical requirements relating to telecommunications networks and facilities. The SDCI also oversees the technical condition and development of the telecommunications industry, including the development of standards and technical rules and supervision of the GSM, D-AMPS, NMT and TDMA networks. The SDCI was established in September 2004 as a division of the Ministry of Transport and Communications of Ukraine, or MTCU. The MTCU was established in July 2004 as a result of the merger of the Ministry of Transport and the SCCI. The SDCI is headed by a director nominated by the Minister of Transport and Communications and appointed by the Cabinet of Ministers of Ukraine.

The National Commission for the Regulation of Communications, or NCRC, established by the new Telecommunications Law described in "—Legislation" below, is an independent regulatory body that will consist of seven members and a chairperson. The members and chairperson of the NCRC are nominated by the Prime Minister and appointed by the President of Ukraine for a five-year term. Although the NCRC had yet to be formed as of the date of this offering memorandum, the NCRC technically took over responsibility for issuing licenses for telecommunication services commencing January 1, 2005 as well as various other responsibilities of the SDCI from that date. The SDCI, on the other hand, remains responsible mainly for establishing and overseeing technical policies and standards.

The State Center for Radio Frequencies of Ukraine, or SCRF. While licenses for radio frequencies for wireless communications are issued by the NCRC, the SCRF is the authority responsible for all technical issues related to the use of radio frequency resources and, in such capacity, is also involved in the issuance of radio frequency licenses. In particular, the SCRF determines frequency availability and the technical aspects of frequency allocation, as well as provides the NCRC with an expert opinion in relation to each application for radio frequency. The SCRF also monitors use of the frequencies and will continue monitoring compliance with the license terms and physically inspecting operators and providers of telecommunications services until the establishment of the State Inspection of Communications, as described below. The SCRF also independently issues individual permissions for the use of radio-electronic and radio-emitting equipment, its development, import, sale and purchase.

The State Inspection of Communications, or SIC, established by the new Telecommunications Law, will be a division of the NCRC. The SIC will be responsible for the general supervision of the telecommunications market and the use of radio frequency resources. The SIC will also monitor compliance with license terms, physically inspect operators and providers of telecommunications services and, together with the SCRF, review cases relating to administrative violations in the areas of telecommunications and radio frequencies. The SCRF will perform the functions of the SIC until the SIC's establishment.

Legislation

The principal legislation regulating the telecommunications industry consists of the Law on Telecommunications dated November 18, 2003, or the Telecommunications Law, and the Radio Frequencies Law dated June 1, 2000, or the Radio Frequencies Law. The Radio Frequencies Law was amended in its entirety in June 2004.

The Telecommunications Law has yet to be implemented and the NCRC has yet to be formed. Thus, as of the date of this offering memorandum, the NCRC has not commenced regulating the telecommunications area and issuing telecommunications licenses, and no other regulatory authority has been designated under the law to perform these functions. Regulations implementing the 1995 Communications Law (now repealed) and the Radio Frequencies Law prior to its amendment are still in effect, as are certain regulations enacted prior to the 1995 Communications Law and the Radio Frequencies Law. Telecommunications operators are required to comply with the Telecommunications Law and the Radio Frequencies Law as well as with the older regulations to the extent that such regulations do not conflict with the Telecommunications Law or the 2004 amendments of the Radio Frequencies Law. Consequently, the current regulatory environment for telecommunications in Ukraine is complicated and uncertain.

The Telecommunications Law provides for, among other things, equal rights for individuals and legal entities, including foreign entities, to offer telecommunications services, fair competition and freedom of pricing. The Telecommunications Law also sets forth the legal, economic and organizational framework for the operation of companies, associations and government bodies forming part of the telecommunications and postal networks. The licensing of telecommunications services, the requirements for equipment certification and liability for violations of Ukrainian legislation on telecommunications are also determined by this legislation. The Telecommunications Law also governs the relations between the state and local governmental bodies, telecommunications operators, organizations and users of telecommunications services and radio frequencies.

The Telecommunications Law addresses new areas of telecommunications services in Ukraine, including numbering requirements, tariff and settlement regulations, interconnection, public telecommunication services, market access rules and licensing issuance and renewal. The Telecommunications Law also significantly expands the definition of the telecommunication services market, including in its scope Internet Protocol telecommunications, transmission of data and facsimile communications.

The Telecommunications Law also restructured the regulatory bodies governing the area of telecommunications. It provided for the creation of the NCRC, which, as of January 1, 2005, is assigned many powers previously held by the SDCI. The NCRC is authorized, *inter alia*, to issue regulations for the telecommunications services, issue telecommunications licenses to operators and providers, issue frequency licenses, request information from operators, providers and authorities, impose administrative penalties and maintain the register of the operators and providers. The NCRC is also authorized to conduct hearings and to resolve disputes among operators concerning the interconnection of telecommunications networks. The powers of the SDCI in the telecommunications area are now relegated primarily to that of technical standards overseer.

Foreign investments in Ukrainian telecommunications operators are not limited; however, in order to provide telecommunications services in Ukraine an entity must be located on the territory of Ukraine and registered in accordance with Ukrainian legislation.

The Radio Frequencies Law sets forth comprehensive rules regarding the allocation, assignment, interrelation and use of radio frequencies, the licensing of the users of radio frequencies and other relevant issues. The 2004 amendments to the Radio Frequencies Law introduced new procedures for issuance, re-execution and termination of frequency licenses and operation permits.

Licensing of Telecommunications Services and Radio Frequency Allocation

Ukrainian legislation provides for two types of telecommunications licenses: telecommunications licenses and frequency licenses. Prior to January 1, 2005, the SDCI issued telecommunications and frequency licenses based on the Law on Licensing Certain Types of Business Activity dated June 1, 2000, the Telecommunications Law and the Radio Frequencies Law. Commencing January 1, 2005, the NCRC has assumed responsibility for issuing telecommunications licenses and frequency licenses pursuant to the Telecommunications Law and the 2004 amendments to the Radio Frequencies Law.

Telecommunications licenses are issued for the following specific types of telecommunications services:

- fixed telephone (local, intercity, international) communication services;
- mobile telecommunications services;
- technical maintenance and exploitation of telecommunications networks and the lease of electric communications channels; and
- intercity and international telecommunications services.

Other telecommunications services do not require licenses.

An operator that is granted a telecommunications license may not commence the provision of wireless telecommunications services until it receives a frequency license. The issuance of a frequency license is, in turn, subject to the availability of radio frequencies in the respective regions of Ukraine. Frequency licenses are issued for specific bandwidths within certain frequency spectrums in specific regions. The GSM spectrum is presently considered to be the most commercially attractive for telecommunications operators. It is currently deemed to be virtually impossible to obtain a license for GSM frequencies in major Ukrainian cities because most of the GSM radio frequencies in such cities are already licensed to the existing GSM operators, including us.

Under applicable legislation, licenses for telecommunications services may be issued and renewed for periods of not less than five years, with the actual period generally ranging from 10 to 15 years. Renewal of a license is made by an application submitted to the NCRC at least four months prior to the expiration of the license term. NCRC officials have fairly broad discretion with respect to both the issuance and the renewal of licenses. The Telecommunications Law further provides that the NCRC must award licenses on a first-come-first-serve basis within 30 days from submission of an application. If resources are limited or consumer interests so require, the NCRC may adopt a decision to limit the number of licenses. In this event, the law requires that such decision be made public along with the rationale and that the licenses be allocated through a tender.

In accordance with the Radio Frequencies Law, the NCRC issues a frequency license concurrently with the issuance of the license for the type of telecommunication services requiring use of radio frequency resources. A telecommunications operator that has a respective telecommunications license may apply for licenses for additional radio frequency bands. Frequency licenses may not be issued for a period shorter than the term of the relevant telecommunications license.

Under applicable legislation, a public tender or an auction for a radio frequency license must be held by the NCRC if demand for radio frequency resources exceeds available resources. Radio frequency licenses issued on the basis of a public tender or an auction for the same type of radio technology must include identical conditions regarding the radio frequency bands and development period.

Applicable legislation prohibits the transfer of a license by the licensee, including by means of assignment or pledge of a license as collateral, and agreements regarding the provision of telecommunications services must be executed and performed by the actual licensee.

Licenses generally contain a number of detailed conditions, including the date by which service must be commenced, the requirement to use only certified equipment, the technical standards which must be observed and the requirement to comply with all environmental regulations. Frequency licenses issued after January 1, 2005 will also contain the date by which the radio frequency resources must be fully utilized.

Telecommunications operators are subject to strict environmental regulations, especially regarding electromagnetic radiation; construction and technical maintenance of a telecommunications network must be carried out in accordance with local regulations applicable in particular regions of Ukraine. Telecommunications operators must submit periodical reports to the NCRC on the amount and quality of services provided under the telecommunications license. We believe we are in material compliance with the applicable laws and regulations related to our Ukrainian licenses.

Some licenses also provide that services for persons entitled to certain social benefits must be provided at or below maximum tariffs established by Ukrainian legislation in effect at that time.

If the terms of a license are not fulfilled or the service provider violates legislation, the license may be suspended or terminated. Both telecommunications services licenses and radio frequency licenses may be terminated for various reasons, including:

- failure to comply with the terms and conditions of the license, including failure to provide services within the period set forth in the license;
- provision of inaccurate information in the application or about the communications services rendered to consumers;
- refusal to provide documents requested by the NCRC or the SIC;
- failure to remedy in a timely manner the circumstances which resulted in a violation of the license terms;
- unfair competition by the license holder in providing the licensed services;

- repeated violation of the license terms;
- transfer or assignment of the license to a third party; and
- other grounds set forth by Ukrainian laws or international treaties.

Radio frequency licenses may also be terminated for the following reasons:

- failure to commence using radio frequency resources within the time period specified in the license;
- termination of use of radio frequency resources specified in the license for more than one year; and
- failure to use radio frequency resources to the full extent within the time period specified in the license.

Decisions of the NCRC on termination of licenses may be appealed in court.

Equipment Certification

The Telecommunications Law requires that all technical devices and equipment to be used in networks of general use must be certified in Ukraine. All radio equipment must also be certified in Ukraine.

If the equipment a prospective operator intends to use is certified in Ukraine by either the manufacturer or the vendor, there is no need for the operator to go through the equipment certification process. However, if the equipment is not certified in Ukraine or if it is certified by a third party that is unwilling or unable to give the operator its permission to utilize its certification, then the operator will need to apply for the certification of the equipment in its own name.

The Radio Frequencies Law provides that users of radio frequency resources must obtain permits for the operation of radio-electronic and radio-emitting equipment, except for equipment used on a permit-free basis in accordance with this law. In order to obtain such operation permit, a company is required to file an application with the SCRF. The Radio Frequencies Law also requires producers and importers of radio-electronic and radio-emitting equipment to be used in the territory of Ukraine to register such equipment with the NCRC.

Competition

The Communications Law provides that one of the purposes of the licensing of telecommunication services is to encourage competition and de-monopolization in the telecommunications industry.

The Anti-monopoly Committee of Ukraine, or the AMC, is the state administrative body charged with the administration of competition legislation and the protection and regulation of economic competition in Ukraine, including economic competition among industry participants in the telecommunications sector.

Ukrainian anti-monopoly legislation prohibits a company operating in Ukraine from using its dominant position in its market to gain an unfair or anti-competitive advantage in the provision of its services or products. A business entity is deemed to be in a dominant position if such entity has no competitor in the market or is not subject to substantial competition due to restricted access or entry barriers for other business entities. Moreover, Ukrainian antimonopoly legislation sets forth that a company having more than 35% of the market share in a given product market may be deemed to be in the dominant position on such market, unless it proves that it is subject to substantial competition.

A telecommunications operator which is found by the AMC to have a dominant position in the market, in particular, may specifically be required to:

- annually submit to the NCRC irrevocable public offers regarding interconnection with the other operators' telecommunications networks;
- comply with the regulations of the NCRC regarding the technical, organizational and commercial terms of interconnection with the other operators' telecommunications networks;
- comply with the calculation factors set by the NCRC for access to the operator's own network;
- not discriminate against other players in the telecommunications market; and
- undertake to develop the "public telecommunications services" at the operator's own expense if the NCRC so decides based on the insufficient supply of such services in certain regions.

Although UMC currently has over a 35% market share of the wireless communications market in Ukraine, it has not been declared a dominant market force by the AMC. In September 2003, the AMC began a review of the telecommunications services market for the purpose of determining the status of competition and the existence of dominant market forces. In August 2004, the AMC notified UMC and its largest competitor, Kyivstar, that the preliminary results of its review of the wireless telecommunications industry indicated that each of UMC and Kyivstar qualified as having a dominant position in the market. The AMC offered UMC and Kyivstar the opportunity to submit their objections to these preliminary findings and indicated that it would issue a decision following its review thereof. On December 21, 2004, the AMC announced its issuance of a decision in which it confirmed that neither UMC nor Kyivstar qualified as having a dominant position in the wireless communications market.

In addition, following disruptions of UMC's service that occurred in the Kiev area on August 31, 2004 and on September 1-2, 2004, the AMC issued a recommendation to UMC to (i) restore trouble-free network operation and provision of cellular services of due quality; (ii) reimburse damages caused to UMC's subscribers; and (iii) take measures to prevent such disruptions in the future. According to an AMC press release, UMC carried out these recommendations by, *inter alia*, providing compensation to subscribers affected during the period of service disruptions and installing a new switchboard that would service 350,000 additional subscribers.

Tariffs

Telecommunications tariffs are regulated by the NCRC for:

- "public telecommunications" services; and
- access to the telecommunications networks (use of electric communications channels) of the operator with the dominant position on the market.

The Telecommunications Law withdrew the authority of the Cabinet of Ministers of Ukraine to regulate the prices for telecommunications services.

Prior to enactment of the Telecommunications Law, the SCCI set maximum tariffs for fixed line public telecommunications services and for access to the wireless communications networks from local universal telephone networks. These tariffs will be revised or cancelled pursuant to the Telecommunications Law. There are currently no other tariff limits in respect of wireless telecommunications services or operators. It is not yet clear how the NCRC will regulate the tariffs for telecommunications services.

Also, where competition laws are violated, the AMC can find tariffs unfair and injurious to competition. In such cases, the AMC may request the violating telecommunications operator to remedy the situation, in particular, by amending its tariff schedule.

Subject to the above, wireless operators are free to set tariffs at levels they consider appropriate.

Interconnection

As of January 1, 2005, interconnection activity is to be regulated by the NCRC. Operators may provide offers for interconnection to the NCRC, and the NCRC is required to publish on an annual or regular basis a catalog of such offers. Operators with a dominant market position in the market are obligated to submit interconnection offers to the NCRC for each catalog.

Interconnection is made pursuant to interconnection agreements between network operators. Such agreements are required under the law to contain certain provisions. An operator with a dominant market position cannot refuse an offer to conclude an interconnection agreement with another operator if the offeror has offered points of interconnection that were previously published by the NCRC in the catalog of interconnection proposals.

The NCRC is authorized to conduct hearings and to resolve disputes among operators concerning the interconnection of telecommunications networks. The decision of the NCRC is binding upon the parties in the dispute.

Technology

There is no specific regulatory regime relating to the development and production of microelectronics, industrial electronics and household appliances under Russian law. However, certain federal laws and by-laws set forth general requirements applicable to these industries, a few examples of which are described below.

Licensing

Current legislation generally does not provide specific licensing requirements in respect of the production of microelectronics, industrial electronics and household appliances. However, the development and manufacturing of integrated microcircuits for military purposes requires a license from the Federal Agency on Industry.

Standardization

Production processes are generally regulated by the Federal Law on Technical Regulation, or the Law on Technical Regulation. This law contains provisions on technical regulations, standardization, certification, accreditation of certification agencies and test laboratories, state control over compliance with the requirements of technical regulations, penalties for violations of technical regulations, product withdrawals and other related issues. In addition, Gosstandart of the Russian Federation, or Gosstandart, sets forth certain quality requirements in relation to microelectronics, industrial electronics and household appliances.

Certification

Industrial electronics and household appliances are certified in accordance with the Rules of Certification of Electronic Equipment approved by Gosstandart, which establishes the procedure for certification, the basis for issuing of compliance certificates and other related rules.

In accordance with the Order of the Ministry of Health on Sanitary-Epidemiological Testing of Products, prior to certification and prior to being put into production, industrial electronics and household appliances must be subjected to sanitary-epidemiological testing to confirm the compliance of the goods with the applicable sanitary-epidemiological requirements. Some goods (including video recorders and DVD and CD players) are exempted from the obligatory sanitary-epidemiological testing.

Legal protection of intellectual property

Generally, industrial intellectual property is governed by the Patent Law of the Russian Federation, or the Patent Law. This law addresses issues which may arise in connection with the legal protection and use of inventions, useful models and industrial designs.

The Federal Law on the Legal Protection of Topologies of Integrated Microcircuits, or the IMC Law, regulates relations arising in connection with the creation, legal protection and use of topologies. The IMC Law protects the right of authorship as an inalienable personal right for an indefinite period of time. The author or some other right-holder enjoys the exclusive right to the protected topology. The IMC Law also sets forth the procedure for registering the right of authorship to topology, the time limit of the exclusive right to a protected topology and rules concerning the infringement of the exclusive right to the protected topology.

Insurance

Insurance activities in Russia are generally governed by the Federal Law on the Organization of Insurance Business in the Russian Federation, or the Insurance Law. Insurance activities carried out in Russia are supervised by the Federal Service for Insurance Supervision, or the FSIS.

The law on obligatory motor third-party liability insurance was adopted in 2003 and is expected to open significant opportunities for the further growth of the market.

Licensing

As of September 30, 2004 ROSNO is licensed to provide 97 types of obligatory and voluntary insurance.

Licensing of insurance organizations (other than medical insurance organizations engaged in obligatory medical insurance) is broadly governed by the Insurance Law and the Conditions of Licensing of Insurance Activities on the territory of the Russian Federation, or the Conditions, approved by the Order of the Federal Service of the Russian Federation for the Supervision of Insurance Activities, one of the predecessors of the FSIS.

Medical insurance organizations engaged in obligatory medical insurance are licensed on the basis of the Federal Law on Medical Insurance of Citizens in the Russian Federation, as amended, and the Rules of Licensing of Medical Insurance Organizations Engaged in Obligatory Medical Insurance approved by the government.

Insurance organizations with foreign investments are licensed on the basis of the Regulations on the Issue of Licenses to Insurance Organizations with Foreign Investments, or the Regulations. For the purposes of the Regulations, insurance organizations with foreign investments include insurance organizations of which more than 49% of the share capital belongs to foreign investors and subsidiaries of foreign insurance organizations.

An insurance license must be obtained from the FSIS for any insurance activity as defined in the Insurance Law and set out in greater detail in the Conditions. In addition, applicants with foreign investments must submit detailed information about each of their foreign investors, including a confirmation from the relevant regulatory authorities of such foreign investor's country of incorporation certifying that such foreign investor has been engaged in the insurance business for not less than 15 years at the time of application as well as a confirmation by the relevant insurance organizations certifying the participation of such foreign investor in the insurance business of such Russian insurance organization for not less than two years.

An application for a license may generally be refused if the application documents do not comply with applicable requirements or, in the case of insurance organizations with foreign investments, if the overall share of all foreign investors in the capital of Russian insurance organizations (and their subsidiaries) exceeds 25% or the application is made for the conduct of insurance prohibited for applicants with foreign investments, such as life insurance and obligatory insurance, or the capital requirements of such applicant are not met by the time of application.

An insurance license may be limited in its application, suspended or revoked by the FSIS in the case of violations by an insurance organization of the Insurance Law. Details are set out in the Insurance Law and the Ministry of Finance Regulations on the Procedure for the Limitation, Suspension and Revocation of a License for the Exercise of Insurance Activities in the territory of the Russian Federation.

Scope of insurance activities

According to the most recent amendments to the Insurance Law, insurance organizations may be engaged in either life insurance, which can be combined with health and voluntary medical insurance, or property insurance, which can be combined with health and voluntary medical insurance. Therefore, life insurance may not be combined with property insurance. Insurance organizations combining such activities and established before the amendments of the Insurance Law are required to choose the relevant type of insurance activities by July 1, 2007. In addition, according to the most recent amendments to the Insurance Law, insurance organizations may not combine life insurance and reinsurance of property risks as of January 17, 2003 when the amendments took effect. Although the latter rule is currently suspended, ROSNO provides life insurance through a subsidiary to comply with this requirement.

Subject to licensing, insurance organizations without foreign investments or insurance organizations with foreign investments (other than a foreign investor's subsidiary or a company in which foreign investment exceeds 49% of share capital) can engage in any type of insurance activity as permitted by the Insurance Law. Insurance organizations with foreign investments may broadly engage only in voluntary insurance and are prohibited from engaging in obligatory insurance and life insurance, except in the case of an insurance organization (i) which is a subsidiary of a foreign company from a member-state party to the Partnership and Cooperation Agreement between the Russian Federation and the European Union, dated June 24, 1994, or (ii) having more than 49% of its charter capital consisting of investments made by such foreign investors.

A company providing obligatory medical insurance services may not engage in any insurance activities other than obligatory and voluntary medical insurance. To comply with this requirement, ROSNO provides such services through a subsidiary.

Capital requirements

The Insurance Law sets minimum equity (share capital) requirements for insurance organizations. The minimum capital requirement is set at 30 million rubles (approximately $1.0 million), in the case of health and medical insurance and/or property insurance; 60 million rubles (approximately $2.0 million), in the case of health and medical insurance and life insurance; 60 million rubles (approximately $2.0 million), in the case of only life insurance; and 120 million rubles (approximately $4.0 million), in the case of reinsurance. Insurance organizations established prior to January 16, 2004, are required to increase their charter capital in three stages: (i) at least one-third of the total established charter capital must have been paid by July 1, 2004; (ii) at least two-thirds of the total established charter capital must be paid by July 1, 2006; and (iii) the established charter capital must be paid in full by July 1, 2007.

Solvency

Statutory solvency requirements are established by FSIS and are based on insurers maintaining a minimum ratio of net asset value to premium written. The required rate is thus a premium-based calculation for the non-life business. FSIS requires that the excess of the actual solvency margin over the normative level should be over 30%. The actual solvency margin is calculated as equity plus retained earnings minus expired receivables, intangibles and certain other items. The normative solvency margin is calculated as the sum of:

- for non-life business: 16% of GWP for the rolling year on the reporting date adjusted to the rate of reinsurance participation in claims; and
- for life business: 5% of life reserve adjusted to the rate of reinsurance participation in life reserve.

Insurance reserve requirements

Insurance organizations must maintain a number of specified reserves, such as an unearned premium reserve, a reserve for declared but unsettled losses, a reserve for losses incurred but not claimed and a stabilization reserve. Each reserve is broadly calculated by reference to the relevant type of insurance contracts multiplied by the total number of insurance contracts for that type of insurance.

Insurance organizations must also maintain an established ratio of assets to insurance liabilities, calculated on the basis of the financial statements of an insurance organization prepared in accordance with Russian Accounting Standards. Accumulated insurance reserves may only be invested in permitted assets such as Russian debt and equity securities, real estate, cash and certain other defined investments.

Medical insurance organizations engaged in obligatory medical insurance must comply with the Procedural Recommendations of the Federal Fund for Obligatory Medical Insurance on the Setting by the Local Funds for Obligatory Medical Insurance of Financial Reserve Rates and Expenditures for the Conduct of Business for Medical Insurance Organizations Engaged in Obligatory Medical Insurance.

Banking

Banking activities in Russia are governed by the Federal Law on Banks and Banking, or the Banking Law, and the Federal Law on the Central Bank of Russia, or the Central Bank Law. The Central Bank of Russia's supervisory roles are outlined below. Other institutions generally have only indirect authority over banks. For example, the Federal Service for Financial Markets issues licenses for banking institutions that act as professional participants in the Russian securities market.

Licensing

A license must be obtained from the Central Bank of Russia for any "banking activity," as defined in the Banking Law. Applicants must be incorporated within the Russian Federation, submit an application for state registration, including a feasibility report, and submit detailed information on management suitability and other information.

MBRD holds a general banking license that allows it to serve both resident and non-resident customers in Russian rubles and foreign currencies.

Mandatory economic ratios

The Central Bank of Russia is authorized to introduce various capital adequacy and liquidity requirements applicable to banks. Such requirements currently exist in the form of the relevant mandatory economic ratios, including minimum capital adequacy ratios, liquidity ratios, etc. In addition, the Central Bank of Russia has introduced minimum provisioning levels.

The capital base of a bank is calculated on the basis of Russian Accounting Standards and defined in Central Bank of Russia regulations as the aggregate amount of its main capital (including, among other items, its statutory charter capital, paid-in capital and certain reserve and other internal funds, as well as certain categories of profit) and additional capital (including, *inter alia*, revaluation surpluses and subordinated loans) decreased by shortfalls in provisioning and loss allowances and by certain other amounts.

Capital requirements

The Central Bank of Russia sets minimum equity (charter capital) requirements for banks. Under Central Bank of Russia Directive No. 1346-U of December 1, 2003, the minimum capital requirement is set at €5 million for each newly-founded bank. Banks with charter capital that exceeds their capital base, are required to adjust their capital base (or, if impossible, their charter capital) accordingly. The procedure for reduction of a bank's charter capital and for adjustment of the amount of a bank's capital base is established by Central Bank of Russia Directive No. 1260-U of March 24, 2003.

Reporting requirements

Banks must regularly submit to the Central Bank of Russia their balance sheets, together with financial statements, all under Russian Accounting Standards, showing their financial position. Banking groups and consolidated groups (*i.e.*, alliances of legal entities in which one bank, directly or indirectly, controls decisions of the governing bodies of the other banks or legal entities and non-credit organizations within such alliances, respectively) must regularly submit consolidated financial statements to the Central Bank of Russia.

The Central Bank of Russia may, at any time, conduct full or selective checks of a bank's financial reports, and may inspect all of its accounting books and records.

Accounting practices

The Central Bank of Russia has established accounting policies for credit organizations and a standard format for the presentation of a bank's financial statements. A bank's financial statements and other accounting information must be prepared and submitted in accordance with Central Bank of Russia Directive No. 1375-U "On the Rules for the Preparation and Submission of Reports to the Central Bank of Russia by Credit Organizations" dated January 16, 2004.

Starting with periods after January 1, 2004, all credit organizations are required to reconcile their accounting reports prepared in accordance with Russian Accounting Standards to IFRS. IFRS financial statements will be required for periods commencing after January 1, 2006.

Money-laundering legislation

Under the Federal Law "On Combating Legalization (Laundering) of Criminally Gained Income and Financing of Terrorism," or the Money-Laundering Law, and Central Bank of Russia Regulation No. 207-P of December 20, 2002, Russian banks are required to provide to the Federal Service on Financial Monitoring of the Russian Federation through the Central Bank of Russia information relating to transactions involving monetary funds and other property subject to obligatory control. The list of such transactions is set out in the Money-Laundering Law and includes, among others, any transaction with monetary funds or other property with a value of not less than 600,000 rubles (approximately $20,000) and satisfying the following criteria:

- where such transaction is in cash;

- where any party to such transaction is a legal entity or individual located in a state which is not a party to any international treaties relating to money-laundering or financing of terrorism; and
- where such transaction is carried out on an anonymous basis.

The Central Bank of Russia has established procedures, instructions and standard formats for banks to follow in recording and reporting such transactions.

MBRD has a unit which monitors transactions involving monetary funds and other property subject to obligatory control. If a transaction satisfies the criteria outlined above, the unit reports information relating to such transaction to MBRD's top management and to regulators.

Mandatory reserve requirements

Pursuant to the Central Bank Law, the Board of Directors of the Central Bank of Russia may establish mandatory reserve requirements for banks in order to regulate general liquidity within the banking system. Currently, banks are required to post mandatory reserves to be held on non-interest bearing accounts with the Central Bank of Russia in the amount equal to 3.5% in respect of funds in rubles and foreign currency held for legal entities and individuals and 2% in respect of short-term funds in rubles and foreign currency attracted from non-resident banks.

The Central Bank of Russia and its regional units have a right to conduct unscheduled audits of credit organizations to check their compliance with the reserves rules.

Provisioning and loss allowances

The Central Bank of Russia put in place certain rules concerning the creation of allowances for loan losses by banks. Central Bank of Russia Instruction No. 62a of June 30, 1997 requires the banks to adopt procedures for calculation and posting of allowances for loan losses and for the continuous monitoring of the financial position of the banks' borrowers.

The Central Bank of Russia distinguishes three levels of security provided for a loan. Depending on such level of security and the credit history of the borrower, the banks are required to classify all loans given by them into four categories: (i) standard (low risk) loans; (ii) non-standard (moderate risk) loans; (iii) doubtful (high risk) loans; and (iv) hopeless loans. Thus, depending on the category of the loans, the banks are required to create reserves in the amount of (i) 1%; (ii) 20%; (iii) 50%; and (iv) 100% of the principal amount of the loans, respectively. If one borrower received several loans from the bank, all of such borrower's loans are required to be classified in the highest risk category applicable to any of such loans.

Allowances for loan losses are calculated at the end of each calendar month in rubles, and then adjusted each month. Such allowances are only used to cover losses relating to the principal amount of the loans made by banks and/or amounts of promissory notes that exclude the relevant interest and discount. The Central Bank of Russia and its regional units have the right to audit the banks' compliance with the requirements relating to allowances for loan losses and check the correct calculation of such allowances in order to balance the need to create allowances on the one hand and ensure the correct preparation of the banks' financial statements for tax purposes on the other.

Since August 1, 2004, Russian credit organizations are required to calculate and establish their allowances for loan losses in accordance with Regulation No. 254-P, dated March 26, 2004. This new regulation replaced Central Bank of Russia Instruction No. 62a and has introduced a number of new rules. In particular, it requires credit organizations to rank their loans into five categories instead of four, and the range of loans that must be provided for has been extended to include rights assigned under contracts, mortgages acquired in the secondary markets, claims relating to purchase of financial assets with deferred payment, rights under repossession contracts (if such repossession contracts are concluded in respect of unlisted securities) and some other operations. The new regulation established that loans classified as Category I loans (standard loans) need not be provided for. Additionally, credit organizations are required to classify their loan security into two groups on the basis of its quality. The new regulation provides for a somewhat simplified procedure with respect to writing off bad debts, especially minor debts, as compared with the previously existing procedure.

The Central Bank of Russia also established rules concerning creation of allowances for possible losses, other than loan losses, which may include losses from investments in securities, funds held in correspondent accounts of other banks, contingent liabilities, forward and other transactions. Central Bank of Russia Instruction No. 232-P of July 9, 2003 requires banks to rank such assets and operations into five risk groups reflecting the following situations (i) no real or potential threat of losses; (ii) moderate potential threat of losses; (iii) serious potential or moderate real threat of losses; (iv) simultaneous potential and moderate real threat of losses or material real threat of losses; and (v) value of particular type of asset or operation is going to be lost completely. Banks are then required to provide allowances for each type of asset or operation in the amounts corresponding to the amounts of possible losses but within the following framework established by the Central Bank of Russia for each risk group indicated above, respectively: (i) 0%; (ii) 1% to 20%; (iii) 21% to 50%; (iv) 51% to 100% and (v) 100%. Banks must report to the Central Bank of Russia on the amounts of created non-loan allowances monthly within 10 days following the reporting month. The Central Bank of Russia and its regional units are responsible for monitoring the compliance of banks with these rules.

Mandatory allowances are also created for operations with residents of off-shore areas (as defined in the relevant Central Bank of Russia regulations). Absent any applicable exemptions, such allowances are created in the amount of up to the greater of (a) 100% of the sum of those of the bank's balance sheet items for which allowances are required to be made, or (b) average daily turnover with residents of off-shore areas during the last month.

Deposit insurance

To increase public confidence in the banking sector and enhance competition in the retail sector by "leveling' the competitive playing field between private banks and Sberbank, which still enjoys a state guarantee on deposits made in Sberbank by private individuals, the new law "On the insurance of individuals' deposits held with Russian banks" was adopted in December 2003. According to this law, banks accepting private deposits and opening accounts for individuals are required to participate in an insurance system introduced by the law and, in particular, to meet certain liquidity, financial reporting and financial stability requirements. MBRD has recently been admitted to the deposit insurance system.

Regulation of currency exposure

In its Instruction No. 41 of May 22, 1996, the Central Bank of Russia established rules regarding exposure of banks to foreign currency and precious metals (collectively, currency exposure), as well as controls over such exposure. Currency exposure is calculated with respect to net amounts of balance sheet positions, spot market positions, forward positions, option positions and positions under guarantees. Open currency position is calculated as the sum of all these net amounts. Such exposure is calculated for each currency and each precious metal, and then recalculated into rubles in accordance with the official exchange rates and the Central Bank of Russia's prices for precious metals.

The Central Bank of Russia established that at the end of each operational day the total amount of all long or short currency positions must not exceed 20% of the bank's capital base. At the same time, at the end of each operational day, the long or short position with respect to one particular currency or precious metal shall not exceed 10% of the bank's capital base.

Banks with a capital base not exceeding €6 million are required to report once a week to the Central Bank of Russia on their currency exposure with breakdowns for each day. Banks with capital base equal to or exceeding €6 million are required to report about their currency exposure daily on the day following the reporting day.

Banking reform plans

The Federal Law on the Insurance of Individuals' Deposits Held with Russian Banks was adopted in December 2003. Banks accepting private deposits and opening accounts for individuals are required to participate in an insurance system introduced by the law and, in particular, to meet certain liquidity, financial reporting and financial stability requirements established by the Central Bank of Russia, as well as to make payments to the newly established insurance fund.

At the end of 2001, the Russian government and the Central Bank of Russia issued a joint declaration entitled "On Strategy of Development of the Banking Sector of the Russian Federation" that set forth the strategy for banking reform in Russia and called for certain legislative steps and structural changes to be implemented during the next five years. Aimed at increasing the stability of the Russian banking sector, the declaration envisages, in part:

- increases in capital adequacy requirements;
- introduction of amendments to the Civil Code that would prevent the early withdrawal of funds held in term deposits;
- implementation of International Accounting Standards by all Russian banks from 2004; and
- gradual implementation of a mandatory system of deposit insurance for banks.

Real Estate

Land

Real estate transactions are generally governed by the Civil Code and, with respect to land, the Federal Land Code. Registration of, and transactions involving, real estate are regulated by the Federal Law on the State Registration of Rights to Immovable Property and Transactions Therewith.

While private ownership of buildings was introduced at the beginning of privatization in Russia in the early 1990s there was no uniform regulation of private ownership of land until the adoption of the Federal Land Code in 2001. In general, foreign individuals and companies are allowed to buy and sell land with certain exceptions (border and other designated areas). As a result, until 2001, owning title to a building did not necessarily include ownership of the land on which such building was situated. However, currently the Federal Land Code provides for the principle of keeping buildings and the land on which they are situated in the same ownership.

The Federal Land Code divides land into the following categories:

- agricultural land;
- land for housing;
- land used for the industrial purposes, power engineering, transportation, communication, radio broadcasting, television, informatics, space-related activities, defense, security or other specialized purposes;
- land of specifically secured territories or installations;
- forestry land;
- water-front land; and
- reserve land (land which is owned by the state, is not used for commercial purposes, and which can be transferred to any of the other categories—in effect, a miscellaneous grouping).

Each of the above listed categories has different conditions for usage and the Federal Land Code requires that each plot of land is used in accordance with the category in which it is designated.

Land used for agricultural purposes is regulated by the Federal Law on Turnover of Agricultural Land. The Law on Turnover of Agricultural land provides that foreign legal entities, foreign individuals and Russian legal entities, in which foreigners control more than 50% of the charter capital may not own agricultural land. They are only permitted to lease agricultural land for up to a maximum period of 49 years.

Most land used by legal entities in Russia remains in permanent use. Under Russian law, legal entities (excluding state-owned enterprises and state and local authorities) must re-register their rights to land that is in their permanent use as a lease or freehold at their own discretion by January 1, 2006. This requirement also applies to land on which buildings are located. At the discretion of a purchaser of the relevant premises, such land plots can be transferred to the purchaser either by lease or title transfer.

With a few exceptions, the land in Moscow is owned by the City of Moscow. In accordance with applicable legislation, a developer becomes the owner of the building/structures on the land in Moscow, but does not become the owner of the land on which such building/structures are allocated. See "Business—Real Estate—Business Overview" above for a description of land lease arrangements with the City of Moscow.

Construction and development

Construction and development of real estate in Russia is primarily governed by the Civil Code, the Federal Land Code, the Federal Law on the State Registration of Rights to Immovable Property and Transactions Therewith, construction norms and regulations approved by the Ministry of Industry and Energy, and others. In addition, a new City Construction Code and the Federal Law on Entry into Effect of the City Construction Code came into force on December 30, 2004. Construction and development is a multi-stage process which involves compliance with burdensome regulatory requirements, coordination of work between many specialists and authorizations from a large number of authorities at the federal, regional and local levels. In particular, the Federal Agency on Construction, Housing and the Communal Sector, or Rosstroi, the Federal Service for Supervision in the Sphere of Use of Natural Resources, the Federal Service on Ecological, Technologic and Nuclear Supervision and regional bodies of the state architectural and construction supervision are involved in the process of authorizing and supervising real estate development.

The main stages for construction of a building typically include the following:

- obtaining the lease or ownership rights to the land;
- changing the zoning status of the land for the purposes of development;
- preparing the project (design) documentation for construction, which includes, *inter alia*, (i) initial authorization documentation, (ii) town-planning documentation, and (iii) project documentation;
- obtaining infrastructure/utilities documentation from the relevant supply organizations;
- obtaining a construction permit from legal, regional or federal authorities;
- performing construction works;
- carrying out the acceptance procedure for a new building by a commission from various representatives of state authorities; and
- registering title to the new building.

In addition, Russian law establishes numerous requirements related to licensing the organizations involved in the construction process. The developer of a building must obtain a customer-developer license, and the contractor must obtain a license for construction activities, both of which are issued by Gosstroi for a five-year term. Upon expiry, the licenses can be renewed upon application of the licensee. Most of the other specialists involved in developing real estate projects and construction (such as sub-contractors, architects and technical supervisors) must also obtain licenses and permissions for their work.

In addition, construction is subject to all applicable environmental, fire safety and sanitary norms and regulations.

Retail

Retail sales in Russia are generally governed by Part 2 of the Civil Code and the Federal Law on Protection of Consumer Rights.

The Civil Code sets forth the basic principles governing retail sales, including, *inter alia*, the form of contract for retail sales, the rights and duties of sellers and buyers, and sellers' liability. The Federal Law on Protection of Consumer Rights regulates consumer-producer and consumer-seller relations and sets forth the mechanism through which consumers can enforce their rights.

Retail sales in Moscow are also regulated by the City of Moscow, which has local regulations relating to the premises occupied by retail sale enterprises, sanitary and veterinary norms, safety requirements, fire-, explosion- and electro-prevention rules, as well as to window displays and street advertising.

There are no detailed regulations or licensing requirements relating specifically to the retail sale of children's goods in Russia. However, certain general federal laws and regulations establish a number of requirements for the retail sale of children's goods which largely focus on moral, safety and sanitary requirements.

Media

Mass media in Russia is generally regulated by the Federal Law on Mass Media, or the Mass Media Law. Mass media legislation applies to mass media established within and outside Russia to the extent its products are distributed in Russia. The Mass Media Law applies to printed periodical publications, radio, television and video programs, newsreel programs and to other forms of periodical distribution of mass information.

Registration

Upon foundation, mass media entities must be registered with the Federal Service on Control over Compliance with Legislation in the Sphere of Mass Communications and Protection of Cultural Heritage, or the Mass Media Service. The term of registration is unlimited. However, certain changes in the mass media entity, including, *inter alia*, a change in the founder, founder's name, language, territory and form of distribution of mass media, will necessitate re-registration. Registration may be invalidated on various grounds, including obtaining registration by fraud or not releasing mass media for more than a year.

Suspension and termination of mass media activities

The activity of a mass media entity may be voluntarily suspended or terminated or may be terminated by a court for a variety of reasons, including if a mass media entity repeatedly violates the law within one year after being notified, fails to comply with a court's order on suspending mass media activities and in other cases prescribed by law.

TV and radio broadcasting

TV and radio broadcasting are subject to licensing. Licensing of broadcasting is regulated by the Mass Media Law and the Federal Regulation on Licensing of TV, Radio Broadcasting and Connection in the Sphere of TV and Radio Broadcasting in the Russian Federation. Licenses are issued by the Mass Media Service for either television or radio broadcasting within Russia or television or radio broadcasting from Russia onto foreign territories.

A broadcasting license is issued for a term from three to five years unless a shorter term is requested by an applicant. Generally, licenses are issued without a tender. However, Russian law requires tenders for licenses to broadcast in the capitals of Russian regions and in cities with over 200,000 people.

A license may be terminated by the Mass Media Service on various grounds, including, *inter alia*, where the license was procured by fraud, for failure to broadcast for three or more months during the license term, for violation of advertising laws, for repeated violations of the license terms or Russian law within a year after an official warning was received by a licensee, for violations of copyright legislation and in other cases provided for under the law.

Broadcasting also requires a communications license and permission to use a particular frequency. These licenses and permissions are issued by the Federal Service on the Control in the Sphere of Connections for a term of three to five years. Under Russian law, a license may be suspended and/or terminated on various grounds including, *inter alia*, if a license holder is guilty of unfair competition).

TAXATION

The following discussion describes the material U.K., U.S. federal and Russian income and withholding tax consequences to an owner of common shares or GDRs. This discussion is not intended as tax advice to any particular investor. It is also not a complete analysis or listing of all potential U.K., U.S. federal or Russian income and withholding tax consequences to you of ownership of common shares or GDRs. No opinion of counsel will be issued with respect to the discussion under the heading "Certain Russian Tax Law Considerations" and, therefore, such discussion is not based on an opinion of counsel. We urge you to consult your own tax adviser regarding the specific U.K., U.S. federal, state and local and Russian tax consequences of the ownership and disposition of the common shares or GDRs in your own particular factual circumstances.

A resident of the United States for purposes of the United States-Russia double tax treaty that is fully eligible for benefits under the United States-Russia double tax treaty and holds the common shares or GDRs is referred to herein as a "U.S. holder." Subject to certain provisions of the United States-Russia double tax treaty relating to limitations on benefits, you generally will be a resident of the United States for treaty purposes and entitled to treaty benefits if you are:

- liable, under the laws of the United States, for U.S. federal income tax (other than taxes in respect only of income from sources in the United States or capital situated therein) by reason of your domicile, residence, citizenship, place of incorporation, or any other similar criterion (and, for income derived by a partnership, trust or estate, residence is determined in accordance with the residence of the person liable for tax with respect to such income); and
- not also a resident of the Russian Federation for Russian tax purposes.

A resident of the United Kingdom for purposes of the United Kingdom-Russia double tax treaty that is fully eligible for benefits under the United Kingdom-Russia double tax treaty and holds the common shares or GDRs is referred to herein as a "U.K. holder." You generally will be a resident of the United Kingdom for treaty purposes and entitled to treaty benefits if you are:

- liable, under the laws of the United Kingdom, for U.K. tax (other than taxes in respect only of income from sources in the United Kingdom or capital situated therein) by reason of your domicile, residence, place of management, or any other similar criterion; and
- not also a resident of the Russian Federation for Russian tax purposes.

The benefits under the United States-Russia double tax treaty and the United Kingdom-Russia double tax treaty discussed in this offering memorandum are not generally available to U.S. or U.K. persons who hold GDRs or common shares in connection with the conduct of a business in the Russian Federation through a permanent establishment as defined in the relevant tax treaty. Subject to certain exceptions, a U.S. or U.K. person's permanent establishment under the relevant tax treaty is a fixed place of business through which such person carries on business activities in the Russian Federation (generally including, but not limited to, a place of management, a branch, an office and a factory). Under certain circumstances, a U.S. or U.K. person may be deemed to have a permanent establishment in the Russian Federation as a result of activities carried on in the Russian Federation through agents of the U.S. or U.K. person. This summary does not address the treatment of those holders.

The following discussion is based on:

- the United States Internal Revenue Code of 1986, as amended, the Treasury regulations promulgated thereunder and judicial and administrative interpretations thereof;
- Russian legislation (in particular, the Tax Code);
- the United States-Russia double tax treaty (and judicial and administrative interpretations thereof);

- U.K. tax law; and
- the United Kingdom-Russia double tax treaty;

all as in effect on the date of this offering memorandum. All of the foregoing are subject to change, possibly on a retroactive basis, after the date of this offering memorandum. This discussion is also based, in part, on representations of the Depositary, and assumes that each obligation in the Deposit Agreements and any related agreements will be performed in accordance with its terms. The discussion with respect to Russian legislation is based on our understanding of current Russian law and Russian tax rules, which are subject to frequent change and varying interpretations. See "Risk Factors—Risks Relating to the Russian Federation and Ukraine—Legal Risks and Uncertainties—Weaknesses relating to the legal system and legislation create an uncertain environment for investment and business activity, which could have a material adverse effect on the value of the GDRs" and "Risk Factors—Risks Relating to the Russian Federation and Ukraine—Legal Risks and Uncertainties—Changes in the Russian tax system could materially adversely affect an investment in the GDRs."

We believe, and the following discussion assumes, that for U.S. federal income tax purposes, we are not a passive foreign investment company for the current taxable year and will not become a passive foreign investment company in the future.

Certain Russian Tax Law Considerations

Russian tax law and procedures are not well developed, and local tax inspectors have considerable autonomy and often interpret tax rules inconsistently. Both the substantive provisions of Russian tax law and the interpretation and application of those provisions by the Russian tax and financial authorities may be subject to more rapid and unpredictable change than in jurisdictions with more developed capital markets.

Currently, the Russian government is still in the process of replacing the existing tax legislation with a comprehensive Tax Code, and it is unclear when this process will be completed and how U.S. and U.K. holders would be affected.

Taxation of Dividends

Dividends paid to U.S. and U.K. holders generally should be subject to Russian withholding tax at a 15% tax rate for holders (legal entities and organizations) and at a 30% rate for individual holders. U.K. holders properly claiming the benefits of the United Kingdom-Russia double tax treaty may be able to decrease the applicable tax rate to 10%. For U.S. holders properly claiming the benefits of the United States-Russia double tax treaty: (1) 5% of the gross amount of the dividends may be applicable if the U.S. holder is a company and beneficial owner of at least 10% of our voting stock; and (2) 10% of the gross amount of the dividends may be applicable in all other cases.

Current Russian tax legislation contains virtually no provisions regarding GDRs, and the Russian tax and finanical authorities have not provided any guidance regarding the treatment of GDR arrangements. The concept of beneficial ownership is not defined in Russian tax law. No assurance can be given that the Russian tax authorities will make the same distinction between legal and beneficial ownership as in the United States. The Methodological Recommendations for application of the Profits Tax Chapter of the Tax Code to foreign legal entities, issued by the tax authorities in 2003, however, may be interpreted to the effect that reduced rates of withholding income tax on dividends may be claimed only by the beneficial owners of income, where such a requirement is compatible with the provisions of particular double tax treaties. The existing guidance in this respect is very limited.

Although the Depositary is the legal owner of the Shares underlying our GDRs, it is likely that the Depositary will not be considered the beneficial owner of dividends for the purposes of application of the United States-Russia or United Kingdom-Russia double tax treaty.

Therefore, with respect to U.S. or U.K. holders (legal entities and organizations) we may be obliged to withhold income tax at the rate of 15% from dividend payments made to the Depositary, unless we are provided with confirmation that U.S. or U.K. holders are beneficial owners of dividends within the meaning of the United States-Russia double tax treaty and United Kingdom-Russia double tax treaty, respectively, and all administrative requirements for claiming treaty benefits are met. See "—Tax Treaty Procedures." Confirmation of beneficial ownership of dividends may be difficult to obtain.

Under current regulations, authorization from the Russian tax authorities is not required to allow us to withhold at reduced rates under applicable double tax treaties provided that all of the numerous administrative requirements are met. See "—Tax Treaty Procedures." To allow us to withhold income tax at reduced rates, U.S. or U.K. holders may be required to prove that they are the beneficial owners of dividends within the meaning of the United States-Russia and United Kingdom-Russia double tax treaties, respectively. Given that such confirmation with respect to each particular U.S or U.K. holder and may be required prior to us effecting the payment of dividends to the Depositary, the application of reduced rates may be limited. U.S. and U.K. holders (legal entities and organizations) may be able to claim a refund of excessively withheld taxes, although the procedure to do so may be time consuming and a successful outcome is not certain.

With respect to U.S. or U.K. holders (individuals) of GDRs, we may also be obliged to withhold income tax at the rate of 15% from dividend payments made to the Depositary. We will not act as a tax agent for U.S. or U.K. holders (individuals) of GDRs and we will not be able to withhold personal income tax with respect to the above payment. U.S. or U.K. holders (individuals) of GDRs will then be obliged to submit an annual personal tax return with the Russian tax authorities by the end of the year following the reporting year and pay personal income tax at the rate of 30% based on this tax return. When submitting the tax return, U.S. or U.K. holders (individuals) may claim application of the reduced rates established by the United States-Russia and the United Kingdom-Russia double tax treaties, respectively, provided the procedures described in "Tax Treaty Procedures" are complied with. The 15% tax withheld from payment of dividends to the Depositary may not be refunded by the tax authorities in practice, as the tax authorities will not likely treat the 15% income tax as a tax liability of the individual holders. Therefore, it is possible that the U.S. or U.K. holders (individuals) may suffer up to a 45% tax burden on their share of dividends.

No assurance can be given that the above provisions on taxation of dividends will apply if the Russian tax authorities take the position that the Depositary is the beneficial owner of any dividend payments.

Taxation of Capital Gains

Under current Russian legislation, capital gains arising from the sale, exchange or other disposition of common shares or GDRs by U.S. or U.K. holders (legal entities or organizations) should not be subject to tax in Russia if the share of immovable property located in Russia constitutes 50% or less of our assets. If more than 50% of our assets were to consist of immovable property located in Russia, which is unlikely, (unless such shares or GDRs are disposed of at a foreign stock exchange) the U.S. or U.K. holders (legal entities or organizations) may be subject to a 20% withholding tax on the gross proceeds from disposal or 24% withholding tax on the respective capital gain being the difference between the sales price and acquisition costs of GDRs or underlying Shares.

Under Russian personal income tax law, the sale of shares or GDRs by U.S. or U.K. holders (individuals) not resident in Russia for tax purposes outside of Russia will not be considered Russian source income and will not be taxable in Russia. The sale of shares and GDRs by U.S. or U.K. holders (individuals) not resident in Russia for tax purposes in Russia will be considered Russian source income and will be subject to tax at the rate of 30% on the difference between the sales price and acquisition value of GDRs or underlying Shares. However, the acquisition price can only be deducted at the source of payment if the sale was made by U.S. or U.K. holders through a professional dealer or broker, provided such broker is a Russian legal entity or a foreign company with a permanent establishment in Russia. Otherwise, no withholding needs to be made and U.S. or U.K. holders will have an obligation to file an annual tax return, report his/her income received and apply for a deduction of acquisition expenses (which includes filing of support documentation). The purchaser is required to report to the Russian tax authorities on the amount of income received by individuals by April 1 of the year following the reporting year.

Under the United States-Russia double tax treaty, capital gains from the sale of shares or GDRs by U.S. holders (individuals, organizations and legal entities) should be exempt from taxation in Russia (unless more than 50% of our assets were to consist of immovable property located in Russia).

Under the United Kingdom-Russia tax treaty, capital gains from the sale of shares or GDRs by U.K. holders (individuals, organizations and legal entities) should be exempt from taxation in Russia (unless the major part of our assets were to consist of immovable property located in Russia, except where respective shares are quoted on an approved stock exchange).

Since the exemption of capital gains from taxation in Russia, provided by both of the above treaties, is not more beneficial for U.S. or U.K. holders (legal entities and organizations) than the treatment provided by current Russian legislation, it is unlikely that the need will arise for the U.K. and U.S. holders (legal entities and organizations) to apply the respective treaties in order to obtain more beneficial treatment of capital gains resulting from the sale, exchange or other disposition of GDRs or underlying Shares.

Where the shares or GDRs are sold by the U.S. or U.K. holders (legal entities or organizations) to persons other than a Russian company or a foreign company with a permanent establishment in Russia, even if the resulting capital gain is considered taxable Russian source income, there is currently no mechanism under which the purchaser will be able to withhold the tax and remit it to the Russian budget.

With respect to the U.S. holders (individuals) the treatment provided by the treaties may be more beneficial in cases where the immovable property does not make up for more than 50% of our assets. With respect to the U.K. holders (individuals), the treatment provided by the treaties may be more beneficial as the United Kingdom-Russia treaty exempts from Russian taxation any gain on the disposition of shares or GDRs quoted on an approved stock exchange.

In order to apply the treaty, the individual holders should receive clearance from the Russian tax authorities as described below in "—Tax Treaty Procedures." However, application of the respective treaties may be difficult in practice, given that Russian tax legislation contains virtually no provisions regarding GDRs and the Russian tax and financial authorities have not provided any guidance regarding the treatment of GDR arrangements.

There is a risk, therefore, that the purchaser (if the sale is made through a professional dealer or broker) will be obliged to withhold the tax at the rate of 30%. The U.S. or U.K. holders (individuals) may then claim a refund; however, in practice the procedures are highly time-consuming and more complicated than those for corporate holders, and the successful outcome is less likely.

Where the U.S. or U.K. holders (individuals) sell shares or GDRs other than through a professional broker or dealer (a Russian legal entity or a foreign company with a permanent establishment in Russia), such U.S. or U.K holders may be required to submit annual tax returns to the Russian tax authorities.

Tax Treaty Procedures

Under the current rules, to claim the benefit of a reduced rate of withholding tax under the United States-Russia double tax treaty or the United Kingdom-Russia double tax treaty, as applicable, a non-resident generally must provide an official document confirming its residence in the U.S. or U.K. for double tax treaty purposes certified by U.S. or U.K. tax authorities. Russian legislation does not establish an obligatory form of such document, although the tax authorities do establish the information which must be reflected in it.

A U.S. holder may obtain the appropriate certification by mailing completed Form 8802, together with any additional required information to: Internal Revenue Service-Philadelphia Service Center, U.S. Residency Certification Request, P.O. Box 16347, Philadelphia, Pennsylvania 19114-0447. The procedures for obtaining certification are described in greater detail in Internal Revenue Service Publication 686. As obtaining the required certification from the Internal Revenue Service may take at least six to eight weeks, U.S. holders should apply for such certification as soon as possible.

A U.K. holder may obtain the appropriate certification by mailing completed forms to his/her local Inspector of Taxes for certification that the U.K. holder is resident in the United Kingdom for tax purposes. As obtaining this confirmation may take several weeks, U.K. holders should apply for such certification as soon as possible.

To allow us to withhold income tax at reduced rates, we need to be provided with such residence confirmation documents with respect to each U.S. or U.K. holder that is a legal entity or organization claiming the benefits of the respective treaties. In practice, submission of certificates for all U.S./U.K holders may be difficult; therefore, the application of the treaty benefits may not be available to U.S. or U.K. holders.

If tax is withheld by a Russian resident on dividends or other amounts at a rate different from that provided in the tax treaty, U.S. or U.K. holders may apply for a tax refund by filing a package of documents with the Russian local tax inspectorate in which the tax agent is registered within three years from the withholding date for U.S./U.K holders which are legal entities.

The package for legal entities should include the appropriate form (1012DT (2002)) for dividend/interest income and 1011DT (2002) for income other than dividends and interest), confirmations of residence of the foreign holder (IRS Form 6166 for U.S. holders), a copy of the agreement or other documents substantiating the payment of income and the transfer of tax to the budget.

Russian legislation establishes special rules for claiming double tax treaty relief by individuals. Under the Tax Code, all treaty relief should be cleared through the tax authorities. In practice, this is normally done based on an annual tax return. Theoretically, the individual can obtain the treaty clearance prior to receipt of income and submit such confirmation to us. This procedure is, however, not often used in practice, and such advance clearance can be delayed.

An individual's package should include confirmations of residence of the foreign holders (IRS Form 6166 for U.S. holders), a copy of the agreement or other documents substantiating the payment of income and the transfer of tax to the budget. The established terms for refunding the tax are contradictory. In accordance with the current legislation on personal income tax, the above mentioned documents should be filed with the tax authorities before the end of the year following the year of withholding. At the same time, the general rules on tax refunds state that a refund can be claimed within three years from the withholding date.

Under the provisions of the Tax Code, the refund of the tax should be effected within one month after the submission of the documents. However, in practice, the process of obtaining the refund may be time consuming and a successful outcome is not guaranteed. The procedures are especially time-consuming and administratively burdensome with respect to individuals.

Neither we nor the Depositary will have any obligation to assist a GDR holder with the completion and filing of any tax forms.

United States Federal Income Tax Considerations

The following is a general description of the material U.S. federal income tax consequences that apply to you if you are, for U.S. federal income tax purposes, a beneficial owner of GDRs or common shares that acquired the GDRs or common shares pursuant to this offering memorandum and you are a citizen or resident of the United States, a corporation (including any entity treated as a corporation for U.S. federal income tax purposes) created or organized in or under the laws of the United States or a political subdivision thereof, an estate the income of which is subject to U.S. tax regardless of its source, or a trust, if a U.S. court can exercise primary supervision over the administration of such trust and one or more U.S. persons can control all substantial trust decisions or, if such trust was in existence on August 20, 1996 and has properly elected to continue to be treated as a U.S. person. If a partnership (including any entity treated as a partnership for U.S. federal income tax purposes) is a beneficial owner of GDRs or common shares, the U.S. federal income tax treatment of a partner in the partnership will generally depend on the status of the partner and the activities of the partnership. Since your U.S. federal income and withholding tax treatment may vary depending upon your particular situation, you may be subject to special rules not discussed below. Special rules will apply, for example, if you are:

- an insurance company;
- a tax-exempt organization;
- a financial institution;
- a person subject to the alternative minimum tax;
- a person who is a broker-dealer in securities;
- an S corporation;
- an expatriate subject to Section 877 of the United States Internal Revenue Code;
- an owner of, directly, indirectly or by attribution, 10% or more of the outstanding common shares; or
- an owner holding GDRs or common shares as part of a hedge, straddle, synthetic security or conversion transaction.

In addition, this summary is generally limited to persons holding common shares or GDRs as "capital assets" within the meaning of Section 1221 of the United States Internal Revenue Code and whose functional currency is the U.S. dollar. The discussion below also does not address the effect of any U.S. state or local tax law or foreign tax law.

For purposes of applying United States federal income and withholding tax law, a holder of a GDR should be treated as the owner of the underlying common Shares represented by that GDR.

The U.S. Treasury has expressed concerns that parties to whom GDRs are pre-released may be taking actions that are inconsistent with the claiming of foreign tax credits by U.S. persons for U.S. federal income tax purposes. Such actions would also be inconsistent with the claiming of the reduced rate of tax applicable to dividends received by certain non-corporate U.S. persons, as described below. Accordingly, the analysis of the creditability of Russian taxes described below, and the availability of the reduced tax rate for dividends received by certain non-corporate U.S. persons, could be affected by future actions that may be taken by the U.S. Treasury.

Taxation of Dividends on Common Shares or GDRs

For U.S. federal income tax purposes, the gross amount of a distribution, including any Russian withholding taxes, with respect to common shares or GDRs will be treated as a taxable dividend to the extent of our current and accumulated earnings and profits, computed in accordance with United States federal income tax principles. For taxable years beginning before January 1, 2009, if you are a non-corporate taxpayer, such dividends may be taxed at the lower applicable capital gains rate provided (1) certain holding period requirements are satisfied, (2) we are eligible for the benefits of the United States-Russia double tax treaty, and (3) we are not a "passive foreign investment company." Non-corporate U.S. holders are strongly urged to consult their tax advisors as to the applicability of the lower capital gains rate to dividends received with respect to GDRs or common shares. Distributions in excess of our current or accumulated earnings and profits will be applied against and will reduce your tax basis in common shares or GDRs and, to the extent in excess of such tax basis, will be treated as gain from a sale or exchange of such common shares or GDRs. You should be aware that we do not intend to calculate our earnings and profits for U.S. federal income tax purposes; and unless we make such calculations, you should assume that any distributions with respect to common shares or GDRs will constitute ordinary dividend income. If you are a corporation, you will not be allowed a deduction for dividends received in respect of distributions on common shares or GDRs, which is generally available for dividends paid by U.S. corporations.

If a dividend distribution is paid in rubles, the amount includible in income will be the U.S. dollar value of the dividend, calculated using the exchange rate in effect on the date the dividend is includible in income by you, regardless of whether the payment is actually converted into U.S. dollars. Any gain or loss resulting from currency exchange rate fluctuations during the period from the date the dividend is includible in your income to the date the rubles are converted into U.S. dollars will be treated as ordinary income or loss. In addition, you may be required to recognize as ordinary income or loss foreign currency gain or loss on the receipt of a refund of Russian withholding tax pursuant to the United States-Russia double tax treaty to the extent the U.S. dollar value of the refund differs from the U.S. dollar equivalent of that amount on the date of receipt of the underlying dividend.

Russian tax withheld from distributions at the rate applicable to you under the United States-Russia double tax treaty should be treated as a foreign income tax that, subject to generally applicable limitations and conditions, is eligible for credit against your U.S. federal income tax liability or, at your election, may be deducted in computing taxable income, provided, in each case, that the amounts withheld and paid to Russian tax authorities are treated as satisfying your tax liability. If, however, the holder of a GDR is not treated as the owner of the underlying common Shares represented by the GDR for U.S. federal income tax purposes, then Russian withholding tax would not be treated as a foreign income tax eligible for credit as described in the preceding sentence. If Russian tax is withheld at a rate in excess of the rate applicable to you under the United States-Russia double tax treaty, you may not be entitled to credits for the excess amount, even though the procedures for claiming refunds and the practical likelihood that refunds will be made available in a timely fashion are uncertain.

A dividend distribution will be treated as foreign source income and will generally be classified as "passive income" or, in some cases, "financial services income" for U.S. foreign tax credit purposes. The recently enacted American Jobs Creation Act of 2004, or the Act, modifies the foreign tax credit limitation by reducing the number of classes of foreign source income to two for taxable years beginning after December 31, 2006. Under the Act, dividends generally constitute "passive category income" but could, in the case of certain U.S. holders, constitute "general category income." The rules relating to the determination of the foreign tax credit, or deduction in lieu of the foreign tax credit, are complex and you should consult your tax advisors with respect to those rules.

Taxation on Sale or Exchange of Common Shares or GDRs

The sale of common shares or GDRs will generally result in the recognition of gain or loss in an amount equal to the difference between the amount realized on the sale and your adjusted basis in such common shares or GDRs. That gain or loss will be capital gain or loss if the common shares or GDRs are capital assets in your hands and will be long-term capital gain or loss if the common shares or GDRs have been held for more than one year. If you are an individual, such realized long-term capital gain is generally subject to a reduced rate of U.S. federal income tax. Limitations may apply to your ability to offset capital losses against ordinary income.

Deposits and withdrawals of common shares by you in exchange for GDRs will not result in the realization of gain or loss for U.S. federal income tax purposes.

A gain realized on the sale of common shares or GDRs will generally be treated as U.S. source income and therefore the use of foreign tax credits relating to any Russian taxes imposed upon such sale may be limited. You are strongly urged to consult your own tax advisors as to the availability of tax credits for any Russian taxes withheld on the sale of common shares or GDRs.

Information Reporting and Backup Withholding

Dividends and proceeds from the sale or other disposition of common shares or GDRs that are paid in the United States or by a U.S.-related financial intermediary will be subject to U.S. information reporting rules and U.S. backup withholding tax, unless you are a corporation or other exempt recipient. In addition, you will not be subject to backup withholding if you provide your taxpayer identification number and certify that no loss of exemption from backup withholding has occurred. Holders that are not U.S. persons generally are not subject to information reporting or backup withholding, but such holders may be required to provide certification as to their non-U.S. status.

United Kingdom Tax Considerations

The comments below are of a general nature based on current U.K. law and practice. They do not necessarily apply where the income is deemed for tax purposes to be the income of persons other than persons who are the absolute beneficial owners of GDRs or common shares. In particular these comments do not apply to the following:

- investors who do not hold their GDRs or common shares as capital assets;
- investors that own (or are deemed to own) 10% or more of our voting rights or common shares (including common Shares represented by GDRs); or
- special classes of investors such as dealers.

Withholding tax on dividends

Dividend payments in respect of GDRs or common shares issued by a company organized under the laws of the Russian Federation should not be subject to U.K. withholding tax. As discussed in "—Certain Russian Tax Law Considerations—Taxation of Dividends," such dividends will be subject to Russian withholding taxes.

Taxation of Dividends

A U.K. holder of interests in GDRs or common shares that receives a dividend on the GDRs or common shares may be subject to U.K. income tax or corporation tax, as the case may be, on the gross amount of any dividend paid before the deduction of any Russian withholding taxes, subject to the availability of any credit for Russian tax withheld. Any individual holder of interests in GDRs or common shares who is resident and domiciled in the United Kingdom will generally be subject to

U.K. income tax on the dividend paid on the GDRs or common shares. An individual holder of interests in GDRs or common shares who is resident but not domiciled in the United Kingdom (or is resident, but not ordinarily resident, and domiciled in the United Kingdom, and either a Commonwealth citizen (this includes a British citizen) or a citizen of the Republic of Ireland) will generally be subject to U.K. income tax on the dividend paid on the GDRs or common shares to the extent that the dividend is remitted to the United Kingdom. A dividend is remitted if it is paid to the United Kingdom or transmitted or brought to the United Kingdom in any way. A dividend may also be treated as remitted to the United Kingdom under certain anti-avoidance legislation.

A corporate holder of interests in GDRs or common shares that is resident in the United Kingdom will generally be subject to U.K. corporation tax on the dividend paid on the GDRs or common shares. A corporate holder of interests in GDRs or common shares that is not resident in the United Kingdom will generally not be subject to U.K. corporation tax on any dividend paid on the GDRs or common shares unless the GDRs or common shares are attributable to a trade carried on in the United Kingdom through a permanent establishment.

Taxation of Disposals

The disposal of a U.K. holder of interests in GDRs or common shares may give rise to a chargeable gain or allowable loss for the purposes of U.K. taxation or chargeable gains.

An individual holder of interests in GDRs or common shares who is resident or ordinarily resident and domiciled in the United Kingdom will generally be liable for U.K. capital gains tax on chargeable gains made on the disposal of any interest in GDRs or common shares. An individual holder of interests in GDRs or common shares who is resident or ordinarily resident, but not domiciled, in the United Kingdom will be liable for U.K. capital gains tax to the extent that the chargeable gains made on the disposal of an interest in GDRs or common shares are remitted or deemed to be remitted to the United Kingdom. Dealings in the GDRs or common shares on the London Stock Exchange may give rise to remitted profits that would, therefore, give rise to a U.K. capital gains tax liability.

A corporate holder of interests in GDRs or common shares that is resident in the United Kingdom will generally be subject to U.K. corporation tax or any chargeable gain arising from a disposal of GDRs or common shares. A corporate holder of interests in GDRs or common shares that is not resident in the United Kingdom will be subject to U.K. corporation tax on any chargeable gains arising from their disposal where the GDRs or common shares in question are attributable to a trade carried on by the holder in the United Kingdom through a permanent establishment.

Effect of withholding taxes

As discussed in "—Certain Russian Tax Law Considerations—Taxation of Dividends" and "—Certain Russian Tax Law Considerations—Taxation of Capital Gains" above, dividend payments in respect of common shares will be, and certain capital gains may be, subject to Russian withholding taxes. A U.K. resident investor should generally be entitled to a credit for Russian tax (if any) properly withheld from such payments against such investor's liability to income tax or corporation tax on such amounts, subject to U.K. tax rules for calculation of such a credit. A U.K. holder will only obtain such credit to the extent that it has taken reasonable steps to minimize Russian tax on dividends.

Stamp duty

Payment of U.K. stamp duty will not normally be required in connection with a transfer of interests in GDRs or common shares, provided that the instrument of transfer is executed and retained outside the United Kingdom and the shareholder register and the GDR register are not held in the United Kingdom.

No U.K. stamp duty reserve tax will be payable in respect of any agreement to transfer interests in GDRs or common shares.

PLAN OF DISTRIBUTION

Description of the Distribution

We, the Selling Shareholders and the underwriters named below (hereinafter, the Underwriters) have entered into an underwriting agreement (hereinafter, the Underwriting Agreement) with respect to the Shares represented by the GDRs being offered. Subject to the satisfaction of certain conditions set out in the Underwriting Agreement, each Underwriter has agreed, severally but not jointly, to subscribe for the GDRs representing the respective number of Shares, and pay for such number of Shares as are set forth opposite its name in the following table.

	Number of Shares (in the form of GDRs)		
Underwriters	Sistema	Selling Shareholders	Total
Credit Suisse First Boston (Europe) Limited(1)	620,000	17,065	637,065
Morgan Stanley & Co. International Limited(2)	620,000	17,065	637,065
Deutsche Bank AG London(3)	77,500	2,134	79,634
ING Bank N.V., London Branch(4)	77,500	2,133	79,633
Renaissance Securities (Cyprus) Limited(5)	77,500	2,133	79,633
Troika Dialog (Bermuda) Limited(6)	77,500	2,133	79,633
Total	1,550,000	42,663	1,592,663

(1) Credit Suisse First Boston is a leading global investment bank and financial services firm, which is regulated by the UK Financial Services Authority. Credit Suisse First Boston has operations in more than 69 locations across more than 33 countries, serving institutional, corporate, government and high net worth clients. Its offices are located at One Cabot Square, London E14 4QJ, United Kingdom.

(2) Morgan Stanley is a global financial services firm that maintains leading market positions in each of its business segments: Institutional Securities, Individual Investor Group, Investment Management and Credit Services. Morgan Stanley's 53,000 plus employees conduct business out of over 600 offices in 28 countries around the globe. Its offices are located at 25 Cabot Square, Canary Wharf, London E14 4QA, United Kingdom.

(3) Deutsche Bank AG London is a leading global provider of financial solutions. Its offices are located at 6th Floor, Winchester House, Great Winchester Street, London EC2N 2BD, United Kingdom.

(4) ING Bank N.V., London Branch is a global financial institution of Dutch origin offering banking, insurance and asset management to more than 60 million clients in over 50 countries. Its offices are located at ING House Location IH 07.202, Postal address: Postbus 810, 1000 AV Amsterdam, The Netherlands.

(5) Renaissance Securities (Cyprus) Limited is an affiliate of a leading independent investment bank operating in the Russian financial market, serving both domestic and international clients. Its offices are located at 2-4 Arch Makarios Avenue, Capital Center, 9th Floor, Nicosia 1505, The Republic of Cyprus.

(6) Troika Dialog (Bermuda) Limited is an affiliate of the oldest and largest private investment company in Russia, Troika Dialog. Its offices are located at Chancery Hall, 52 Reid Street, Hamilton HM12, Bermuda.

The GDRs will be represented by a Master Rule 144A GDR and a Master Regulation S GDR, and will be subject to certain restrictions as further discussed in "Description of the Global Depositary Receipts."

The offer price is $850.00 per Share, equating to $17.00 per GDR. The Underwriters will receive a combined management and underwriting commission of 0.8%, equal to $6.80 per Share or $0.136 per GDR, and a selling commission of 1.2%, equal to $10.20 per Share or $0.204 per GDR. The total commissions amount to $17.00 per Share or $0.34 per GDR, equating to $27,075,271.00. In addition, the Joint Global Coordinators will receive an incentive fee of $1.70 per Share ($0.034 per GDR) equating to $2,707,527.10.

The Selling Shareholders have granted to the Joint Global Coordinators, on behalf of the Underwriters, an over-allotment option, exercisable until 30 days after the Closing Date, to purchase or procure purchasers for up to 238,900 additional Shares, comprising up to 11,945,000 additional GDRs, at the offer price referred to above and on the terms and conditions of the offering, solely to cover over-allotments, if any, and to cover short positions resulting from stabilization activities.

The Selling Shareholders have provided the Underwriters with customary representations and warranties under the Underwriting Agreement in relation to their title to the Shares they are selling in the offering.

The Underwriting Agreement provides that the obligations of the Underwriters are subject to certain conditions precedent. In addition, the Joint Global Coordinators, on behalf of the Underwriters, may terminate the Underwriting Agreement in certain circumstances prior to the Closing Date. We and the Selling Shareholders have agreed in the Underwriting Agreement, subject to its terms, to indemnify the Underwriters against certain liabilities in connection with the sale of the Shares and the GDRs. In addition, we have agreed to reimburse the Underwriters for certain of their expenses.

Limitations Prior to Registration of Placement Report and Consequences of Non-registration

Until the registration of the placement report by the Federal Service for the Financial Markets, you will not be entitled to instruct the Depositary to exercise any voting rights on your behalf as our shareholder, and the Depositary and the Custodian will not exercise any voting rights as a shareholder. You may not withdraw our Shares or other property deposited with the Depositary in respect of the GDRs sold in the offering prior to the registration of the placement report with the Federal Service for the Financial Markets. See "Risk Factors—Risks Relating to the GDRs and the Trading Market—You will not be able to withdraw the Shares underlying the GDRs prior to the registration of a placement report for newly issued Shares, and the failure to register this placement report could result in the offering being withdrawn and newly issued Shares underlying the GDRs being cancelled." Such limitation on withdrawal and voting of the Shares will not prohibit trading in the GDRs.

Pending the registration of the placement report by the Federal Service for the Financial Markets, the proceeds of the offering will be deposited as follows:

- the net proceeds payable to us will be converted into rubles, paid into our ruble-denominated account at ZAO Bank Credit Suisse First Boston, converted back into U.S. dollars at the original conversion rate and then deposited in U.S. dollar-denominated accounts at Raiffeisenbank Austria ZAO, ZAO CB Citibank and ZAO Bank Credit Suisse First Boston; and
- the Underwriters' commissions and the net proceeds to the Selling Shareholders will be deposited in a U.S. dollar-denominated escrow account at Credit Suisse Limited.

In the event that the placement report is not registered by the Federal Service for the Financial Markets within 60 days after the Closing Date (or such later date to which we and the Selling Shareholders agree with the Underwriters), we have agreed with the Underwriters to issue a press release and to notify the Depositary, the banks holding the escrow and escrow-type accounts, the Underwriters and the London Stock Exchange of the termination of the offering by the close of business on the termination date. Under Russian law, in the case of non-registration of the placement report, we are required to return the full amount of ruble proceeds that were initially deposited into our ruble-denominated account on the Closing Date. This will be effected by converting the U.S. dollar-denominated proceeds maintained in the escrow-type accounts into rubles, and such ruble amount will be converted into U.S. dollars for release to the Depositary for remittance to the holders of the GDRs. As these conversions are expected to be effected at the same rate of exchange, the U.S. dollar-denominated proceeds held in the escrow-type accounts should not suffer any diminution. We have agreed that we will pay such additional amounts (if any) as may be necessary to ensure that the

U.S. dollar funds released to the Depositary from the Russian escrow-type accounts will be equal to the original U.S. dollar proceeds deposited in the Russian escrow-type accounts plus interest, if any, received on such escrowed proceeds. All funds in the escrow accounts will also be released to the Depositary in U.S. dollars, without the need for such conversions. The Depositary will promptly distribute through DTC, Euroclear and Clearstream, as applicable, the funds it has received to the holders of the GDRs on the termination date. The amount returned to the holders of the GDRs as of the termination date is expected to be all of the escrowed proceeds plus interest, if any, received on the funds held in escrow and escrow-type accounts regardless of the then-prevailing market prices for the GDRs, subject to applicable withholding taxes. However, the return of funds may be delayed due to Russian currency control, banking and securities regulations or practices and may be prevented if there is a change in such regulations or practices. Because of the legal and practical limitations on the enforceability of the escrow and escrow-type arrangements, the holders of the GDRs will be taking credit risk on us and on the Selling Shareholders for the return of funds in the event that the placement report is not registered. See "Escrow of Proceeds and Registration of Placement Report."

Lock up Arrangements

We and the Selling Shareholders have agreed, as part of the Underwriting Agreement, subject to certain exceptions, not to issue, offer, sell, contract to sell, pledge, charge, grant options over or otherwise dispose of, directly or indirectly, any shares in us or securities convertible or exchangeable into or exercisable for any shares in us or warrants or other rights to purchase such shares or any security or financial product whose value is determined directly or indirectly by reference to the price of the underlying securities, including equity swaps, forward sales and options or GDRs representing the right to receive any such securities or publicly announce any intention to do any of the foregoing, for a period of 180 days from the Closing Date, without the prior written consent of the Joint Global Coordinators. However, such consent shall not be required for the sale of the Shares to the Underwriters pursuant to the Underwriting Agreement.

Selling Restrictions

The Shares and the GDRs 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 GDRs have not been and will not be marketed or made available in whole or in part to the public in conjunction with the application for the GDRs to be admitted to the Official List and to trading on the London Stock Exchange's market for listed securities.

In addition, until 40 days after the commencement of the offering of the Shares and the GDRs, an offer or sale of Shares and the GDRs 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.

The Underwriters propose to offer the Shares (i) in the form of GDRs to institutional investors outside the United States in accordance with Regulation S, and (ii) in the form of GDRs through the U.S. selling agents of certain of the Underwriters, only to QIBs in the United States in accordance with Rule 144A. Each of the Underwriters has agreed that, except as permitted in the Underwriting Agreement, it will not offer, sell or deliver Shares or the GDRs within the United States.

Each of the Underwriters has represented and agreed that: (i) it has not offered or sold and will not offer or sell any GDRs to persons in the United Kingdom prior to admission of the GDRs to listing in accordance with Part VI of the FSMA, except to persons whose ordinary activities involve them in acquiring, holding, managing or disposing of investments (as principal or agent) for the purposes of their businesses or otherwise in circumstances which have not resulted and will not result in an offer to the public in the United Kingdom within the meaning of the Public Offers of Securities Regulations 1995 or the FSMA; (ii) it has only communicated or caused to be communicated and will only communicate or cause to be communicated any 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 GDRs in circumstances in which section 21(1) of the FSMA does not apply to Sistema; and (iii) 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 or GDRs in, from or otherwise involving the United Kingdom.

Each of the Underwriters has represented and agreed that it has not offered or sold and will not offer or sell any GDRs, directly or indirectly, in Japan or to or for the account of any resident of Japan except (A) pursuant to an exemption from the registration requirements of the Securities and Exchange Law of Japan and (B) in compliance with any other applicable requirements of Japanese law.

Each of the Underwriters has represented and agreed that it has not offered or sold and will not offer or sell any GDRs to or for the benefit of any persons resident, incorporated, established or having their usual residence in Russia or to any person located within the territory of Russia unless and to the extent otherwise permitted under Russian law.

Each of the Underwriters has represented and agreed that the GDRs (including rights representing an interest in a Master GDR) may not be offered, have not been offered and will not be offered, directly or indirectly, in the Netherlands, as part of their initial distribution or as part of any re-offering, other than to persons who trade or invest in securities in the conduct of their profession or business (which includes banks, securities firms, investment institutions, insurance companies, pension funds, other institutional investors and treasury departments and finance companies of large enterprises).

Neither we nor the Underwriters, nor any person acting on our or the Underwriters' behalf, have taken or will take any action in any jurisdiction that would permit a public offering of the Shares or the GDRs, or the possession, circulation or distribution of this offering memorandum or any other material relating to us or the Shares and the GDRs, in any jurisdiction where action for such purpose is required. Accordingly, the Shares and the GDRs may not be offered or sold, directly or indirectly, nor may this offering memorandum or any other offering material or advertisement in connection with such securities be distributed or published, in or from any country or jurisdiction except under circumstances that will result in compliance with any applicable rules and regulations of any such country or jurisdiction.

No dealer, salesperson or other person has been authorized to give any information or to make any representation not contained in this offering memorandum, and, if given or made, such information or representation must not be relied upon as having been authorized by us or any Underwriter. This offering memorandum does not constitute an offer to sell or the solicitation of an offer to buy any securities other than the securities to which it relates or an offer to sell or the solicitation of an offer to buy such securities in any circumstances in which such offer or solicitation is unlawful. Neither the delivery of this offering memorandum nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in our affairs since the date hereof or that the information contained in this offering memorandum is correct as of a date after its date.

Other

Credit Suisse First Boston (Europe) Limited, Morgan Stanley & Co. International Limited and their respective affiliates have engaged in transactions with and performed various investment banking, financial advisory and other services for us and for our affiliates, for which they received customary fees, and Credit Suisse First Boston (Europe) Limited, Morgan Stanley & Co. International Limited and their respective affiliates may provide such services for us or for them in the future.

SETTLEMENT AND DELIVERY

Clearing and Settlement of GDRs

Custodial and depositary links have been established between Euroclear, Clearstream and DTC to facilitate the initial issue of the GDRs and cross-market transfers of the GDRs associated with secondary market trading.

The Clearing Systems

Euroclear and Clearstream

Euroclear and Clearstream each hold securities for participating organizations and facilitate the clearance and settlement of securities transactions between their respective participants through electronic book-entry changes in accounts of such participants. Euroclear and Clearstream provide to their respective participants, among other things, services for safekeeping, administration, clearance and settlement of internationally-traded securities and securities lending and borrowing. Euroclear and Clearstream participants are financial institutions throughout the world, including underwriters, securities brokers and dealers, banks, trust companies, clearing corporations and certain other organizations. Euroclear and Clearstream have established an electronic bridge between their two systems across which their respective customers may settle trades with each other. Indirect access to Euroclear or Clearstream is also available to others, such as banks, brokers, dealers and trust companies which clear through or maintain a custodial relationship with a Euroclear or Clearstream participant, either directly or indirectly.

Distributions of dividends and other payments with respect to book-entry interests in the GDRs held through Euroclear or Clearstream will be credited, to the extent received by the Depositary, to the cash accounts of Euroclear or Clearstream participants in accordance with the relevant system's rules and procedures.

DTC

DTC has advised Sistema as follows: DTC is a limited-purpose trust company organized under the laws of the State of New York, a "banking organization" within the meaning of the New York Banking Law, a member of the United States Federal Reserve System, a "clearing corporation" within the meaning of the New York Uniform Commercial Code, and a "clearing agency" registered pursuant to the provisions of Section 17A of the Exchange Act. DTC holds securities for DTC participants and facilitates the clearance and settlement of securities transactions between DTC participants through electronic computerized book-entry changes in DTC participants' accounts. DTC participants include securities brokers and dealers, banks, trust companies, clearing corporations, and certain other organizations. Indirect access to the DTC system is also available to others such as securities brokers and dealers, banks, and trust companies that clear through or maintain a custodial relationship with a DTC participant, either directly or indirectly.

Holders of book-entry interests in the GDRs holding through DTC will receive, to the extent received by the Depositary, all distributions of dividends or other payments with respect to book-entry interests in the GDRs from the Depositary through DTC and DTC participants. Distributions in the United States will be subject to relevant U.S. tax laws and regulations. See "Taxation—United States Federal Income Tax Considerations".

As DTC can act on behalf of DTC direct participants only, who in turn act on behalf of DTC indirect participants, the ability of beneficial owners who are indirect participants to pledge book-entry interests in the GDRs to persons or entities that do not participate in DTC, or otherwise take actions with respect to book-entry interests in the GDRs, may be limited.

Registration and Form

Book-entry interests in the GDRs held through Euroclear and Clearstream will be represented by the Master Regulation S GDR Certificate registered in the name of BT Globenet Nominees Limited as common nominee Deutsche Bank AG London, as common depositary for Euroclear and Clearstream. Book-entry interests in the GDRs held through DTC will be represented by the Master Rule 144A GDR Certificate registered in the name of Cede & Co., as nominee for DTC, which will be held by the Depositary as custodian for DTC. As necessary, the Registrar will adjust the amounts of GDRs on the relevant register for the accounts of the common nominee and nominee, respectively, to reflect the amounts of GDRs held through Euroclear, Clearstream and DTC, respectively. Beneficial ownership in the GDRs will be held through financial institutions as direct and indirect participants in Euroclear, Clearstream and DTC.

The aggregate holdings of book-entry interests in the GDRs in Euroclear, Clearstream and DTC will be reflected in the book-entry accounts of each such institution. Euroclear, Clearstream and DTC, as the case may be, and every other intermediate holder in the chain to the beneficial owner of book-entry interests in the GDRs, will be responsible for establishing and maintaining accounts for their participants and customers having interests in the book-entry interests in the GDRs. The Depositary will be responsible for maintaining a record of the aggregate holdings of GDRs registered in the name of the common nominee for Euroclear and Clearstream and the nominee for DTC. The Depositary will be responsible for ensuring that payments received by it from the Company for holders holding through Euroclear and Clearstream are credited to Euroclear or Clearstream, as the case may be, and the Depositary will also be responsible for ensuring that payments received by it from the Company for holders holding through DTC are received by DTC.

The Company will not impose any fees in respect of the GDRs; however, holders of book-entry interests in the GDRs may incur fees normally payable in respect of the maintenance and operation of accounts in Euroclear, Clearstream or DTC and certain fees and expenses payable to the Depositary in accordance with the terms of the Deposit Agreements.

Global Clearance and Settlement Procedures

Initial Settlement

The GDRs will be in global form evidenced by the two Global Master GDRs. Purchasers electing to hold book-entry interests in the GDRs through Euroclear and Clearstream accounts will follow the settlement procedures applicable to depositary receipts. DTC participants acting on behalf of purchasers electing to hold book-entry interests in the GDRs through DTC will follow the delivery practices applicable to depositary receipts.

Secondary Market Trading

Transfer restrictions

For a description of the transfer restrictions relating to the GDRs, see "Description of the Global Depositary Receipts—Transfer Restrictions."

Trading between Euroclear and Clearstream participants

Secondary market sales of book-entry interests in the GDRs held through Euroclear or Clearstream to purchasers of book-entry interests in the GDRs through Euroclear or Clearstream will be conducted in accordance with the normal rules and operating procedures of Euroclear and Clearstream and will be settled using the normal procedures applicable to depositary receipts.

Trading between DTC participants

Secondary market sales of book-entry interests in the GDRs held through DTC will occur in the ordinary way in accordance with DTC rules and will be settled using the procedures applicable to depositary receipts, if payment is effected in U.S. dollars, or free of payment, if payment is not effected in U.S. dollars. Where payment is not effected in U.S. dollars, separate payment arrangements outside DTC are required to be made between the DTC participants.

Trading between DTC seller and Euroclear/Clearstream purchaser

When book-entry interests in the GDRs are to be transferred from the account of a DTC participant to the account of a Euroclear or Clearstream participant, the DTC participant must send to DTC a delivery free of payment instruction at least two business days prior to the settlement date. DTC will in turn transmit such instruction to Euroclear or Clearstream, as the case may be, on the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream participant. On the settlement date, DTC will debit the account of its DTC participant and will instruct the Depositary to instruct Euroclear or Clearstream, as the case may be, to credit the relevant account of the Euroclear or Clearstream participant, as the case may be. In addition, on the settlement date, DTC will instruct the Depositary to (i) decrease the amount of book-entry interests in the GDRs registered in the name of a nominee for DTC and represented by the Master Rule 144A GDR Certificate and (ii) increase the amount of book-entry interests in the GDRs registered in the name of the common nominee for Euroclear and Clearstream and represented by the Master Regulation S GDR Certificate.

Trading between Clearstream/Euroclear seller and DTC purchaser

When book-entry interests in the GDRs are to be transferred from the account of a Euroclear or Clearstream participant to the account of a DTC participant, the Euroclear or Clearstream participant must send to Euroclear or Clearstream a delivery free of payment instruction at least one business day prior to the settlement date. Separate payment arrangements are required to be made between the DTC participant and the relevant Euroclear or Clearstream participant, as the case may be. On the settlement date, Euroclear or Clearstream, as the case may be, will debit the account of its participant and will instruct the Depositary to instruct DTC to credit the relevant account of Euroclear or Clearstream, as the case may be, and will deliver such book-entry interests in the GDRs free of payment to the relevant account of the DTC participant. In addition, Euroclear or Clearstream, as the case may be, shall on the settlement date instruct the Depositary to (i) decrease the amount of the book-entry interests in the GDRs registered in the name of the common nominee and evidenced by the Master Regulation S GDR Certificate and (ii) increase the amount of the book-entry interests in the GDRs registered in the name of a nominee for DTC and represented by the Master Rule 144A GDR Certificate.

General

Although the foregoing sets out the procedures of Euroclear, Clearstream and DTC in order to facilitate the transfers of interests in the GDRs among participants of Euroclear, Clearstream and DTC, none of Euroclear, Clearstream or DTC are under any obligation to perform or continue to perform such procedures, and such procedures may be discontinued at any time.

None of Sistema, the Underwriters, the Depositary, the Custodian or their respective agents will have any responsibility for the performance by Euroclear, Clearstream or DTC or their respective participants of their respective obligations under the rules and procedures governing their operations.

Pre-issue Trades Settlement

It is expected that delivery of GDRs will be made against payment therefor on the Closing Date thereof, which could be more than three business days following the date of pricing of the GDRs. Pursuant to Rule 15c6-1 under the Exchange Act, trades in the United States secondary market generally are required to settle within three business days (T+3), unless the parties to any such trade expressly agree otherwise. Accordingly, purchasers who wish to trade GDRs in the United States on the date of pricing or the next succeeding business days until three days prior to the relevant Closing Date will be required, by virtue of the fact the GDRs initially will settle beyond T+3, to specify an alternate settlement cycle at the time of any such trade to prevent a failed settlement. Settlement procedures in other countries will vary. Purchasers of GDRs may be affected by such local settlement practices and purchasers of GDRs between the date of pricing and the relevant Closing Date should consult their own adviser.

INFORMATION RELATING TO THE DEPOSITARY

The Depositary is Deutsche Bank Trust Company Americas. Deutsche Bank Trust Company Americas was incorporated on March 5, 1903 as a bank with limited liability in the State of New York and is an indirect wholly-owned subsidiary of Deutsche Bank AG. The Depositary is subject to regulation and supervision by the New York State Banking Department, the Federal Reserve Board and the Federal Deposit Insurance Corporation. The registered office of the Depositary is located at 60 Wall Street, New York, NY 10005 and the registered number is BR1026. A copy of the Depositary's By-laws, as amended, together with copies of the most recent financial statements and annual report of the Depositary will be available for inspection at the principal administrative establishment of the Depositary located at 60 Wall Street, DR Department, 25th Floor, New York, NY 10005 and at the office of the Depositary located at Winchester House, 1 Great Winchester Street, London EC2N 2DB. Such information will be updated as long as the GDRs are admitted to listing on the Official List.

LEGAL MATTERS

Certain legal matters with respect to the offering will be passed upon for us by Latham & Watkins, London, England and Latham & Watkins LLP, New York, New York. Certain legal matters under Russian law will be passed upon for us by Andrey Gorodissky & Partners, Moscow, Russian Federation. Certain legal matters with respect to the offering will be passed upon for the Underwriters by Linklaters, London, England and Linklaters CIS, Moscow, Russian Federation.

INDEPENDENT AUDITORS

The consolidated financial statements of Sistema and its subsidiaries and the consolidated financial statements of Mobile TeleSystems OJSC and its subsidiaries as of and for the years ended December 31, 2001, 2002 and 2003 have been audited by ZAO Deloitte & Touche CIS, independent auditors, Business Center "Mokhovaya," 4/7 Vozdvizhenka Street, Bldg. 2, Moscow 125009, Russian Federation. Each of their reports, in respect of such years, expresses unqualified opinions. The reports on the consolidated financial statements of Sistema and its subsidiaries include explanatory paragraphs for the adoption of SFAS No. 142, "Goodwill and Other Intangible Assets" for 2002; and a change in accounting principle regarding the recognition of subscriber acquisition costs in its equity method investee, Mobile TeleSystems OJSC, in 2001. The reports on the consolidated financial statements of Mobile TeleSystems OJSC and its subsidiaries include an explanatory paragraph for a change in accounting principle regarding the recognition of subscriber acquisition costs in 2001.

EXPERTS

Cushman & Wakefield Healey & Baker, 43/45 Portman Square, London, W1A 3BG United Kingdom, an internationally recognized real estate appraisal company, has given and not withdrawn its written consent to the inclusion of its report, appearing on page A-1 of this offering memorandum, in the form and context in which it is included, and has authorized the contents of that part of the listing particulars for the purposes of Regulation 6(1)(e) of The Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001.

LISTING AND GENERAL INFORMATION

1. It is expected that the GDRs will be admitted, subject only to the issue of the Master Regulation S GDR and the Master Rule 144A GDR, to the Official List on or about February 14, 2005. Application has been made for the GDRs to be traded on the London Stock Exchange. Prior to admission to the Official List, however, dealings will be permitted by the London Stock Exchange in accordance with its rules. Transactions will normally be effected for delivery on the third working day after the day of the transaction. A copy of this offering memorandum has been delivered to the Registrar of Companies in England and Wales, as required by Section 83 of the FSMA.

2. The issue of the Shares was authorized by the extraordinary shareholders meeting of Sistema held on September 1, 2004 and by the Board of Directors of Sistema on October 2, 2004.

3. Sistema has obtained all consents, approvals and authorizations in Russia in connection with the issue of the Shares (except for the registration of the placement report with the Federal Service for the Financial Markets which, in accordance with Russian law, will be applied for upon the completion of the placement) and the GDRs.

4. Copies of the following will be available for inspection and may be obtained free of charge, during normal business hours on any weekday, at the office of Deutsche Bank AG London, Winchester House, 1 Great Winchester Street, London EC2N 2DB, United Kingdom for 14 days from the date of this offering memorandum:

   - the charter of Sistema (English translation);
   - the Deposit Agreements;
   - the Underwriting Agreement;
   - copies of Sistema's audited consolidated financial statements as of December 31, 2001, 2002 and 2003 and for the years then ended, together with the auditors' report relating thereto;
   - copies of MTS' audited consolidated financial statements as of December 31, 2001, 2002 and 2003 and for the years then ended, together with the auditors' report relating thereto;
   - copies of Sistema's unaudited interim consolidated financial statements as of September 30, 2004 and for the nine-month period then ended;
   - the valuation report of C&WH&B; and
   - the consent of ZAO Deloitte & Touche CIS.

5. Sistema prepares annual and interim consolidated financial statements in accordance with U.S. GAAP. Copies of Sistema's future annual audited consolidated financial statements and unaudited interim consolidated financial statements required to be provided to holders of GDRs will be available for inspection and may be obtained free of charge at the office of Deutsche Bank AG London.

6. If definitive certificates are issued in exchange for the Master GDRs, Sistema will appoint an agent in the United Kingdom.

7. The GDRs will be accepted for clearance through DTC. The Common Code for the Regulation S GDRs is 021034240, the ISIN for the Regulation S GDRs is US48122U2042 and the CUSIP number for the Regulation S GDRs is 48122U 20 4. The Common Code for the Rule 144A GDRs is 021034495, the ISIN for the Rule 144A GDRs is US48122U1051 and the CUSIP number for the Rule 144A GDRs is 48122U 10 5.

8. On August 26, 2004, the General Prosecutor of Kiev requested the Ukrainian Constitutional Court to review whether certain provisions of the Ukrainian privatization law limiting the alienation of assets by privatized companies were applicable to the sale by Ukrtelecom of UMC shares to MTS. In the event that MTS' purchase of UMC is found to have violated Ukrainian law or the purchase is unwound, in whole or in part, MTS' and our business, prospects and results of operations would be materially adversely affected. This potential loss cannot be quantified. UMC's revenues for the nine months ended September 30, 2004 were $586.4 million. Except as described above, neither we nor any of our subsidiaries is or has been involved in any legal or arbitration proceedings that may have, or have had, during the 12 months preceding the date of this offering memorandum, a significant effect on the financial position of Sistema or the Sistema Group nor are we aware that any such proceedings are pending or threatened.

9. Except as otherwise disclosed in this offering memorandum, there has been no significant change in the financial or trading position of Sistema or the Sistema Group since September 30, 2004 (the date of the latest interim financial statements), and no material adverse change in the financial position or prospects of Sistema or the Sistema Group since December 31, 2003 (the date of the latest audited financial statements).

10. The following table sets forth the registered offices of certain of our subsidiaries:

Company	Beneficial Ownership(1)	Voting Interest(2)	Registered office
Telecommunications			
MTS	51%	51%	4 Marksistskaya Street, Moscow 109147, Russian Federation
UMC	51%	100%	15 Leptsigsyaka Street, Kiev 01015, Ukraine
Telecom XXI(3)	51%	100%	51 Shpalernaya Street, St. Petersburg 193015, Russian Federation
Kuban GSM(4)	51%	100%	61 Gimnazicheskaya, Krasnodar 350000, Russian Federation
MGTS	46%	56%	12 Petrovsky Boulevard, building 3, Moscow 103051, Russian Federation
Sky-Link	42%	50%	18/7 Kuznetsky Most Street, building 1, Moscow 107031, Russian Federation
Comstar UTS(5)			27 Smolenskaya-Sennaya Street, building 2, Moscow 119121, Russian Federation
MTU-Inform	76%	99%	27 Smolenskaya-Sennaya Street, building 2, Moscow 119121, Russian Federation
Comstar	77%	100%	27 Smolenskaya-Sennaya Street, building 2, Moscow 119121, Russian Federation
Telmos	62%	80%	15 Zemledelchesky Pereulok, Moscow 119121, Russian Federation
MTU-Intel	87%	100%	27 Smolenskaya-Sennaya Street, building 2, Moscow 119121, Russian Federation
Golden Line	87%	100%	51/4 Shepkina Street, Moscow 129110, Russian Federation
MTT	36%	45%	22 Marksistskaya Street, Moscow 109147, Russian Federation
Sistema Telecom	100%	100%	5 First Tverskaya-Yamskaya, Moscow 125047, Russian Federation
Technology			
CSC	78%	78%	12, Pervyi Zapadnyi Proezd, building 1, Moscow 124460, Russian Federation
STROM telecom s.r.o.	52%	67%	4 Praha, Minchelska, Czech Republic
Kvazar Micro	50%	51%	1-3 Severo-Syretskaya Street, Kiev 13, 04136, Ukraine
Mikron	60%	77%	12, Pervyi Zapadnyi Proezd, building 1, Moscow 124460, Russian Federation

Company	Beneficial Ownership[1]	Voting Interest[2]	Registered office
Sitronics	78%	100%	4, Proezd 4806, building 1, Yuzhnaya Promzona, Zelenograd 124460, Russian Federation
Insurance			
ROSNO	49%	51%	30 Ozerkovskaya Naberezhnaya, Moscow 115184, Russian Federation
Banking			
MBRD	95%	99%	5 Yeropkinsky Pereulok, building 1, Moscow 119034, Russian Federation
East-West United Bank	49%	49%	10 Boulevard Joseph II, L-1840 Luxembourg
Media			
Sistema Mass Media	90%	90%	13 Kostyansky Pereulok, Moscow 107045, Russian Federation
Retail			
Detsky Mir	75%	75%	5 Teatralny Proezd, Moscow 109012, Russian Federation
Detsky Mir Center	100%	100%	37, Prospect Vernadskogo, building 3, Moscow 117415, Russian Federation
Real Estate			
Sistema Hals	100%	100%	40/37 Bolshaya Ordynka, building 11, Moscow 119017, Russian Federation
Landshaft	100%	100%	35 Bolshaya Tatarskaya Street, building 4, Moscow 113184, Russian Federation
Other Businesses			
Intourist	91%	91%	Kosmos Hotel, 150 Prospekt Mira, Moscow 129366, Russian Federation
RTI Systems	100%	100%	10 Eighth of March Street, building 1, Moscow 127083, Russian Federation
Medical Technology Holding Company	74%	74%	35, Bolshaya Tatarskaya Street, building 4, Moscow 113184, Russian Federation
ECU GEST	99%	99%	41 rue des Glacis, L-1628 Luxembourg
Sistema Finance S.A.[6]	100%	100%	5 rue Eugène Ruppert, L-2453 Luxembourg
Sistema Holding Limited[7]	100%	100%	Grigoriou Xenopoulou 17, Totalserve House, P.C. 3106 Limassol, Cyprus

(1) "Beneficial ownership" represents the percentage of ownership interests of the relevant entity that are beneficially owned by Sistema, directly or indirectly, based on Sistema's proportionate ownership of the relevant entity through its consolidated subsidiaries. Our ownership interests in the subsidiaries presented above are calculated based on shares owned by us as well as shares owned by certain companies affiliated but not owned by us, which we are required to consolidate under U.S. GAAP (FIN 46R). Excluding the ownership interests of these affiliated companies, our beneficial ownership interests in certain subsidiaries listed above would have been lower by the following amounts: CSC (2.0%), Mikron (1.5%), STROM telecom (1.4%), Sitronics (2.0%), ROSNO (1.8%), MBRD (28.8%), Detsky Mir (4.5%), Sistema-Hals (1.1%) and Landshaft (1.1%).

(2) "Voting interest" represents the percentage of ownership interests of the relevant entity that Sistema or any of its consolidated subsidiaries has the power to vote.

(3) Telecom XXI, a wholly-owned subsidiary of MTS, is a wireless operator that operates in northwest Russia, including St. Petersburg.

(4) Kuban GSM, a wholly-owned subsidiary of MTS, is a wireless operator in the Krasnodar region of Russia.

(5) The entities comprising the businesses of Comstar UTS are currently being restructured and combined into a single legal entity. After the completion of the merger, we expect that Sistema will own at least 51% of Comstar UTS directly with an additional stake owned indirectly through MGTS. References herein to "Comstar" are to our alternative fixed line subsidiary Comstar only.

(6) Sistema Finance S.A. is our Luxembourg finance subsidiary.

(7) Sistema Holding Limited is our Cyprus finance subsidiary that holds 193,473,900 of our shares in MTS as security for our 10¼% guaranteed senior secured notes due 2008.

11. The GDRs have no nominal or par value. The offer price was determined based on the results of the bookbuilding exercise conducted by the Joint Lead Managers.

12. ZAO Deloitte & Touche CIS has given and not withdrawn its written consent to the inclusion of its reports, appearing on pages F-2 and F-114 of this offering memorandum, in the form and context in which they are included, and has authorized the contents of those parts of the listing particulars for the purposes of Regulation 6(1)(e) of The Financial Services and Markets Act 2000 (Official Listing of Securities) Regulations 2001.

13. Holders of GDRs may contact Deutsche Bank Trust Company Americas, as depositary for the GDRs (Attn: Broker Services, Winchester House, 1 Great Winchester Street, London EC2N 2DB, United Kingdom, tel +44 207 547 6500) with questions relating to the transfer of GDRs on the books of the depositary, which shall be maintained at the Depositary's corporate trust office at 60 Wall Street, New York, New York 10005 (tel +1 212 250 9100).

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INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

INDEPENDENT AUDITORS' REPORT

To the Shareholders of JSFC Sistema:

We have audited the accompanying consolidated balance sheets of JSFC Sistema and subsidiaries (the "Group") as of December 31, 2003, 2002 and 2001, and the related consolidated statements of operations and comprehensive income, changes in shareholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, based on our audits, such financial statements present fairly, in all material respects, the consolidated financial position of the Group as of December 31, 2003, 2002 and 2001, and the consolidated results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the consolidated financial statements, as of January 1, 2002, the Group adopted Financial Accounting Standard ("FAS") No. 142, "Goodwill and Other Intangible Assets". The adoption of FAS No. 142 resulted in recognition of a goodwill impairment charge of $21.5 million, which is classified as a cumulative effect of a change in accounting principle for the year ended December 31, 2002.

As discussed in Note 3 to the consolidated financial statements, effective January 1, 2001, MTS changed its method of accounting for recognition of subscriber acquisition costs. The Group's share of the cumulative effect of this change in the amount of $6.2 million (net of tax effect of $1.1 million) was charged to income for the year ended December 31, 2001.

/s/ ZAO Deloitte & Touche CIS

June 10, 2004

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

DECEMBER 31, 2003, 2002 and 2001
(Amounts in thousands of U.S. dollars, except share amounts)

	Notes	2003	2002	2001
ASSETS				
CURRENT ASSETS:				
Cash and cash equivalents	6	$ 283,165	$ 157,267	$ 91,962
Short-term investments	7	278,850	164,315	86,187
Loans to customers and banks, net	8	364,982	160,744	226,860
Insurance-related receivables	9	69,855	50,140	30,878
Accounts receivable, net	10	182,251	69,553	54,172
Other receivables and prepaid expenses, net	11	567,125	81,687	65,870
Inventories	12	166,203	48,104	37,885
Deferred tax assets, current portion	26	53,964	9,358	4,542
Assets of discontinued operations	5	—	20,716	12,429
Total current assets		1,966,395	761,884	610,785
Property, plant and equipment, net	13	3,368,121	910,042	804,732
Advance payments for non-current assets		52,969	8,348	7,037
Long-term receivables	14	1,223	9,930	5,534
Long-term investments	15	41,393	32,273	24,766
Investments in affiliated companies	16	150,936	536,338	423,241
Goodwill	3	71,998	19,982	44,237
Licenses, net	17	669,988	—	—
Other intangible assets, net	18	446,381	26,042	11,411
Debt issuance costs, net	3	17,251	—	—
Deferred tax assets	26	5,575	23,492	26,641
TOTAL ASSETS		$6,792,230	$2,328,331	$1,958,384

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Continued)

DECEMBER 31, 2003, 2002 and 2001
(Amounts in thousands of U.S. dollars, except share amounts)

	Notes	2003	2002	2001
LIABILITIES AND SHAREHOLDERS' EQUITY				
CURRENT LIABILITIES:				
Accounts payable		$ 234,871	$ 62,067	$ 56,905
Bank deposits and notes issued	19	173,748	171,293	202,796
Insurance-related liabilities	20	180,986	137,109	105,273
Taxes payable		117,142	25,375	24,215
Deferred tax liabilities, current portion	26	508	1,371	—
Accrued expenses and other current liabilities	21	607,083	129,573	79,594
Short-term notes payable	22	349,083	198,597	144,485
Current portion of long-term debt	24	844,106	106,843	71,904
Liabilities of discontinued operations	5	—	49,166	41,836
Total current liabilities		2,507,527	881,394	727,008
LONG-TERM LIABILITIES:				
Capital lease obligations	23	4,943	9,691	14,906
Long-term debt	24	1,475,921	265,880	289,790
Subscriber prepayments, net of current portion	25	103,059	66,935	54,875
Deferred tax liabilities	26	230,986	25,425	13,205
Postretirement benefits	27	8,590	6,277	6,810
Total long-term liabilities		1,823,499	374,208	379,586
Deferred revenue	28	115,363	89,894	73,043
TOTAL LIABILITIES		4,446,389	1,345,496	1,179,637
Minority interests in equity of subsidiaries		1,356,557	388,055	364,411
Commitments and contingencies	32	—	—	—
SHAREHOLDERS' EQUITY:				
Share capital (68,325,000 shares with par value of 0.1 RUR authorized, 8,100,000 shares issued and outstanding)	29	171	171	171
Additional paid-in capital	4, 5	189,934	200,931	188,215
Retained earnings		783,258	396,211	230,235
Accumulated other comprehensive income/(loss)		15,921	(2,533)	(4,285)
TOTAL SHAREHOLDERS' EQUITY		989,284	594,780	414,336
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		$6,792,230	$2,328,331	$1,958,384

See notes to consolidated financial statements.

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001

(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	2003	2002	2001
Sales	30	$3,543,154	$ 720,905	$ 614,345
Revenues from financial services	30	216,761	168,601	106,191
TOTAL REVENUES		3,759,915	889,506	720,536
Cost of sales, exclusive of depreciation and amortization shown separately below		(1,256,494)	(405,947)	(346,091)
Financial services related costs, exclusive of depreciation and amortization shown separately below		(131,533)	(115,520)	(78,692)
TOTAL COST OF SALES		(1,388,027)	(521,467)	(424,783)
Selling, general and administrative expenses		(689,057)	(141,401)	(95,272)
Depreciation and amortization		(520,976)	(72,042)	(59,978)
Goodwill impairment	3	(19,251)	—	—
Other operating (expenses)/income, net		(37,326)	12,762	(704)
Equity in net income of investees		465	124,625	96,635
Net gain on disposal of subsidiaries		—	3,787	4,452
OPERATING INCOME		1,105,743	295,770	240,886
Interest income		19,341	1,622	1,812
Interest expense		(198,346)	(53,111)	(39,737)
Currency exchange and translation (loss)/gain		(3,015)	5,113	2,482
Income from continuing operations before income tax, minority interests and cumulative effect of a change in accounting principle		923,723	249,394	205,443
Income tax expense	26	(290,933)	(43,398)	(29,170)
Income from continuing operations before minority interest and cumulative effect of a change in accounting principle		632,790	205,996	176,273
Minority interests		(402,120)	(35,109)	(28,953)
Income from continuing operations before cumulative effect of a change in accounting principle		230,670	170,887	147,320
Gain/(loss) from discontinued operations (net of income tax effect of $3,553, $1,492, and $475 respectively)	5	12,810	(3,156)	(5,886)
Gain on disposal of discontinued operations (net of income tax effect of $18,278 and nil, respectively)	5	143,567	19,725	—
Cumulative effect of a change in accounting principle (net of income tax effect of nil and $1,090, respectively)	3	—	(21,480)	(6,179)
NET INCOME		$ 387,047	$ 165,976	$ 135,255
Other comprehensive income/(loss):				
Change in unrealized gain on securities available for sale, net of income tax of nil		5,582	1,752	1,036
Translation adjustment, net of minority interest of $24,426 and income tax of nil	3	35,321	—	—
Income tax effect of changes in the functional currency, net of minority interest of $17,184	3	(22,449)	—	—
Comprehensive income		$ 405,501	$ 167,728	$ 136,291
Weighted average number of common shares outstanding		8,100,000	8,100,000	8,100,000
Earnings per share, basic and diluted:				
Income from continuing operations before cumulative effect of a change in accounting principle		$ 28.5	$ 21.1	$ 18.2
Gain/(loss) from discontinued operations		19.3	2.0	(0.7)
Cumulative effect of a change in accounting principle		—	(2.7)	(0.8)
Net income		47.8	20.5	16.7

See notes to consolidated financial statements.

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001

(Amounts in thousands of U.S. dollars)

	2003	2002	2001
OPERATING ACTIVITIES:			
Net income	$ 387,047	$ 165,976	$ 135,255
Adjustments to reconcile net income to net cash provided by operations:			
(Gain)/loss from discontinued operations	(12,810)	3,156	5,886
Depreciation and amortization	520,976	72,042	59,978
Goodwill impairment	19,251	—	—
Loss on disposal of property, plant and equipment	15,048	1,176	1,345
Gain on disposal of discontinued operations	(143,567)	(19,725)	—
Gain on disposal of subsidiaries	—	(3,787)	(4,452)
Gain on disposal of shares in affiliates	—	(9,100)	—
Cumulative effect of a change in accounting principle, net	—	21,480	6,179
Minority interests	402,120	35,109	28,953
Equity in net income of investees	(465)	(124,625)	(96,635)
Provision for deferred income taxes	(42,601)	12,216	(8,016)
Provision for doubtful accounts receivable	9,972	7,172	674
Allowance for loan losses	9,902	1,637	1,467
Inventory obsolescence charge	(797)	—	—
Changes in operating assets and liabilities, net of effects from purchase of businesses:			
Trading securities	(38,988)	(67,025)	(31,222)
Loans to banks	(121,444)	75,853	(88,180)
Insurance-related receivables	(19,715)	(19,262)	(21,983)
Accounts receivable	(47,005)	(17,407)	(14,666)
Other receivables and prepaid expenses	(101,632)	(15,420)	(32,142)
Inventories	(54,406)	(8,584)	(8,733)
Accounts payable	(1,600)	(2,631)	18,421
Insurance-related liabilities	43,877	31,836	56,211
Taxes payable	24,694	(812)	8,406
Accrued expenses, subscriber prepayments and other liabilities	136,567	49,874	7,214
Postretirement benefits	1,978	(533)	3,046
Net cash provided by operations	$ 986,402	$ 188,616	$ 27,006

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001

(Amounts in thousands of U.S. dollars)

	2003	2002	2001
INVESTING ACTIVITIES:			
Purchase of property, plant and equipment	$(1,024,870)	$(148,436)	$(144,937)
Purchase of intangible assets	(134,424)	(2,323)	(308)
Purchase of businesses, net of cash acquired	(1,005,451)	(12,952)	(33,466)
Proceeds from disposal of subsidiaries, net of cash disposed	71,417	22,478	1,263
Purchase of long-term investments	(88,281)	(5,235)	(19,174)
Proceeds from sale of long-term investments	6,538	16,425	2,752
Purchase of short-term investments	(102,165)	(22,853)	(7,807)
Proceeds from sale of short-term investments	312	8,895	31,523
Proceeds from sale of property, plant and equipment	4,384	3,870	1,704
Net increase in loans to customers	(92,696)	(11,374)	(79,693)
Net cash used in investing activities	(2,365,236)	(151,505)	(248,143)
FINANCING ACTIVITIES:			
Proceeds from short-term borrowings, net	120,772	74,072	—
Principal payments on short-term borrowings, net	—	—	(9,035)
Net (decrease)/increase in deposits from customers	(15,294)	(33,540)	115,465
Net increase/(decrease) in bank promissory notes issued	56,449	(7,402)	19,301
Proceeds from sale of common stock	—	—	72,564
Proceeds from grants	7,390	3,202	15,086
Payments to shareholders of subsidiaries, net	(63,069)	—	—
Proceeds from long-term borrowings	2,182,802	133,697	260,107
Principal payments on long-term borrowings	(758,784)	(132,905)	(205,750)
Principal payments on capital lease obligations	(25,534)	(8,930)	(15,395)
Net cash provided by financing activities	$ 1,504,732	$ 28,194	$ 252,343
INCREASE IN CASH AND CASH EQUIVALENTS	$ 125,898	$ 65,305	$ 31,206
CASH AND CASH EQUIVALENTS, beginning of year	157,267	91,962	60,756
CASH AND CASH EQUIVALENTS, end of year	$ 283,165	$ 157,267	$ 91,962
CASH PAID DURING THE YEAR FOR:			
Interest, net of amounts capitalized	$ (146,863)	$ (50,456)	$ (42,186)
Income taxes	(335,636)	(29,407)	(33,681)
NON-CASH INVESTING AND FINANCING ACTIVITIES:			
Property, plant and equipment contributed free of charge	$ 18,793	$ 21,337	$ 12,736
Equipment acquired through vendor financing	17,093	8,522	18,314
Equipment acquired under capital lease	17,709	10,106	29,670

In addition, non-cash investing activities during 2003, 2002 and 2001 included acquisitions and dispositions of subsidiaries and affiliates, as described in Notes 4 and 5.

See notes to consolidated financial statements.

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001

(Amounts in thousands of U.S. dollars)

	Share capital	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income/(loss)	Total
Balances at January 1, 2001	**$171**	**$186,858**	**$ 94,980**	**$ (5,321)**	**$276,688**
Change in unrealized gain on securities available for sale, net of income tax of nil	—	—	—	1,036	1,036
Capital transactions of subsidiaries	—	1,357	—	—	1,357
Net income	—	—	135,255	—	135,255
Balances at December 31, 2001	**$171**	**$188,215**	**$230,235**	**$ (4,285)**	**$414,336**
Change in unrealized gain on securities available for sale, net of income tax of nil	—	—	—	1,752	1,752
Capital transactions of subsidiaries	—	12,716	—	—	12,716
Net income	—	—	165,976	—	165,976
Balances at December 31, 2002	**$171**	**$200,931**	**$396,211**	**$ (2,533)**	**$594,780**
Change in unrealized gain on securities available for sale, net of income tax of nil	—	—	—	5,582	5,582
Translation adjustment, net of minority interest of $24,426 and income tax of nil (Note 3)	—	—	—	35,321	35,321
Income tax effect of changes in the functional currency, net of minority interest of $17,184 (Note 3)	—	—	—	(22,449)	(22,449)
Capital transactions of subsidiaries (Notes 4, 5)	—	(10,997)	—	—	(10,997)
Net income	—	—	387,047	—	387,047
Balances at December 31, 2003	**$171**	**$189,934**	**$783,258**	**$ 15,921**	**$989,284**

See notes to consolidated financial statements.

1. DESCRIPTION OF BUSINESS

The financial statements of JSFC Sistema and subsidiaries (the "Group") reflect the consolidation of separate financial statements of operating entities related by means of direct or indirect ownership of their voting stock by the Group's holding company, JSFC Sistema. Most of the consolidated entities and the parent company are incorporated in the Russian Federation ("RF").

The controlling shareholder of JSFC Sistema is Vladimir P. Evtushenkov. Minority holdings are owned by certain top executives and former top executives of the Group.

The principal activities of the significant entities of the Group are as follows:

Operating entities	Short name	Principal activity
JSFC Sistema	JSFC Sistema	Investing and financing activities, consulting services
Telecommunications Segment:		
MTS and subsidiaries	MTS	Wireless and fixed line telecommunication services, data transmission and internet services
MGTS and subsidiaries	MGTS	
MTU-Intel and subsidiary	MTU-Intel	
Comstar and subsidiaries	Comstar	
Telmos	Telmos	
Technology Segment:		
CSC and subsidiaries	CSC	Production and marketing of integrated circuits, wafers, electronic devices and consumer electronics, research and development
Concern Scientific Center and subsidiaries	Scientific Center	
Insurance Segment:		
Rosno and subsidiaries	Rosno	Medical, property, casualty, life and personal insurance and reinsurance, administration of state medical insurance programs
Banking Segment:		
Moscow Bank for Reconstruction and Development and subsidiaries	MBRD	Banking activities, securities transactions and foreign currency transactions

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

Operating entities	Short name	Principal activity
Other businesses:		
Detsky Mir and subsidiaries	Detsky Mir	Retail trading in Moscow and other Russian cities
Detsky Mir-Center	DM-Center	
Bauland	Bauland	
VAO Intourist and subsidiaries	Intourist	Sale of tour packages in the RF and abroad
Sistema-Hals and subsidiaries	Sistema-Hals	Development and marketing of real estate projects in Moscow
Sistema Mass Media and subsidiaries	Sistema Mass Media	Production and distribution of periodicals, publishing activities, broadcasting, advertising
Concern Media Center SMM and subsidiaries	Media-Center	
Concern RTI Systems and subsidiaries	Concern RTI	Manufacturing of radiotechnical equipment, research and development
ECU GEST HSA and subsidiaries	ECU GEST	Securities transactions, investing in real estate projects

During 1998-2002 the Group acquired ownership interests in a number of entities involved in manufacturing of radiotechnical equipment and related research and development activities, for an aggregate consideration of approximately $4.5 million. In 2000 the Group established Concern RTI, a 100% subsidiary, and contributed its interests in the voting stock of the radiotechnical business line entities into the share capital of Concern RTI. Prior to 2003, most of the Concern RTI's subsidiaries operated under governmentally imposed restrictions. Such restrictions precluded consolidation of Concern RTI in the Group's financial statements. In those periods the Group accounted for its investments in Concern RTI at cost of acquisition, net of impairment charges. In 2003, most of these restrictions have been waived (except as relates to NIIDAR, a Research and Development Institute of Long-Distance Radio Communications) and the Group started consolidating operations of the radiotechnical business line effective January 1, 2003 (except for operations of NIIDAR, that is continued to be accounted for at cost, net of impairment charges). Revenues and net income of the radiotechnical business line for the year ended December 31, 2003 amounted to $29.1 million and $0.6 million, respectively. Consolidation of operations of the radiotechnical business line effective January 1, 2001, would have immaterial effect on the consolidated net income for the years ended December 31, 2002 and 2001.

2. WORKING CAPITAL

As of December 31, 2003 the Group had a net working capital deficit of $541.1 million. Management believes, on the basis of cash flow forecasts, that the total facilities available to the Group will be sufficient to cover all of the Group's current obligations.

3. SUMMARY OF 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. The accompanying financial statements differ from the financial statements prepared for statutory purposes in Russia in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the accounting books of the Group's entities.

Principles of Consolidation—The consolidated financial statements include the accounts of JSFC Sistema, as well as entities, where JSFC Sistema, directly or indirectly, owns a majority voting interest, or has operating and financial control in accordance with charter documents. All significant intercompany transactions, balances and unrealized gains (losses) on transactions have been eliminated.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The ownership interest of JSFC Sistema and proportion of voting power of the Group and related parties in the significant subsidiaries as of December 31, 2003, 2002 and 2001 are as follows:

	Ownership interest			Proportion of voting power		
Operating entities	**2003**	**2002**	**2001**	**2003**	**2002**	**2001**
MTS	51%[1]	Affiliate	Affiliate	51%	Affiliate	Affiliate
Ukrainian Mobile Communications ("UMC"), subsidiary of MTS	51%[1]	—	—	100%	—	—
Telecom XXI, subsidiary of MTS	51%[1]	Affiliate	Affiliate	100%	Affiliate	Affiliate
Kuban-GSM, subsidiary of MTS	51%[1]	Affiliate		100%	Affiliate	
Telecom-900, subsidiary of MTS	51%[1]	Affiliate	Affiliate	100%	Affiliate	Affiliate
SCS-900, subsidiary of MTS	45%[1]	Affiliate	Affiliate	89%	Affiliate	Affiliate
FECS-900, subsidiary of MTS	30%[1]	Affiliate	Affiliate	60%	Affiliate	Affiliate
Uraltel, subsidiary of MTS	51%[1]	Affiliate	Affiliate	100%	Affiliate	Affiliate
Recom, subsidiary of MTS	27%[1]	Affiliate	Affiliate	54%	Affiliate	Affiliate
BM-Telecom, subsidiary of MTS	51%[1]	Affiliate	—	100%	Affiliate	—
TAIF-Telcom, subsidiary of MTS	27%[1]	—	—	53%	—	—
Dontelecom, subsidiary of MTS	51%[1]	Affiliate	—	100%	Affiliate	—
Sibchallenge, subsidiary of MTS	51%[1]	—	—	100%	—	—
Tomsk Cellular Communications, subsidiary of MTS	51%[1]	—	—	100%	—	—
MGTS	56%	56%	56%	56%	56%	56%
MTU-Inform, subsidiary of MGTS	76%[1]	76%[1]	76%[1]	99%	99%	99%
Personal Communications ("P-Com"), subsidiary of MTU-Inform	63%[1]	63%[1]	72%[1]	83%	83%	91%
MTU-Intel	87%[1]	87%[1]	48%[1]	100%	100%	100%
Golden Line, subsidiary of MTU-Intel	87%[1]	87%[1]	Affiliate	100%	100%	Affiliate
Comstar	77%[1]	Affiliate	Affiliate	100%	Affiliate	Affiliate
Telmos	62%[1]	62%[1]	62%[1]	80%	80%	80%
Rosno	47%	47%	47%	51%	51%	51%
MBRD	59%[1]	52%[1]	47%[1]	86%	86%	86%
Intourist	91%	91%	55%	91%	91%	75%
Detsky Mir	71%	71%	71%	75%	74%	71%
DM-Center	100%	53%[1]	53%[1]	100%	100%	100%
NIIME and Plant Mikron ("Mikron"), subsidiary of CSC	57%[1]	56%[1]	63%[1]	72%	70%	63%
Strom Telecom, subsidiary of CSC	80%[1]	80%[1]	Affiliate	100%	100%	Affiliate
Sistema-Hals	99%[1]	98%[1]	97%[1]	100%	100%	100%
Nasha Pressa, subsidiary of Media-Center	100%[1]	100%[1]	—	100%	100%	—
Concern RTI	100%	100%	100%	100%	100%	100%
ECU GEST	99%	99%	59%	99%	99%	59%

(1) Including indirect ownership.

As of December 31, 2003, 2002 and 2001 the Group's ownership structure included interests in certain subsidiaries owned by entities, related by means of common control. Net assets and operating results of these subsidiaries related to such holdings are accounted for as minority interest.

Accounts of newly-acquired subsidiaries have been consolidated in the Group's financial statements from the beginning of the year, when control was acquired, with pre-acquisition earnings of an interest purchased during the year included in minority interest in the statement of operations.

MGTS's non-convertible non-cumulative preferred shares carry guaranteed dividend rights amounting to the higher of 10% of the income of MGTS as disclosed in the Russian statutory accounting reports and the dividends paid on common shares. In the event of MGTS liquidation, preferred shareholders receive the par value of their shares, or the amounts payable to common shareholders, if higher. Where the preferred dividend is not paid in any year the preferred shares carry voting rights, that are otherwise limited to resolutions regarding liquidation or reorganization of MGTS, changes to dividend levels of preferred shares, and issuance of additional preferred stock. Dividends on MGTS's preferred shares are recorded in the statements of operations when declared.

Use of Estimates—The preparation of 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 at the date of the financial statements and the reported amounts of revenues and expenses of the reporting period. Actual results could differ from those estimates.

Concentration of Business Risk—The Group's principal business activities are within the RF. Laws and regulations affecting businesses operating in the RF are subject to rapid changes, which could impact the Group's assets and operations.

Foreign Currency Translation—The Group follows a translation policy in accordance with Statement on Financial Accounting Standards ("FAS") No. 52, "Foreign Currency Translation". Due to a highly inflationary economy in the RF in 2002, the U.S. dollar (the Group's reporting currency) has been designated as the Group's functional currency. Accordingly, all foreign currency amounts were translated into U.S. dollars ("USD") using the remeasurement method.

Starting from January 1, 2003, the Russian economy ceased to be considered highly inflationary for accounting purposes. Management has determined that for the fiscal year beginning January 1, 2003 the functional currency of MGTS, Rosno, Kuban-GSM, Mikron, Detsky Mir, DM-Center, Sistema Mass Media, Media-Center and Concern RTI is the Russian Ruble ("RUR"), the functional currency of UMC is the Ukrainian Hryvna ("UAH") and the functional currency of Strom-Telecom is the Czech Krona. Accordingly, the reporting currency amounts for these subsidiaries were translated into their functional currency at the exchange rate current at January 1, 2003. These amounts became the new accounting basis for the non-monetary assets and liabilities. Management believes that USD is still the appropriate functional currency for the other subsidiaries of the Group due to pervasive use of the U.S. dollar in their operations.

Pursuant to Emerging Issues Task Force ("EITF") Issue No. 92-8, "Accounting for the Income Tax Effects under FASB Statement No. 109 of a Change in Functional Currency When an Economy Ceases to Be Considered Highly Inflationary", the differences between the new functional currency bases of non-monetary assets and liabilities and their tax basis represent temporary differences, for which deferred taxes must be recognized. Income tax effect of changes in the functional currency amounting to $22.4 million, net of minority interest of $17.2 million, was reported as other comprehensive loss for the year ended December 31, 2003.

The Group has selected the USD as its reporting currency and has translated financial statements of subsidiaries with a different functional currency into USD. Assets and liabilities are translated at the exchange rates current at the balance sheet date, while income and expense items are translated at average rates of exchange prevailing during the period. The resulting cumulative translation adjustment in amount of $35.3 million, net of minority interest of $24.4 million, is recorded as a separate component of other comprehensive income.

The Ruble is not a fully convertible currency outside of the territory of the Russian Federation. The translation of RUR denominated assets and liabilities into USD for the purpose of these financial statements does not indicate that the Group could or will in the future convert the reported values of the assets and liabilities in USD.

Revenue Recognition—The Telecommunications Segment of the Group earns revenues from provision of wireless telecommunication services, local telephone and data transmission services and usage of its local exchange networks and facilities. Segment revenues consist of (i) usage charges, (ii) monthly subscription fees, (iii) service activation and connection fees, (iv) sale of prepaid phone cards, (v) charges for value-added telecommunication services, (vi) roaming fees charged to other operators for guest roamers utilizing the Group's network and (vii) equipment sales. The Group records revenues over the periods they are earned as follows:

(i) Revenues derived from wireless and local telephone usage and data transmission are recognized as the services are provided.

(ii) Monthly telephone and network service fees are recognized in the month during which the telephone services are provided to customers.

(iii) Upfront fees received for installation and activation of wireless, wireline and data transmission services are deferred and recognized over the expected customer relationship period. The Group estimates that average expected term of the subscriber relationship for MTS's subscribers is 39 months in Russia and 47 months in Ukraine. The customer relationship period for residential wireline voice phone subscribers is 15 years. For all other categories of subscribers the customer relationship period is estimated at 3 to 5 years.

(iv) The Group recognizes revenues from the prepaid phone cards in the period when customer uses time under the phone card. Unused time on sold cards is not recognized as revenues until the related services have been provided to the customer or the prepaid phone card has expired. In 2002, MTS introduced a new line of prepaid service tariff plans, whereby a customer may purchase a package that allows a connection to the MTS network and a predetermined allotment of wireless phone calls and/or other services offered by the Group. Revenues under these plans are allocated between connection fees and service fees based on their relative fair values.

(v) Revenues derived from value-added telecommunication services are recognized in the period when the services are provided to customers.

(vi) The Group charges roaming per-minutes fees to other wireless operators for their subscribers utilizing the Group's networks. Revenues derived from roaming services are recognized as the services are provided.

(vii) The Group sells handsets and accessories to customers who are entering into contracts for service and as separate distinct transactions. The Group recognizes revenues from the handsets and accessories when title passes to the customer. Estimated returns are recorded as a direct reduction of sales at the time the related sales are recorded. In Ukraine, the Group also from time to time sells handsets at prices below cost. The Group recognizes these subsidies in cost of equipment when sale is recorded.

Local telephone services, provided by MGTS, totaling approximately 6%, 20% and 24% of consolidated revenues for the years ended December 31, 2003, 2002 and 2001, respectively, are regulated tariff services, and changes in rate structure is subject to Ministry of Antimonopoly Policy approval.

MGTS is required to grant discounts ranging from 20% to 100% on installation and monthly fees to certain categories of residential subscribers, such as pensioners, military veterans and disabled individuals, and is entitled to reimbursement from the federal budget for these discounts. Due to the lack of certainty of reimbursement, MGTS accounts for such revenues upon collection.

Strom Telecom's arrangements with its customers typically include multiple elements, such as equipment and software development, installation services and post-contract customer support. In accordance with the Statement of Position ("SOP") No. 97-2, "Software Revenue Recognition," the aggregate arrangement fee is allocated to each of the undelivered elements in an amount equal to its fair value with the residual of the arrangement fee allocated to the delivered elements. Fair values are based upon vendor-specific objective evidence. Fees allocated to each element of an arrangement are recognized as revenue when the following criteria have been met: (a) a written contract for the delivery of an element has been executed, (b) the Group has delivered the product to the customer, (c) the fee receivable is fixed or determinable, and (d) collectibility of the resulting receivable is deemed probable. If evidence of fair value of the undelivered elements of the arrangement does not exist, all revenue from the arrangement is deferred until such time evidence of fair value does exist, or until all elements of the arrangement are delivered. Fees allocated to post-contract customer support are recognized as revenue ratably over the support period. Fees allocated to other services are recognized as revenue as services are performed.

Premiums on written non-life insurance of the Insurance Segment are recognized on a pro-rata basis over the term of the related policy coverage, normally not exceeding 1 year. The unearned premium provision represents that portion of premiums written relating to the unexpired term of the policy. Premiums from traditional life and annuity policies with life contingencies are recognized as revenue when due from the policyholder.

Interest income of the Banking Segment is recognized on accrual basis. Loans are placed on non-accrual status when interest or principal is delinquent for a period in excess of 90 days, except when all amounts due are fully secured by cash or marketable securities and collection proceedings are in process. Interest income is not recognized where recovery is doubtful. Loans are written off against allowance for loan losses in case of uncollectibility of loans and advances, including through repossession of collateral.

Revenues on construction contracts are recognized under the completed-contract method.

The other Group's entities recognize revenues when products are shipped or when services are rendered to customers.

In arrangements where the Group acts as an agent, including travel agency arrangements and arrangements to administer construction projects, only the net agency fee is recognized as revenue.

Cash and Cash Equivalents—Cash and cash equivalents include cash on hand, amounts on deposit in banks, cash invested temporarily in various instruments with maturities of three months or less at the time of purchase and minimum reserve deposits with the Central Bank of Russian Federation. Short-term interbank loans originated by MBRD with original maturities of three months or less are included in loans to customers and banks.

Financial Instruments—The Group's financial instruments include cash, short-term investments and long-term investments, receivables, payables and debt. Except as described below, the estimated fair value of such financial instruments as of December 31, 2003 approximate their carrying value as reflected in the consolidated balance sheet. The fair value of the Group's publicly traded long-term notes as of December 31, 2003 ranged from 101.3% to 110.2% of the principal amount. As of December 31, 2003, fair value of other fixed rate debt including capital lease obligation, and variable rate debt approximated carrying value.

As of January 1, 2001 the Group adopted Financial Accounting Standard ("FAS") No. 133 "Accounting for Derivative Instruments and Hedging Activities". This statement requires that all derivatives, including some embedded derivatives, be measured at fair value and recognized as either assets or liabilities on balance sheets. Changes are recorded in comprehensive income, depending on the designated use of the instruments. During the years ended December 31, 2003, 2002 and 2001, the Group did not enter into significant derivative contracts.

MBRD also enters into sale and purchase back agreements ("repos") and purchase and sale back agreements ("reverse repos") in the normal course of its business. A repo is an agreement to transfer a financial asset to another party in exchange for cash or other consideration and a concurrent obligation to reacquire the financial assets at a future date for an amount equal to the cash or other consideration exchanged plus interest. Assets sold under repos are retained in the financial statements and a consideration received is recorded in liabilities as collateralized deposit received. A reverse repo is an agreement to purchase assets and resell them at a future date with accrued interest received. Assets purchased under reverse repos are recorded in the financial statements as cash received on deposit which is collateralized by securities or other assets. During the years ended December 31, 2003, 2002 and 2001, the Group did not enter into material repo or reverse repo agreements.

Accounts Receivable—Accounts receivable are stated at their net realizable value after deducting an allowance for doubtful accounts. Such provisions reflect either specific cases of delinquencies or defaults or estimates based on evidence of collectibility.

Loans to Customers and Banks—Loans to customers and banks arise out of operations of Banking Segment. The determination of the allowance for losses in respect of loans provided by MBRD is based on an analysis of the loan portfolio and reflects the amount, which, in the judgment of management of the Group, is adequate to provide for losses inherent in the loan portfolio. A specific provision is made as a result of a detailed appraisal of risk assets. In addition, a general provision is carried to cover risks, which although not specifically identified, are present in any portfolio of banking assets.

Management's evaluation of the allowance is based on MBRD's past loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and current economic conditions. It should be understood that estimates of loan losses involve an exercise of judgment. While it is possible that in particular periods MBRD may sustain losses, which are substantial relative to the allowance for loan losses, it is the judgment of management that the allowance for loan losses is adequate to absorb losses inherent in the loan portfolio.

Insurance-related Receivables—Insurance-related receivables include receivables arising from insurance operations and advances to health care providers under voluntary and obligatory medical insurance programs. Receivables arising from insurance operations consist of outstanding direct premiums due from policyholders, outstanding assumed premiums due from ceding companies and receivables due from claims ceded.

Policy Acquisition Costs—Policy acquisition costs represent costs of the acquisition or renewal of insurance policies by Rosno. They are deferred as an asset and are amortized over the period for which costs are expected to be recoverable out of associated revenues. Deferred acquisition costs are included in other receivables and prepaid expenses, net of the unexpired risk provision, that is recognized when unearned premiums are insufficient to meet claims and expenses, which may be incurred after the end of the financial year.

Subscriber Acquisition Costs—Effective January 1, 2001 MTS (then an affiliate of the Group) changed its accounting principle regarding recognition of subscriber acquisition costs. Prior to 2001, MTS capitalized these costs to the extent of any revenues that had been deferred from the acquisition of a subscriber and amortized on a straight-line basis over the estimated average subscriber life. The Group now expenses such costs as incurred. This change of accounting principle was made to facilitate comparison of MTS's results with other telecommunication companies. The Group's share of the cumulative effect of this change in the amount of $6.2 million (net of tax effect of $1.1 million) was charged to income in 2001.

Inventories—Inventories are stated at the lower of cost or market. The cost of MGTS's inventories (including mostly spare parts) is computed on an average cost basis. Cost of goods for resale held by retail businesses of the Group is determined using the retail method. Other subsidiaries of the Group account for their inventories using the FIFO cost method.

Cost of raw materials includes cost of purchase, customs duties, transportation and handling costs. Work-in-progress and finished goods are stated at production cost which includes direct production expenses. Project costs include the accumulated costs of projects contracted with third parties, net of related progress billings. The entities of the Group periodically assess their inventories for obsolete or slow moving stock and record an appropriate provision.

Value-Added Taxes—Value-added taxes ("VAT") related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions that are not reclaimable as of the balance sheet dates are recorded in other receivables and prepaid expenses.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

Property, Plant & Equipment—For subsidiaries acquired by the Group through business combinations accounted for by the purchase method, property, plant and equipment ("PP&E") were assigned their fair values at the acquisition date. If fair values of the identifiable net assets of the acquired entities exceeded acquisition cost, the fair values of non-current assets held by the acquired entities at the acquisition date, including PP&E, were reduced by such excess. All subsequent additions to PP&E have been recorded at cost.

Cost includes major expenditures for improvements and replacements, which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance are charged to the statement of operations as incurred.

Capital leases are recorded at the lower of the fair market value of the asset or the present value of future minimum lease payments.

Depreciation is computed under the straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	20–50 years
Leasehold improvements	Lesser of the estimated useful life or the term of the lease
Switches and transmission devices	17–31 years
Network and base station equipment	5–12 years
Other plant, machinery & equipment	3–15 years

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.

Construction-in-progress and equipment for installation are not depreciated until an asset is placed into service.

Goodwill and Other Intangible Assets—As of January 1, 2002, the Group adopted FAS No. 142, "Goodwill and Other Intangible Assets". This Standard eliminates goodwill amortization from the consolidated statement of operations and requires an evaluation of goodwill for impairment (at the reporting unit level) upon adoption of this Standard, as well as subsequent evaluations on an annual basis, and more frequently if circumstances indicate a possible impairment. This impairment test is comprised of two steps. The initial step is designed to identify potential goodwill impairment by comparing an estimate of the fair value of the applicable reporting unit to its carrying value, including goodwill. If the carrying value exceeds fair value, a second step is performed, which compares the implied fair value of the applicable reporting unit's goodwill with the carrying amount of that goodwill, to measure the amount of goodwill impairment, if any. Upon adoption, the Group performed a transitional impairment test on its two reporting units with significant amounts of goodwill assigned: P-Com (Telecommunications Segment) and MBRD (Banking Segment). The carrying amount of goodwill in other reporting units was immaterial. As a result of this impairment test, the Group recorded an impairment charge for goodwill assigned to MBRD of $21.5 million, which was classified as a cumulative effect of a change in accounting principle for the year ended December 31, 2002.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

In May 2003, the Group announced its intention to curtail further investments in P-Com, a provider of telecommunication services in CDMA-800 standard. Concurrently, the Group performed an impairment test of goodwill assigned to P-Com and recorded an impairment charge of $19.3 million, which was charged to operating expenses.

For purposes of these impairment tests the fair value of MBRD and P-Com was determined based on a present value technique.

Subsequent impairment tests will be performed, at a minimum, in the fourth quarter of each year, in conjunction with the Group's annual planning process.

The carrying amount of goodwill attributable to each reportable operating segment with goodwill balances and changes therein, are as follows:

	Telecom-munications	Banking	Corporate and Other	Total
		(000's)		
Balance as of January 1, 2002	$ 22,122	$ 21,480	$635	$ 44,237
Transitional impairment charge	—	(21,480)	—	(21,480)
Goodwill written off related to disposal of a non-controlling interest in a subsidiary	(2,775)	—	—	(2,775)
Balance as of December 31, 2002	19,347	—	635	19,982
Purchase price allocation	71,267	—	—	71,267
Impairment charge	(19,251)	—	—	(19,251)
Balance as of December 31, 2003	**$ 71,363**	**$ —**	**$635**	**$ 71,998**

Costs of licenses for providing telecommunications services are capitalized as a result of purchase price allocated to licenses acquired in business combinations (Note 4) and licenses purchased directly from government organizations, which require license payments. As the Group and the telecommunications industry do not have sufficient experience with the renewal of licenses, license costs are being amortized, subject to periodic review for impairment, on the straight-line basis over the term of the license commencing from the date such license area becomes commercially operational.

Other intangible assets represent acquired customer base, trademarks, roaming contracts with other telecommunications operators, telephone numbering capacity, rights to use premises and various purchased software costs. Trademarks and telephone numbering capacity with unlimited contractual life are not amortized, but are reviewed, at least annually, for impairment in accordance with the provisions of FAS No. 142, "Goodwill and Other Intangible Assets."

Acquired customer base is amortized over the estimated average subscriber life. Deferred telephone numbering capacity costs with limited contractual life and the rights to use premises are being amortized over their contractual lives, which vary from five to twenty years. Software costs and other intangible assets are being amortized over three to five years. All finite-life intangible assets are being amortized using the straight-line method.

Investments—The Group's share in net assets and net income of certain entities, where the Group holds 20% to 50% of voting shares and has the ability to exercise significant influence over their operating and financial policies ("affiliates") is included in the consolidated net assets and operating results using the equity method of accounting. Due to the Group's day-to-day involvement in the affiliates' business activities, the Group's share of their income is recorded within the operating income.

Investments in corporate shares where the Group owns more than 20% of voting shares, but does not have the ability or intent to control or exercise significant influence over operating and financial policies, including investments in entities of the radiotechnical business line (Note 1), as well as investments in corporate shares where the Group owns less than 20% of share capital, are accounted for at cost of acquisition. Management periodically assesses realizability of the carrying values of such investments and records impairment charges, if required.

Trading and available for sale securities held by the Group are stated at market value. Unrealized holding gains and losses for trading securities are included in earnings. Unrealized holding gains and losses for available-for-sale securities, net of tax effect, are reported in other comprehensive income.

The Group also purchases promissory notes from its customers or in the market. These notes are carried at cost and the discount against the nominal value is accrued over the period to maturity. A provision is made, based on management assessment, for notes that are considered uncollectible.

Debt Issuance Costs—Debt issuance costs are amortized using the effective interest method over the terms of the related loans. Debt issuance costs as of December 31, 2003, amounted to $17.3 million, net of accumulated depreciation of $5.8 million.

Impairment of Long-lived Assets—The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with FAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group compares undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. For the years ended December 31, 2003, 2002 and 2001, no such impairments have occurred.

Bank Deposits and Notes Issued—Bank deposits and notes issued arise out of operations of the Banking Segment and include deposits from banks and customers, promissory notes and bonds issued.

Insurance-related Liabilities—Insurance-related liabilities arise out of operations of the Insurance Segment and include the unearned premium provision, loss provision for outstanding claims, undisbursed funds of the Moscow Government Fund for Obligatory Medical Insurance ("MGFOMS"), accumulated under an obligatory medical insurance program, prepaid insurance and reinsurance premiums and liabilities under deposit type insurance contracts (policies in force under which the Group does not assume insurance risk).

Rosno provides for losses on outstanding claims on an individual case basis for the estimated cost of claims notified but not settled as at the balance sheet date. Provision is also made for the ultimate cost of claims, including claims incurred but not reported, or not fully reported. This provision is actuarially determined by line of business, and includes assumptions based on prior years claims experience. The loss provision for life insurance is actuarially determined based upon mortality, morbidity and interest rate assumptions applied to all life insurance policies in force as at year-end.

Unexpired risk provision is recognised when unearned premiums are insufficient to meet claims and expenses, which may be incurred after the end of the financial year. The Group does not consider anticipated investment income in making determination whether a premium deficiency exists.

MGFOMS carries out an obligatory medical insurance program to provide RF citizens with free of charge medical services via certain appointed insurers, including Rosno. Rosno has contracted with MGFOMS to administer a portion of this plan. Rosno receives advances from MGFOMS and makes payments to medical centers in respect of services provided by them to policyholders. Any funds received from MGFOMS by Rosno, which are not paid out for medical services, are retained and recorded as a liability. These funds may be spent by the Group only on the provision of the medical facilities and care, as presently defined under the program.

Deferred Revenue—Telecommunication equipment and transmission devices, installed at the newly constructed properties in Moscow, have been historically transferred to MGTS free of charge. These assets are capitalized by the Group at their market value at the date of transfer. Simultaneously deferred revenue is recorded in the same amount, which is amortized to the consolidated statement of operations over the contributed assets' life.

Deferred grant revenue represents funds contributed to the Group, which usage is restricted. Deferred grants are released to income when the conditions of the grant are substantially met.

Income Taxes—Income taxes have been computed in accordance with RF laws. In accordance with legislation, effective January 1, 2002, income tax rate equals 24%. Income tax rate on dividends paid within Russia is 6%. The foreign subsidiaries of the Group are paying income taxes in their jurisdictions. Income tax rate in the Ukraine and in the Czech Republic equals 25% and 31%, respectively.

Deferred income taxes are accounted for under the liability method and reflect the tax effect of all significant temporary differences between the tax basis of assets and liabilities and their reported amounts in the accompanying consolidated financial statements. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Group will be able to realize the benefit, or the future deductibility is uncertain.

Stock-Based Compensation—The Group accounts for stock options issued to employees, non-employee directors and consultants of MTS following the requirements of FAS No. 123, "Accounting for Stock-Based Compensation" and FAS No. 148, "Accounting for Stock Based Compensation—Transition and Disclosure, an amendment to FASB Statement No. 123." These statements allow measuring compensation to employees and non-employee directors based on the intrinsic value of options on the measurement date, calculated as a difference between the fair market value of stock and exercise price at that date. Compensation to consultants is measured based on the fair value of options on the measurement date as determined using a Black-Scholes option-pricing model.

During the years ended December 31, 2003, 2002 and 2001, MTS made several grants pursuant to its stock option plan to its employees and directors. These options are generally vested over a two year period from the date of the grant, contingent on continued employment with MTS. A summary of the status of MTS stock option plan is presented below:

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

	Shares of MTS	Weighted average exercise price
Outstanding at January 1, 2001	—	—
Granted	1,829,221	1.31
Outstanding at December 31, 2001	1,829,221	1.31
Granted	2,846,681	1.49
Forfeited	(27,481)	1.31
Outstanding at December 31, 2002	4,648,421	1.42
Granted	1,952,632	2.43
Exercised	(37,557)	1.31
Exchanged for cash award	(1,746,310)	1.31
Forfeited	(19,776)	1.31
Outstanding at December 31, 2003	4,797,410	1.87

None of the options outstanding at December 31, 2003, 2002 and 2001 were exercisable. Options outstanding at December 31, 2003, have exercise price ranging from $1.49 to $2.43 per share and their weighted average remaining contractual life was approximately one year at December 31, 2003.

During the year ended December 31, 2003, 19,776 stock options were forfeited, and 1,746,310 options were exchanged for cash consideration of $2.9 million that was included in operating expenses in the consolidated statements of operations. Since the date of the grant total options amounting to 1,913, nil and 45,344 related to 2003, 2002 and 2001 grants, respectively have been forfeited.

Fair values of options granted in the years ended December 31, 2003, 2002 and 2001 were $1.02, $0.50 and $0.36 per share, respectively, and were estimated using the Black-Scholes option pricing model. The risk free rates applied for the years ended December 31, 2003, 2002 and 2001 were 5.2%, 6.1%, and 15.5%, respectively. The following assumptions were applied to options granted in the years ended December 31, 2003, 2002 and 2001, respectively: (i) expected dividend yield of approximately 3.0%; (ii) expected volatility rates of 40.0%, 50.0% and 45.0%, and (iii) expected lives of 2 years.

If the Group had elected to recognize compensation costs based on the fair values of options at the date of the grant, net income and earnings per share amounts for the years ended December 31, 2003, 2002 and 2001 would have been as follows:

	2003	2002	2001
		(000's)	
Net income as reported	$387,047	$165,976	$135,255
Pro forma effect of the application of fair value method of accounting for stock options	(371)	(188)	(129)
Pro forma net income	386,676	165,788	135,126
Earnings per share, basic and diluted			
As reported	$ 47.8	$ 20.5	$ 16.7
Pro forma	$ 47.7	$ 20.5	$ 16.7

Retirement and Post-Retirement Benefits—Subsidiaries of the Group contribute to the local state pension fund and social fund, on behalf of all its employees.

In Russia, starting from January 1, 2001 all social contributions, including contributions to the pension fund, were substituted with a unified social tax (“UST”) calculated by the application of a regressive rate from 35.6% to 2% of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 28% to 2%, respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

During the years ended December 31, 2003 and 2002, the Group established and managed a defined contribution plan to provide eligible employees with additional income upon retirement. The Group’s contributions to the plan totaled $1.7 million and $2.0 million for the years ended December 31, 2003 and 2002, respectively.

In addition, MGTS has historically offered its employees certain benefits upon and after retirement. The cost of such benefits is recognized during an employee’s years of active service (Note 27).

The Group accounts for pension plans following the requirements of FAS No. 87, “Employers’ Accounting for Pensions”.

Borrowing Costs—Borrowing costs were recognized as an expense in the period in which they were incurred. Borrowing costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets’ estimated useful lives. The capitalized borrowing costs during the years ended December 31, 2003, 2002 and 2001 amounted to $1.2 million, $0.8 million and $1.5 million, respectively.

Advertising Costs—Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2003, 2002 and 2001 were $120.0 million, $10.3 million and $7.5 million, respectively, and were reflected as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations.

Earnings per Share—Basic earnings per share (“EPS”) have been determined using the weighted average number of shares outstanding during the years ended December 31, 2003, 2002 and 2001. Diluted EPS reflect the potential dilution of MTS’ stock options, granted to employees. There are 4,797,410 MTS’ stock options outstanding as at December 31, 2003.

Distributions to Shareholders—Distributable retained earnings of the Group are based on amounts extracted from statutory accounts of individual entities and may significantly differ from amounts calculated on the basis of U.S. GAAP.

Disposition of Subsidiaries—As of January 1, 2002 the Group adopted FAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets”. FAS No. 144 establishes a single accounting model for long-lived assets to be disposed of by sale consistent with the fundamental provisions of the superseded FAS No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of”. While it supersedes APB Opinion No. 30, “Reporting the Results of operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions”, it retains the presentation of discontinued operations but broadens that presentation to include a component of an entity (rather than a segment of a business). However, discontinued operations are no longer recorded at net realizable value and future operating losses are no longer recognized before they occur. Under FAS No. 144 there is no longer a requirement to allocate goodwill to long-lived assets to be tested for impairment. It also establishes a probability weighted cash flow estimation approach to deal with situations in which there is a range of cash flows that may be generated by the asset being tested for impairment. FAS No. 144 also establishes criteria for determining when an asset should be treated as held for sale.

New Accounting Pronouncements—In June 2001, FASB issued FAS No. 143, "Accounting for Asset Retirement Obligations". FAS No. 143 requires that the fair value of a liability for an asset retirement obligation is recorded in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depreciated over the asset's useful life. Changes in the liability resulting from the passage of time will be recognized as operating expense. The Group adopted SFAS No. 143 effective January 1, 2003. The adoption of FAS No. 143 did not have a material impact on the Group's results of operations or its financial position.

In April 2002, FASB issued FAS No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections". This Standard rescinds FAS No. 4, "Reporting Gains and Losses from Extinguishments of Debt", and an amendment of that Standard, Standard No. 64, "Extinguishments of Debt Made to Satisfy Sinking-Fund Requirements" to address classification of gains and losses from extinguishment of debt in the statement of operations. This Standard also amended Standard No. 13, "Accounting for Leases", to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required sale-leaseback accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. The adoption of FAS No. 145 did not have a material impact on the Group's results of operations or its financial position.

In June 2002, FASB issued FAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which requires the recognition of a liability when incurred for costs associated with an exit or disposal activity. The fundamental conclusion reached by the FASB in this Statement is that an entity's commitment to a plan, by itself, does not create a present obligation to others that meets the definition of a liability. FAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. The Group adopted the provisions of FAS No. 146 effective January 1, 2003. The adoption of FAS No. 146 did not have a material impact on the Group's results of operations or its financial position.

In November 2002, FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires that the guarantor recognize, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing such guarantee. FIN 45 also requires additional disclosure requirements about the guarantor's obligations under certain guarantees that it has issued. The Group adopted initial recognition and measurement provisions of this interpretation on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not have a material impact on the Group's financial position or results of operations.

In November 2002, the EITF issued a final consensus on EITF Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables". EITF Issue No. 00-21 provides guidance on when and how an arrangement involving multiple deliverables should be divided in separate units of accounting. The Group adopted the requirements of EITF Issue No. 00-21 prospectively for arrangements entered into after June 15, 2003. The adoption of EITF Issue No. 00-21 did not have a material impact on the Group's financial position or results of operations.

In December 2003, FASB issued a revision to Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46R" or the "Interpretation"). FIN 46R clarifies the application of ARB No. 51, "Consolidated Financial Statements", to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public companies, to the end of the first reporting period ending after March 15, 2004, except that all public companies must at minimum apply the provisions of the Interpretation to entities that were previously considered "special-purpose entities" under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003. The Group is evaluating whether the adoption of FIN 46 will have a material impact on its financial position, cash flows and results of operations.

In April 2003, FASB issued FAS No. 149, "Amendments of FASB Statements No. 133 on Derivative Instruments and Hedging Activities." FAS No. 149 clarifies under what circumstances a contract with an initial investment meets the characteristic of a derivative, clarifies when a derivative contains a financing component, amends the definition of an underlying and certain other existing pronouncements. The Group adopted the requirements of FAS No. 149 for contracts entered into or modified and for hedging relationships designated after June 30, 2003. The adoption of FAS No. 149 did not have a material impact on the Group's financial position or results of operations.

In May 2003, FASB issued FAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity". FAS No. 150 requires issuers to classify as liabilities (or assets in some circumstances) certain classes of freestanding financial instruments that embody obligations for the issuer, including mandatorily redeemable financial instruments, obligations to repurchase the issuer's equity shares by transferring assets and certain obligations to issue a variable number of shares. The Group adopted the requirements of FAS No. 150 effective July 1, 2003. The adoption of FAS No. 150 did not have a material impact on the Group's financial position or results of operations.

In November 2003, the EITF reached a final consensus on Issue No. 03-10, "Application of EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor', by Resellers to Sales Incentives Offered to Consumers by Manufacturers." The consensus was reached that consideration received by a reseller from the vendor in exchange for vendor sales incentives tendered by consumers should not be reported as a reduction of the cost of the reseller's purchases from the vendor but instead should be shown as revenue. EITF Issue No. 03-10 is effective for reporting periods beginning after November 25, 2003. The Group does not anticipate that the adoption of Issue No. 03-10 will have a material impact on the Group's results of operations or financial position.

In December 2003, the U.S. Securities Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition". SAB 104 updates portions of the interpretive guidance included in Topic 13 of the codification of Staff Accounting Bulletins in order to make this interpretive guidance consistent with current authoritative accounting guidance and SEC rules and regulations. The Group believes it is following the guidance of SAB 104.

In March 2004, the EITF reached a consensus on Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share". This Issue defines participating security and clarifies some practical issues related to including participating securities in the calculation of EPS. EITF Issue No. 03-6 is effective for reporting periods beginning after March 31, 2004. The Group does not anticipate that the adoption of Issue No. 03-6 will have a material impact on the Group's financial position or results of operations.

Reclassifications—Certain other reclassifications of prior years' amounts have been made to conform to the presentation adopted for 2003.

4. ACQUISITIONS

Acquisition of MTS

In March 2003, the Group entered into a call option agreement to acquire 199,332,614 shares of MTS, representing 10% of its outstanding share capital. In connection with the call option, the Group also entered into an agreement with T-Mobile, a shareholder of MTS. Under the shareholders' agreement, T-Mobile undertakes to vote when necessary to ensure (in so far that it is able) that the Group will have a majority of the members of the MTS board of directors. However, certain actions will require T-Mobile's approval, including new issuances of MTS shares, actions which would dilute T-Mobile's shareholding in MTS and acquisitions by MTS with a value between 25% and 50% of the balance sheet value of MTS' total assets, in accordance with Russian accounting standards. Under the agreement, both the Group and T-Mobile have a right of first refusal with respect to sales of MTS shares by the other party to third parties, subject to certain exceptions. The Group and T-Mobile agreed to consult each other with respect to any dividend policy of MTS, with the expectation that annual distributions of not less than the equivalent of 25% of MTS' net profits (as determined under Russian accounting standards) will be made as dividends, including dividends with respect to MTS' fiscal year 2002.

In April 2003, the Group exercised its option with T-Mobile to purchase an additional 6% of the outstanding common stock of MTS and T-Mobile's 49% interest in Invest-Svyaz-Holding, a subsidiary of the Group holding 8% of the outstanding common stock of MTS, for $370.0 million in cash. Additionally, $0.8 million was paid in legal fees. As a result of this transaction, the Group's share in MTS increased to 50.6%.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The acquisition was accounted for using the purchase method. Purchase price allocation was as follows:

	(000's)
Current assets	$ 687,587
Non-current assets	1,983,412
License costs	497,738
Acquired customer base	113,979
Goodwill	67,615
Trademarks	41,780
Roaming contracts	35,220
Current liabilities	(588,374)
Non-current liabilities	(874,238)
Deferred taxes	(164,726)
Minority interest	(900,423)
Carrying value of the Group's investment in MTS as of the date of acquisition	(528,810)
Purchase price allocation	**$ 370,760**

In accordance with FAS No. 141 "Business Combinations," the Group recognized $67.6 million of goodwill primarily relating to workforce-in-place and expectation of MTS, due to its established status on the telecommunications market, being able to prolong its operating licenses beyond their current terms for a consideration lower than their market value.

Acquisition of UMC

In March 2003, MTS acquired 58% of the outstanding voting interest of UMC, a provider of wireless telecommunication services in Ukraine, for the cash consideration of $199.0 million. In connection with the acquisition, MTS also assumed debt of UMC with face value of approximately $65.0 million, with the fair value of approximately $62.0 million. The purchase price allocation was as follows:

	(000's)
Current assets	$ 82,293
Non-current assets	272,721
License costs	82,200
Acquired customer base	30,927
Current liabilities	(63,551)
Non-current liabilities	(78,580)
Deferred taxes	(27,425)
Minority interest	(99,581)
Purchase price allocation	**$199,004**

MTS paid $171.5 million of the purchase price in cash and agreed to pay the balance of the purchase price of $27.5 million within one year. The amount payable accrued interest of 9% per annum and was paid in April 2004.

MTS also had an option agreement with Ukrtelecom to purchase its remaining 26% stake in UMC, exercisable from February 5, 2003 to November 5, 2005, with an exercise price of $87.6 million. In June 2003 MTS exercised this call option. As a result of the transaction, the Group's voting power in UMC has increased from 58% to 84%.

In addition, MTS entered into a put and call option agreement for the purchase of remaining 16% stake in UMC. The exercise period of the call option was from May 5, 2003 to November 5, 2004, and the put option was exercisable from August 5, 2003 to November 5, 2004. The call option price was $85.0 million plus interest accrued from November 5, 2002 to the date of the exercise at 11% per annum; the price of the put option was calculated based on reported earnings of UMC prior to the exercise and was subject to a minimum amount of $55.0 million. In July 2003, the Group exercised its rights under the put and call option agreement for a cash consideration of approximately $91.7 million.

UMC is one of the two leading operators in Ukraine, operating under nationwide GSM 900/1800 and NMT 450 licenses.

Acquisition of Minority Interest in Kuban-GSM

In September 2003, MTS acquired 100% of Kubtelesot for cash consideration of $107.0 million. Kubtelesot owned 47.3% of Kuban-GSM, and the Group's purchase of this stake increased its voting power in Kuban-GSM to 100%.

Kuban-GSM operates in thirteen major cities throughout the south of the European part of RF, including Sochi, Krasnodar and Novorossiisk.

Acquisition of TAIF-Telcom

In April 2003, the Group acquired 51% of the common shares of TAIF-Telcom, a provider of mobile telecommunication services in the Republic of Tatarstan, RF and in the Volga region of Russia, for cash consideration of $51.0 million and 50% of the preferred shares of TAIF-Telcom for cash consideration of $10.0 million. In May 2003, the Group acquired an additional 2% of the common shares of TAIF-Telcom for cash consideration of $2.3 million. In connection with the acquisitions, the Group also assumed indebtedness of approximately $16.6 million that is collateralized by telecom equipment. As a result of this transaction the Group acquired 53% voting interest in TAIF- Telcom.

The Group also entered into call and put option agreements with the existing shareholders of TAIF-Telcom to acquire the remaining 47% of common shares and 50% of preferred shares of TAIF-Telcom. The exercise period for the call option on common shares is 48 months from the acquisition date and for the put option on common shares is 36 months following an 18 month period after the date of acquisition. The call and put option agreements for the common shares stipulate a minimum purchase price of $49.0 million plus 8% per annum commencing from the acquisition date. The exercise period for the call option on preferred shares is 48 months following a 24 month period after the date of acquisition and for the put option on preferred shares it is a 24 month period after the date of acquisition. The call and put option agreements for the preferred shares stipulate a minimum purchase price of $10.0 million plus 8% per annum commencing from the acquisition date.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The purchase price allocation was as follows:

	(000's)
Current assets	$ 3,870
Non-current assets	48,391
License costs	68,407
Current liabilities	(26,099)
Non-current liabilities	(5,550)
Deferred taxes	(16,814)
Minority interest	(8,965)
Purchase price allocation	**$ 63,240**

TAIF-Telcom provides mobile services in the GSM-900/1800 standard in the Republic of Tatarstan and in the Volga region in Russia.

Acquisition of Sibchallenge

In August 2003, MTS completed the purchase of 100% of Sibchallenge, a cellular operator in the Krasnoyarsk region, for cash consideration of $45.5 million, paid a finder's fee of $2.0 million and assumed net debt of approximately $6.6 million. Sibchallenge provides mobile telecommunication services in the Krasnoyarsk region of Siberia, the Republic of Khakasiya, and in the Taimyr Autonomous region.

The purchase price allocation was as follows:

	(000's)
Current assets	$ 4,078
Non-current assets	16,678
License costs	52,625
Current liabilities	(6,405)
Non-current liabilities	(6,628)
Deferred taxes	(12,894)
Purchase price allocation	**$ 47,454**

Acquisition of Tomsk Cellular Communications

In September 2003, MTS purchased 100% of Tomsk Cellular Communications ("TSS") for cash consideration of $47.0 million. TSS holds licenses to provide mobile telecommunication services in the Tomsk region.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The purchase price allocation was as follows:

	(000's)
Current assets	$ 3,299
Non-current assets	11,412
License costs	49,282
Current liabilities	(4,543)
Non-current liabilities	(105)
Deferred taxes	(12,345)
Purchase price allocation	**$ 47,000**

Acquisition of Comstar and Kosmos-TV

In September and October 2002, the Group acquired senior discounted notes of Metromedia International Group, a U.S.-based company with interests in telecommunications and mass media businesses in RF, for $34.3 million. The par value of the notes acquired by the Group equaled $56.7 million. In April 2003, the Group disposed of the notes to a third party as an advance for acquisition of 50% of the voting shares of Comstar, an affiliate of the Group and 50% of the voting shares and debt of $23.3 million (including accrued interest of $4.8 million) of Kosmos-TV, a provider of satellite television services, operating in Moscow.

In December 2003, the Group acquired 50% of voting shares of Comstar, 50% of voting shares of Kosmos-TV and debt of $23.3 million in exchange for the notes with the fair value of $20.8 million, $7.2 million and $6.3 million, respectively. This transaction increased the Group's voting power in Comstar to 100% and resulted in obtaining control over Comstar operations by the Group.

The purchase price allocation was as follows:

	(000's)
Current assets	$ 23,645
Non-current assets	53,165
Current liabilities	(16,983)
Non-current liabilities	(6,540)
Carrying value of the Group's investment in Comstar as of the date of acquisition	(32,495)
Purchase price allocation	**$ 20,792**

Other Acquisitions

In August 2003, the Group reached an agreement to acquire, in a series of related transactions, equity interests in five Russian regional mobile phone operators from MCT Corporation for a total of $71.0 million. The Group agreed to purchase a 44% stake in Uraltel and 100% of Vostok Mobile BV, which holds a 50% stake in Primtelefon.

In August 2003, the Group completed the acquisition of Vostok Mobile BV and recorded a 50% stake investment in Primtelefon using the equity method of accounting.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

In October 2003, the Group completed the purchase of Vostok Mobile South and thus acquired a 50% stake in Volgograd Mobile and Astrakhan Mobile and an 80% stake in Mar Mobile GSM. Also, in a separate transaction the Group completed the acquisition of the remaining 20% stake in Mar Mobile GSM from existing shareholders unrelated to MCT Corporation, thus consolidating a 100% ownership in the company.

During the year ended December 31, 2003, the Group increased its ownership interests in MBRD from 52% to 59%, in DM-Center from 53% to 100% and in Bolshaya Ordynka from 0% to 70% by acquiring their shares from related parties for an aggregate cash consideration of less than $0.1 million. The aggregate effect of such transactions on the Group's equity amounted to a net decrease of $2.7 million, which was charged to additional paid-in capital.

Pro forma results of operations (unaudited)

The following unaudited pro forma financial data for the years ended December 31, 2003 and 2002 give effect to the acquisition of MTS, UMC, Kuban-GSM, TAIF-Telcom, Sibchallenge, TSS and Comstar as if they had occurred at January 1, 2002:

	2003	2002
	(000's)	
Net revenues	$3,759,915	$2,625,516
Income from continuing operations before cumulative effect of a change in accounting principle	277,579	178,603
Net income	433,956	173,692
Earnings per share, basic and diluted	$ 53.6	$ 21.4

The pro forma information is based on various assumptions and estimates. The pro forma information is not necessarily indicative of the operating results that would have occurred if the Group's acquisitions had been consummated at the beginning of the respective period, nor is it necessarily indicative of future operating results. The pro forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions.

5. DISPOSITIONS AND CAPITAL TRANSACTIONS OF SUBSIDIARIES

In December 2002, the Group disposed of non-controlling interest of 7.6% in Micron to a minority shareholder of Corona-Semiconductor, Micron's subsidiary, in exchange for settlement of a debt of $2.8 million and a receivable of RUR 140.2 million (equivalent of $4.8 million as of December 31, 2003). As a result of this transaction, the Group recognized a net gain of $6.4 million that was included in results of operations for the year ended December 31, 2002.

In 2002 and 2003, the Group disposed of its oil business line through a series of transactions as described below.

In 2002 and 2003, the Group disposed of its interests in FPK Kedr-M, a network of 30 gasoline stations located in Moscow, to a third party. The deal was structured to be executed in two stages. In December 2002, the Group sold 50% of Kedr-M's voting shares and recognized gain on disposal, classified as gain on disposal of discontinued operations, in amount of $19.7 million. Sale of the remaining 50% of the Group's shares in Kedr-M to the same buyer for cash consideration of $22.5 million was closed in February 2003.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

In May 2003, the Group acquired 33% of common voting shares of Belkamneft, an oil extraction company, operating in Udmurtia, RF, for $32.6 million in cash. In June 2003, the Group contributed its interest in Belkamneft into the share capital of United Oil Company ("ONK"), a newly-created entity, in exchange for 50% ownership. The other shareholders of ONK contributed to its share capital the equivalent number of Belkamneft's voting shares. During 2003 the Group acquired 100% of Consortium-12, an oil extraction company in Udmurtia, RF, and Baikal Oil, an oil trader in Bashkortostan, RF, and a shareholder of ONK, for cash consideration of $135.0 million.

Additionally, the Group increased its ownership in Sistema-Neft, a holding company of the Group's oil business line from 76% to 100% by acquiring its shares from a party under common control for an aggregate cash consideration of $19.2 million. As a result of this transaction, the Group's equity decreased by the same amount, which was charged to additional paid-in capital.

In December 2003, the Group sold its interests in ONK, Consortium-12, Baikal Oil and Sistema-Neft and subsidiaries to a third party for total cash consideration of $292.5 million and a promissory note with fair value of $15.9 million maturing in 2004.

The results of oil business line and gain on disposal of oil assets in amount of $143.6 million, net of income tax effect of $18.3 million were classified as discontinued operations in the consolidated statements of operations.

Assets and liabilities of discontinued operations as of December 31, 2002 and 2001 consisted of the following:

	2002	2001
	(000's)	
Current assets	$14,080	$ 3,765
Non-current assets	6,636	8,664
Total assets of discontinued operations	**20,716**	**12,429**
Current liabilities	35,166	16,200
Non-current liabilities	14,000	25,636
Total liabilities of discontinued operations	**$49,166**	**$41,836**

During the year ended December 31, 2003, the Group sold shares of several immaterial subsidiaries to related parties for an aggregate consideration of approximately $10.0 million. The amount of the consideration received, net of minority interest, was credited to additional paid-in capital.

6. CASH AND CASH EQUIVALENTS

Cash equivalents amounting to $56.1 million, $42.1 million and $23.5 million as of December 31, 2003, 2002 and 2001, respectively, are comprised primarily of term deposits with banks with original maturities less than 90 days. Within the amounts as of December 31, 2003 and 2002, $44.3 million and

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

$4.3 million, respectively, represent the Group's deposit with East-West United Bank, an affiliate of the Group.

Also included in cash as of December 31, 2003, 2002 and 2001 are $45.7 million, $19.4 million, and $22.5 million respectively, which represent the MBRD's minimum reserve deposit required by the Central Bank of RF ("CBR").

7. SHORT-TERM INVESTMENTS

Short-term investments as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Trading securities:			
RF Eurobonds	$ 54,394	$ 30,210	$24,973
Metromedia notes (Note 4)	—	34,298	—
Corporate bonds	19,696	12,856	4,212
Municipal bonds	4,012	—	—
Corporate shares	2,250	6,888	6,393
Other trading securities	10,998	2,408	1,028
	91,350	86,660	36,606
Other short-term investments:			
Credit linked notes	38,170	—	—
Promissory notes from third parties	95,881	24,480	28,040
Promissory notes from related parties	20,946	33,956	15,131
Bank deposits with original maturities exceeding 90 days	24,040	16,971	—
Other short-term investments	8,463	2,248	6,410
	187,500	77,655	49,581
Total	**$278,850**	**$164,315**	**$86,187**

Russian Federation Eurobonds are interest bearing securities denominated in USD, issued by the Ministry of Finance of the Russian Federation, and are freely tradable internationally. These bonds have maturity dates from 2005 to 2030 and coupon rates of 9–13% per annum.

Corporate bonds denominated in RUR represent bonds issued by major Russian companies with maturity dates from 2004 to 2008 and coupon rates of 8–17% per annum.

Municipal bonds are RUR-denominated securities issued by local authorities of Moscow. These bonds have maturity dates from 2004 to 2005 and coupon rates of 10–15% per annum.

Corporate shares are liquid publicly traded shares of Russian companies. They are reflected at period-end market value based on last traded prices obtained from Moscow Interbank Currency Exchange ("MICEX").

The weighted average interest rate on promissory notes from third parties as of December 31, 2003 was 8%, while promissory notes from related parties are mostly interest-free. Most of the notes mature within 1 year from the latest balance sheet date.

The effective interest rate on bank deposits with original maturities exceeding 90 days as of December 31, 2003 was 11% for RUR-denominated deposits, and 8% on deposits in USD.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

8. LOANS TO CUSTOMERS AND BANKS, NET

Loans to customers and banks, net of allowance for losses, as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Loans to customers	$231,918	$139,222	$127,848
Loans to banks	147,518	26,074	101,927
	379,436	165,296	229,775
Less allowance for loan losses	(14,454)	(4,552)	(2,915)
Total	**$364,982**	**$160,744**	**$226,860**

Loans to customers as of December 31, 2003, 2002 and 2001 included loans to related parties of $151.6 million, $96.9 million and $115.0 million, respectively.

9. INSURANCE-RELATED RECEIVABLES

Insurance-related receivables as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Receivables from insurance operations	$44,612	$29,517	$15,902
Advances to health care providers	25,243	20,623	14,976
Total	**$69,855**	**$50,140**	**$30,878**

10. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net of provision for doubtful accounts, as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Trade receivables	$211,333	$79,423	$60,241
Less: provision for doubtful accounts	(29,082)	(9,870)	(6,069)
Total	**$182,251**	**$69,553**	**$54,172**

Included in trade receivables as of December 31, 2003, 2002 and 2001 are receivables for services provided to the Group's affiliates and parties related by means of common control in the amounts of $4.3 million, $15.0 million and $9.2 million, respectively. Management anticipates no losses in respect of receivables from related parties.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

11. OTHER RECEIVABLES AND PREPAID EXPENSES, NET

Other receivables and prepaid expenses, net of provision for doubtful accounts, as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Recoverable VAT	$278,441	$40,092	$26,096
Receivables for sale of oil assets (Note 5)	153,500	—	—
Advances to suppliers	58,266	13,445	17,237
Prepaid expenses	15,897	9,283	2,755
Deferred policy acquisition costs	9,410	6,906	11,759
Other taxes prepaid	11,728	5,038	1,431
Receivables for sale of Micron shares	4,759	—	
Other	39,406	11,874	8,172
Less: provision for doubtful accounts	(4,282)	(4,951)	(1,580)
Total	**$567,125**	**$81,687**	**$65,870**

Policy acquisition costs' amortization charge for the years ended December 31, 2003, 2002 and 2001, was $22.5 million, $24.8 million and $19.6 million, respectively.

12. INVENTORIES

Inventories as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Raw materials and spare parts	$ 51,216	$17,971	$14,355
Work-in-progress	15,643	7,663	5,622
Finished goods and goods for resale	62,693	11,469	12,266
Project costs—construction, net of progress billings	36,651	11,001	5,642
Total	**$166,203**	**$48,104**	**$37,885**

Inventories with a book value of $1.9 million, $3.2 million and $1.3 million as of December 31, 2003, 2002 and 2001, respectively, were pledged as collateral in respect of loans from banks.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

13. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net of accumulated depreciation, as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Land	$ 3,894	$ 3,409	$ 4,631
Buildings and leasehold improvements	439,838	224,183	177,225
Switches, transmission devices, network and base station equipment	2,223,603	497,416	451,595
Other plant, machinery and equipment	412,519	247,117	172,486
Construction in progress and equipment for installation	764,178	80,757	91,988
	3,844,032	1,052,882	897,925
Less: accumulated depreciation	(475,911)	(142,840)	(93,193)
Total	**$3,368,121**	**$ 910,042**	**$804,732**

Depreciation expense for the years ended December 31, 2003, 2002 and 2001 amounted to $335.3 million, $70.4 million and $58.1 million, respectively.

14. LONG-TERM RECEIVABLES

Long-term receivables as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Lease receivable—long-term portion	$1,223	$6,890	$2,701
Receivable from sale of Combellga shares	—	2,710	2,412
Other long-term receivables	—	330	421
Total	**$1,223**	**$9,930**	**$5,534**

During 1999, the Group disposed of its 10% holding in ZAO Combellga, a Moscow telecommunications operator. In April 2002, the Group agreed to defer repayment of $3.1 million outstanding on the respective note receivable to April 2005. In December 2003, the note receivable was settled for the amount of $3.9 million, which included principal amount and interest accrued.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The Group has entered a number of agreements for the leasing of network equipment and a billing system from a related party. The leases meet the criteria for direct financing capital leases and the future minimum rentals receivable are as follows:

	(000's)
2004	$ 6,580
2005	1,001
2006	536
Less: amount representing interest	(1,201)
Less: current portion of lease receivable	(5,693)
Lease receivable—long-term portion	**$ 1,223**

15. LONG-TERM INVESTMENTS

Long-term investments as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Loans and promissory notes from related parties	14,279	17,721	13,444
Loans and promissory notes from third parties	6,836	—	—
Mutual investment funds	9,616	—	—
Other	10,662	14,552	11,322
Total	**$41,393**	**$32,273**	**$24,766**

Loans and promissory notes from parties related by means of common control are mostly RUR denominated and interest-free. Majority of such loans and promissory notes mature from 2004 to 2006.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

16. INVESTMENTS IN AFFILIATED COMPANIES

Investments in affiliated companies as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003		2002		2001	
	Voting power, %	Carrying value	Voting power, %	Carrying value	Voting power, %	Carrying value
			(000's)			
MTS	Consolidated		41%	$474,587	41%	$352,395
Telecom-900	Consolidated		—	—	19%	6,270
Golden Line	Consolidated		Consolidated		50%	4,435
Comstar	Consolidated		50%	32,906	50%	32,450
Primtelefon	50%	$ 31,174	—	—	—	—
East-West United Bank	30%	8,382	30%	6,092	25%	3,215
ZETA Telecom	49%	7,390	49%	6,882	49%	7,000
Kosmos TV	50%	7,239	—	—	—	—
MTS Belarus	49%	5,884	—	—	—	—
Astrakhan Mobile and Volgograd Mobile	50%	5,806	—	—	—	—
MCC	24%	4,862	24%	4,330	24%	6,730
Mosdachtrest	44%	4,024	44%	3,297	44%	3,007
Loans to MTS Belarus	—	51,481	—	—	—	—
Loans to Astrakhan Mobile and Volgograd Mobile	—	6,850	—	—	—	—
Acquired debt of Kosmos TV (Note 4)	—	6,333	—	—	—	—
Other investments and loans to investees	Various	11,511	Various	8,244	Various	7,739
Total		**$150,936**		**$536,338**		**$423,241**

Investments in affiliates include $51.5 million in loans to MTS Belarus bearing interest at 3% to 11% per annum. Based on projected cash flows of MTS Belarus, the Group has concluded that no impairment of the Group's investments in MTS Belarus is required as of December 31, 2003.

17. LICENSES, NET

Licenses, net of accumulated amortization, as of December 31, 2003 consisted of the following:

	(000's)
Operating licenses	$ 773,073
Less: accumulated amortization	(103,085)
Total	**$ 669,988**

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

Amortization expense for licenses for the year ended December 31, 2003 amounted to $103.1 million. Based on the licenses existing at December 31, 2003, the estimated amortization expense for each of the five succeeding years and thereafter is as follows:

	(000's)
2004	$140,307
2005	136,108
2006	131,508
2007	97,408
2008	66,398
Thereafter	98,259
	$669,988

Actual amortization expense to be reported in future periods could differ from these estimates as a result of new licenses acquisitions, changes in useful lives and other relevant factors.

18. OTHER INTANGIBLE ASSETS, NET

Intangible assets, other than goodwill and licenses, net of accumulated amortization, as of December 31, 2003, 2002 and 2001 consisted of the following:

	December 31, 2003			December 31, 2002			December 31, 2001		
	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
Amortized intangible assets:									
Acquired customer base	$137,747	(28,877)	108,870	$ 1,599	(178)	1,421	—	—	—
Numbering capacity with finite contractual life, rights to use premises, software and other	319,498	(53,007)	266,491	4,365	(2,017)	2,348	$ 2,100	(1,875)	225
	457,245	(81,884)	375,361	5,964	(2,195)	3,769	2,100	(1,875)	225
Unamortized intangible assets:									
Numbering capacity with indefinite contractual life	28,855	—	28,855	12,415	—	12,415	11,186	—	11,186
Trademarks	42,165	—	42,165	9,858	—	9,858	—	—	—
Total intangible assets	**$528,265**	**(81,884)**	**446,381**	**$28,237**	**(2,195)**	**26,042**	**$13,286**	**(1,875)**	**11,411**

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

Amortization expense recorded on the intangible assets for the years ended December 31, 2003, 2002 and 2001 amounted to $82.6 million, $1.6 million and $1.0 million, respectively. The estimated amortization expense for each of the five succeeding years is as follows:

	(000's)
2004	144,110
2005	111,409
2006	67,849
2007	20,220
2008	6,803
Thereafter	24,970
	$375,361

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.

19. BANK DEPOSITS AND NOTES ISSUED

Bank deposits and notes issued as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Deposits repayable on demand	$ 57,981	$ 63,553	$ 59,055
Term deposits	67,446	85,868	123,906
Bonds issued	—	9,439	—
Promissory notes issued	48,321	12,433	19,835
Total	**$173,748**	**$171,293**	**$202,796**

Bank deposits and notes issued as of December 31, 2003, 2002 and 2001 include deposits from and promissory notes issued to related parties for $30.2 million, $54.5 million and $105.0 million, respectively.

In August 2002, MBRD issued 1-year RUR-denominated bonds with a face value of 300 million RUR. The bonds were traded on the MICEX, carried a coupon rate of 18.8% and were repaid in August 2003.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

20. INSURANCE-RELATED LIABILITIES

Insurance-related liabilities as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Unearned premium provision, net of reinsurance	72,511	59,163	48,769
Loss provision, net of reinsurance	39,349	24,154	17,525
Undisbursed MGFOMS funds	38,140	36,063	24,806
Other insurance related liabilities	30,986	17,729	14,173
Total	**$180,986**	**$137,109**	**$105,273**

Usage of MGFOMS funds in the amount of $38.1 million, accumulated and undisbursed by Rosno as of December 31, 2003 is limited to payments for medical facilities and care provided to RF citizens by medical centers under MGFOMS's obligatory medical insurance program.

21. ACCRUED EXPENSES AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Subscriber prepayments, current portion (Note 25)	$255,988	$ 54,209	$34,974
Payables for purchase of oil assets (Note 5)	96,530	—	—
Payroll and other accrued expenses	39,836	12,032	9,322
Accrued interest on loans	50,726	7,980	5,868
Customers' advances	38,586	11,292	9,659
Payables for purchase of UMC shares (Note 4)	27,500	—	—
Current portion of long-term capital lease obligations (Note 23)	11,387	26,973	4,089
Dividends payable	10,841	4,337	2,573
Tax and legal contingencies	27,179	6,000	6,000
Other	48,510	6,750	7,109
Total	**$607,083**	**$129,573**	**$79,594**

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

22. SHORT-TERM NOTES PAYABLE

Short-term notes payable as of December 31, 2003, 2002 and 2001 consisted of the following:

	Currency	Annual interest rate (Actual at December 31, 2003)	2003	2002	2001
				(000's)	
Credit linked notes	USD	10.8%	$100,000	$ 15,000	$ 10,000
Credit Suisse First Boston	USD	LIBOR+3.5% (4.7%)	35,000	—	—
Trust Bank	USD	8.0%			
		Russian Interbank Refinancing	25,000	10,000	—
Deutsche Bank	USD	Rate+5.5% (14.5%)	15,280	—	20,000
AVAL Bank	UAH	10.0%–16.0%	10,890	—	—
Commerzbank Eurasia	USD	LIBOR+5.0% (6.2%)	10,000	17,000	4,750
Sberbank	RUR	15.0%–18.0%	3,828	4,488	3,215
USD promissory notes issued	USD	—	—	21,809	—
RUR promissory notes issued	RUR	—	—	—	12,872
Dresdner Bank	USD	—	—	10,000	—
Donau Bank	USD	—	—	9,864	—
Renaissance Nominees Ltd.	USD	—	—	5,000	—
Loans and promissory notes payable to related parties	Various	Various	134,574	90,538	84,222
Other	Various	Various	14,511	14,898	9,426
Total			**$349,083**	**$198,597**	**$144,485**

Credit Linked Notes—In February 2003, the Group borrowed $100.0 million at 10.75% per annum under a credit linked note program. The Group has repurchased $38.2 million of the credit linked notes during the year ended December 31, 2003 (Note 7). The notes were repaid in February 2004.

Credit Suisse First Boston—In May and December 2003, the Group entered into loan agreements with Credit Suisse First Boston for an aggregate amount of $35.0 million. The interest rate on the loans was LIBOR+3.5%. The loans were repaid in January 2004.

Trust Bank—In October 2003, the Group entered a loan agreement with Trust Bank for $25.0 million. The loan bears interest at 9.5% per annum and is due in July 2004.

Deutsche Bank—In February 2003, the Group borrowed $15.3 million from Deutsche Bank with an interest rate determined as the Russian interbank refinancing rate plus 5.5%. The loan was repaid in January 2004.

AVAL Bank—On December 31, 2003, the Group had a balance of $10.9 million of overdraft with AVAL bank. The short-term overdraft facility is limited to 110.0 million hryvnas (equivalent of $20.0 million as of December 31, 2003), bears interest at 10–16% per annum and matures in June 2004.

Commerzbank Eurasia—In November 2003, the Group entered a loan agreement with Commerzbank Eurasia for the amount of $10.0 million. The loan bears interest at LIBOR+5% and is due in November 2004.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

Sberbank—The Group has entered several short-term loans with Sberbank. The outstanding balance under the loans as of December 31, 2003 is \$3.8 million. The loans bear interest of 15%-18% and mature in 2004.

Sberbank loans are collateralized by pledge of PP&E with the carrying value of approximately \$6.0 million. Other short-term loans are unsecured.

23. CAPITAL LEASE OBLIGATIONS

Capital lease obligations as of December 31, 2003, 2002 and 2001 consisted of the following:

	2003	2002	2001
		(000's)	
Capital lease obligations	\$ 16,330	\$ 36,664	\$18,995
Less: current portion of capital lease obligations (Note 21)	(11,387)	(26,973)	(4,089)
Total	**\$ 4,943**	**\$ 9,691**	**\$14,906**

During 2001-2003 the Group entered several lease agreements for telecommunications equipment and vehicles. Most of the agreements expire in 2004–2006 and assume transfer of ownership for leased assets to the Group at the end of the lease term. Sistema guaranteed \$8.2 million under the lease agreements entered by the Group's subsidiaries.

The net book value of leased assets comprised \$23.2 million, \$36.7 million and \$35.9 million as of December 31, 2003, 2002 and 2001, respectively. Rent expense, recorded within income from continuing operations, was \$4.2 million, \$3.0 million and \$2.8 million in 2003, 2002 and 2001, respectively. Future minimum payments under the lease agreements and lease commitments are disclosed in Note 32.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

24. LONG-TERM DEBT

Long-term debt as of December 31, 2003, 2002 and 2001 consisted of the following:

	Currency	Annual interest rate (Actual at December 31, 2003)	2003	2002	2001
				(000's)	
Sistema Finance Notes	USD	10.3%	$ 348,561	$ —	$ —
MTS Notes due 2010	USD	8.4%	400,000	—	—
MTS Notes due 2008	USD	9.8%	400,000	—	—
MTS Notes due 2004	USD	11.0%	299,640	—	—
Floating Rate Notes due 2004	USD	LIBOR+4.0% (5.2%)	298,196	—	—
Sistema Finance Investments Bonds	RUR	15.0%	40,747	37,488	—
MGTS Bonds	RUR	11.3%–12.3%	52,643	38,393	44,789
Micron Bonds	RUR	15.0%	7,541	2,613	684
TAIF-Telcom Bonds	RUR	20.6%	4,074	—	—
Total Corporate Bonds			**1,851,402**	**78,494**	**45,473**
ING-Bank	USD	LIBOR+4.2% (5.4%)	60,000	10,000	—
Deutsche Telecom	USD	LIBOR+0.3%–7% (1.5%–8.2%)	57,981	50,000	50,000
Hermes Credit Facility	EUR	EURIBOR+0.7% (2.8%)	55,550	—	—
Sberbank	RUR	12.0%	34,732	61,285	72,854
Raiffeisenbank	USD	LIBOR+5.0%–7.0% (6.2%–8.2%)	33,036	29,886	—
Vendor Financing	Various	Various	25,033	32,992	37,690
HSBC	USD	LIBOR+2.8% (3.9%)	25,000	—	—
Ericsson Project Finance	USD	LIBOR+4% (5.2%)	23,400	34,412	38,958
Commerzbank (Eurasia)	USD	LIBOR+1.4%–3.5% (2.6%–4.7%)	19,958	—	—
Citibank	USD	LIBOR+1.6%V5.0% (2.8%V6.2%)	18,616	7,577	9,427
Vneshtorgbank	USD	10.0%	17,297	21,565	11,899
Dresdner Bank	USD	LIBOR+3.2%–3.4% (4.4%4.6%)	15,400	—	—
International Moscow Bank	RUR	13.4%	10,864	—	—
Vnesheconombank	USD	7.0%	6,974	—	—
TDC Mobile International	USD	LIBOR+5%–7% (6.2%–8.2%)	6,838	—	—
WestLB International	EUR	EURIBOR+2% (4.2%)	5,092	—	—
Loans from related parties	Various	Various	31,898	38,859	72,820
Other	Various	Various	20,956	7,653	22,573
			2,320,027	372,723	361,694
Less amounts maturing within one year			(844,106)	(106,843)	(71,904)
Total			**$1,475,921**	**$265,880**	**$289,790**

Corporate Bonds—In April 2003, Sistema Finance, a subsidiary of the Group, issued $350.0 million 10.25% notes, due in April 2008, at 99.52% of par. These notes are collateralized by 193,473,900 shares of common stock of MTS. The notes are listed on the Luxembourg Stock Exchange. JSFC Sistema is a guarantor of the notes. Interest on the notes is payable semi-annually in arrears. On or prior to April 14, 2006, the Group may redeem up to 35% of the notes with the net proceeds of offerings of Sistema's common equity at 110.25% of par. These notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, restrictions on mergers or consolidations, limitations on liens and dispositions of assets and limitations on transactions with affiliates. In addition, these notes provide the holders with a right to require Sistema Finance to redeem all of the notes outstanding at 101% of the principal amount of the notes plus accrued interest upon any change in control.

In October 2003, MTS Finance, a subsidiary of the Group, issued $400.0 million notes bearing interest at 8.375% at par. The cash proceeds, net of issuance costs of approximately $4.6 million, amounted to $395.4 million. These notes are fully and unconditionally guaranteed by MTS and will mature in October 2010. MTS Finance is required to make interest payments on the notes semi-annually in arrears in April and October of each year, commencing April 2004. The notes are listed on the Luxembourg Stock Exchange. These notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, limitations on MTS's ability to enter into sale-leaseback transactions, restriction on any merger, consolidation or disposition of assets, restrictions on the sales of any licenses. In addition, these notes provide the holders a right to require MTS Finance to redeem all of the notes outstanding at 101% of the principal amount of the notes plus accrued interest upon any change in control, as defined.

In August 2003, MTS Finance issued $300.0 million notes bearing interest at floating rate of 3-month LIBOR+4% (5.2% as of December 31, 2003) at 99% of par. These notes are fully and unconditionally guaranteed by MTS and mature in August 2004. MTS Finance is required to make interest payments on the notes quarterly, commencing November 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes, net of underwriting discount, were $297.0 million and related debt issuance costs of $1.8 million were capitalized (see also Note 33).

In November 2002, Sistema Finance Investments, a subsidiary of the Group, issued RUR denominated bonds with face value of 1,200.0 million RUR (equivalent of $40.7 million as of December 31, 2003). The bonds are traded on MICEX, mature in November 2004 and carry a coupon rate of 17.75% during the first year of trading and of 15% during the second year.

In the fourth quarter of 2001, MGTS issued RUR denominated bonds (second issue) with face value of 1,000 million RUR (equivalent of $33.4 million as of December 31, 2003) due in 2004. Interest is payable semiannually. The issue has a floating interest rate, which is set for each coupon payment not later than 6 days before the date of the prior coupon payment. Interest (11.3% as of December 31, 2003) should not be less than the weighted average interest rate of OFZ as at the date the interest rate is fixed. As of December 31, 2003 MGTS has repurchased on the open market approximately 44% of the second issue.

In February 2003, MGTS issued 2-year RUR denominated bonds (third issue) in the amount of 1,000.0 million RUR (equivalent of $33.4 million as of December 31, 2003). The bonds carry coupon of 12.3% during the first year of trading and 17.0% during the second year. Prior to the placement of the third issue MGTS repurchased on the open market the first issue of its bonds. The repurchase of the bonds did not have a material effect on the Group's financial results.

In the fourth quarter of 2001, Mikron issued RUR denominated bonds with face value of 150.0 million RUR (equivalent of $4.7 million as of December 31, 2003). Interest is payable semiannually. The interest rate is set at 26.7% while two-thirds of the interest is covered by the municipal government. The bonds were repaid in 2003.

In July 2003, Mikron issued RUR denominated bonds with face value of RUR 300.0 million (equivalent of $9.9 million as of December 31, 2003) due in January 2005. Interest is payable semiannually. The interest rate is set at 15% per annum, while two-thirds of the interest payments are covered by the municipal government. As of December 31, 2003 the Group has repurchased on the open market approximately 26% of Mikron bonds issued.

ING Bank—In September 2003, UMC entered into a $60.0 million syndicated credit facility with ING Bank (Eurasia), Standard Bank and Commerzbank Aktiengesellschaft with an interest rate of LIBOR+4.2% (5.3% as of December 31, 2003). The loan is guaranteed by MTS. The proceeds were used by UMC to refinance its existing indebtedness. The loan is payable in 8 equal quarterly installments starting from September 2004. As of December 31, 2003 the principal outstanding under this credit facility is $60.0 million.

Deutsche Telecom—The Group obtained a loan of $50.0 million from Deutsche Telecom due in 2004. Interest of LIBOR+0.3% per annum (1.5% as of December 31, 2003) is payable semiannually. The Group pledged 5% of MTS common shares under the agreement. The loan was provided to the Group through a related party.

Hermes Credit Facility—In December 2003, UMC entered into Hermes Credit Facility with ING BHF Bank and Commerzbank to finance the acquisition of GSM equipment from Siemens AG. The aggregate amount available under this credit facility is EUR 47.4 million (equivalent of $59.3 million as of December 31, 2003). The loan is guaranteed by MTS and bears interest at EURIBOR+0.7% (2.8% as of December 31, 2003). The amount outstanding will be redeemable in 10 equal semi-annual installments, commencing July 2004. The balance outstanding as of December 31, 2003 was EUR 44.5 million (equivalent of $55.6 million as of December 31, 2003).

Sberbank—In December 2000, MGTS signed a credit facility with Sberbank for a total amount equivalent to $90.0 million to refinance its obligations under Eurobond borrowings. The loan was received in three tranches during the first quarter of 2001. In September 2002, MGTS prolonged repayment of $30.6 million of the principal to the first quarter of 2005. The remaining balance was repaid in 2003. The interest rate on the prolonged loan was 18% during the first six months and 12% during the second six months of 2003. Equipment with fair value of $87.3 million is pledged to collateralize the outstanding balance as of December 31, 2003.

Raiffeisenbank—In September 2002, MGTS entered a credit line with Raiffeisenbank limited to $15.0 million. The equipment pledged under the credit line as of December 31, 2003 is valued at $22.5 million. In addition, MGTS is required to maintain monthly gross cash flows with the bank of not less than $1.5 million. The loan bears interest of LIBOR+5% (6.2% as of December 31, 2003) and matures in 2007. As of December 31, 2003, approximately $15.0 million was outstanding under this credit line.

In November 2002 the Group entered a credit line with Raiffeisenbank (Austria) limited to $20.0 million. The building pledged under the credit line as of December 31, 2003 is valued at $22.7 million. In addition, the Group is required to maintain monthly gross cash flows with the bank of not less than $1.5 million. The loan bears interest of LIBOR+7% per annum (8.2% as of December 31, 2003) and matures in 2007. As of December 31, 2003, approximately $18.0 million was outstanding under this credit line.

Vendor Financing—Foreign suppliers of telecommunications equipment provide non-collateralized commercial credit (vendor financing) to the Group denominated in various currencies on short-term and long-term bases, mostly interest free.

HSBC—In October 2003, TAIF-Telcom entered into a $25.0 million credit facility with HSBC Bank LLC which is guaranteed by MTS. The facility bears interest at LIBOR+2.8% (3.9% as of December 31, 2003) and is redeemable in ten equal quarterly installments commencing June 2004. The loan is subject to certain restrictive covenants including, but not limited to, restriction on the amount of dividends paid by TAIF-Telcom until MTS owns 100% of its outstanding common stock. As of December 31, 2003 the outstanding balance is $25.0 million.

Ericsson Project Finance—In December 1996, Rosico, then a subsidiary of the Group, entered into a credit agreement with Ericsson Project Finance AB which provides for a credit facility with an aggregate principal amount of $60.0 million. The loan bears interest of LIBOR plus 4% per annum (5.2% as of December 31, 2003). The loan is collateralized by a pledge of 16.8% of MGTS voting shares held by the Group. In February 2003, Ericsson Project Finance AB assigned all of its rights and obligations under the loan to Salomon Brothers Holding Company, Inc.

Commerzbank (Eurasia)—InvestSvyazHolding, a subsidiary of the Group, entered in a number of credit facilities with Commerzbank (Eurasia) for a total amount of $21.6 million. As of December 31, 2003, approximately $20.0 million was outstanding under these credit line facilities. The loans are guaranteed by MTS.

Citibank—In July 2001, an uncollateralized bank loan was provided to MGTS by Citibank at LIBOR+1.6% (2.8% as of December 31, 2003) for the purchase of equipment. The loan is guaranteed by Export Guarantee and Insurance Corporation, Czech Republic and JSFC Sistema. In September 2003, MGTS received a loan from Citibank for the purchase of equipment in the amount of $6.1 million. The loan bears interest of LIBOR+5% (6.2% as of December 31, 2003), and is repayable in 8 semi-annual installments. The loan is collateralized by pledge of equipment in the amount of $5.4 million and by deposit in Citibank and guaranteed by Export Guarantee and Insurance Corporation, Czech Republic. As of December 31, 2003, approximately $8.6 million was outstanding under these loans.

Vneshtorgbank—In 2001 the Group received three loans from Vneshtorgbank maturing in 2002-2003 to finance working capital. The loans are collateralized by pledge of equipment valued by the parties at $15.4 million. All loans have fixed interest rates and the weighted average interest rate on these loans is 16.1%. During the year ended December 31, 2002, the Group also received a number of loans from Vneshtorgbank maturing in 2003-2007 to finance working capital. The loans are collateralized by pledge of equipment valued by the parties at $7.6 million and collateralized by a pledge of shares of MGTS. The weighted average interest rate on the Vneshtorgbank loans outstanding as of December 31, 2003 was 10.0% per annum.

International Moscow Bank—In June 2003, the Group entered into a credit facility with the International Moscow Bank for RUR 350.0 million (equivalent of $11.9 million as of December 31, 2003). Amounts borrowed under this facility mature in June 2005 and have an interest rate of 13.4% until June 2004. The interest rate thereafter will be fixed under a separate agreement. As of December 31, 2003, approximately $10.9 million was outstanding under this facility.

Debt Assumed by Acquisition of MTS, UMC, TAIF-Telcom and Comstar

Corporate Bonds—In December 2001, MTS Finance, a subsidiary of the Group, issued $250.0 million 10.95% notes at 99.25% of par. Proceeds received from the notes, net of underwriting discount, were $248.0 million. In March 2002, MTS Finance issued additional $50.0 million 10.95% notes at 101.62% of par. Proceeds received from these notes, including the offering premium, were $50.8 million. All the notes are guaranteed by MTS and mature in December, 2004. MTS Finance makes interest payments on the notes semi-annually in arrears. The notes are listed on the Luxembourg Stock Exchange. In May 2002 these notes were registered with the SEC under the Securities Act of 1933.

In January 2003, MTS Finance issued $400.0 million 9.75% notes at par. These notes are guaranteed by MTS and mature in January, 2008. MTS Finance is required to make interest payments on the notes semi-annually in arrears. The notes are listed on the Luxembourg Stock Exchange.

In April 2000, TAIF-Telcom issued RUR denominated bonds for approximately $4.0 million. The bonds mature in February 2007 and bear interest at 20% per annum, adjustable for the change in USD exchange rate and payable on a quarterly basis (20.6% per annum as of December 31, 2003).

Deutsche Telecom and TDC Mobile International—UMC had an uncollateralized long-term revolving USD denominated credit facility agreements with Deutsche Telekom and TDC Mobile International. The maximum borrowing limit under the agreements is $54.0 million. These credit agreements were amended in connection with the Group's purchase of a majority stake in UMC to provide for UMC's repayment of the outstanding amounts under these facilities. The credit facilities bear interest at LIBOR+5% (6.2% as of December 31, 2003) and LIBOR +7% (8.2% as of December 31, 2003), respectively, and are redeemable in five equal quarterly installments commencing April 2003. As of December 31, 2003, UMC had $7.9 million liability to Deutsche Telekom and $6.8 million liability to TDC Mobile International under the facilities. The amounts outstanding under these facilities were guaranteed by MTS. The debt was fully repaid in April 2004.

Dresdner Bank—In December 2001 and April 2002, UDN-900, a subsidiary of MTS, entered into credit agreements with Dresdner Bank, expiring on April 2004. As of December 31, 2003, the amount outstanding under this agreement was $5.4 million. The borrowing bears interest at LIBOR+3.2% (4.4% as of December 31, 2003) per annum and is guaranteed by MTS.

In October 2002, MSS, a subsidiary of MTS, entered into a credit agreement with Dresdner Bank to borrow up to $10.0 million. As of December 31, 2003, $10.0 million was outstanding under this agreement. Borrowing under this agreement bears interest of LIBOR+3.4% (4.6% as of December 31, 2003) per annum and matures in October 2004. The loan is guaranteed by MTS.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

Citibank—In November 2002, Telecom XXI entered into a credit facility with Citibank. Amounts borrowed under the credit facility and outstanding as of December 31, 2003 must be repaid in June 2004 and bear interest of LIBOR+3.5% (4.7% as of December 31, 2003) per annum. Overdue amounts bear an additional 3% per annum. As of December 31, 2003, $10.0 million was outstanding under this facility. The loan is guaranteed by MTS.

Vnesheconombank—In 1994, Comstar entered a loan facility with Vnesheconombank bearing interest at 7.0% per annum. As of December 31, 2003, the amount of borrowings under this facility was approximately $7.0 million. The loan is guaranteed by MGTS.

WestLB International—In July 2002, MTS-P, a wholly-owned subsidiary of MTS, entered into a credit facility agreement with WestLB International S.A. As of December 31, 2003, the amount of borrowings under this agreement was $5.0 million. Amounts outstanding under this agreement bear interest of EURIBOR+2% (4.2% as of December 31, 2003) per annum for the first two years for each advance and 4% per annum for the remaining interest periods for each advance until maturity. Final maturity of this agreement is December 2006. The loan is guaranteed by MTS.

The loan repayments over the five-year period beginning on December 31, 2003 are as follows:

	(000's)
2004	844,106
2005	193,525
2006	60,136
2007	22,479
2008	768,724
Thereafter	431,057
Total	**2,320,027**

25. SUBSCRIBER PREPAYMENTS

Subscriber prepayments as of December 31, 2003, 2002 and 2001 consisted of the following:

	(000's)		
	2003	2002	2001
Current portion (Note 21)			
Connection fees	$ 60,609	$ 27,782	$20,503
Advances and customers' deposits	195,379	26,427	14.471
	255,988	54,209	34,974
Non-current portion			
Connection fees	103,059	66,935	54,875
Total	**$359,047**	**$121,144**	**$89,849**

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

26. INCOME TAX

The Group's provision for income taxes is as follows for the years ended December 31, 2003, 2002 and 2001:

	(000's)		
	2003	2002	2001
Current provision	$333,534	$31,182	$37,186
Deferred (benefit)/provision	(42,601)	12,216	(8,016)
Total income tax expense	**$290,933**	**$43,398**	**$29,170**

The provision for income taxes is different from that which would be obtained by applying the statutory income tax rate (24% in 2003 and 2002 and 35% in 2001) to net income from continuing operations before income tax, minority interests and cumulative effect of a change in accounting principle. The items causing this difference are as follows:

	(000's)		
	2003	2002	2001
Income tax provision computed on income from continuing operations before taxes at statutory rate	$221,694	$59,855	$71,905
Adjustments due to:			
Change in valuation allowance	91	(4,844)	(15,212)
Non-deductible items	42,366	12,496	24,054
Non-taxable items	—	(1,589)	(8,708)
Taxable losses not carried forward	7,566	3,140	4,855
Currency exchange and translation differences	18,083	(2,323)	2,010
Investment allowance	—	—	(12,360)
Goodwill amortization	—	—	(6,721)
Effect of change in income tax rate	—	—	(9,594)
Effect of rates different from standard	1,133	(23,337)	(21,059)
Income tax expense	**$290,933**	**$43,398**	**$29,170**

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The tax effects of temporary differences that give rise to the deferred tax assets and liabilities are presented below:

	(000's)		
	2003	2002	2001
Deferred tax assets			
Subscriber and customer prepayments	$ 40,014	$ 18,325	$ 9,942
Property, plant and equipment	21,191	—	—
Allowance for doubtful accounts	20,338	3,233	2,750
Deferred revenues	19,070	12,188	12,855
Tax losses carried forward	8,795	9,129	14,783
Accrued expenses	3,434	4,862	4,266
Post-retirement benefits	1,175	1,062	1,634
Insurance reserves	—	1,031	3,319
Inventory obsolescence	—	866	673
Capital lease obligations	—	112	2,296
Other	2,187	1,263	1,125
	116,204	52,071	53,643
Less: valuation allowance	(9,142)	(4,336)	(12,178)
Total deferred tax assets	**107,062**	**47,735**	**41,465**
Deferred tax liabilities			
Intangible assets	(191,249)	—	—
Property, plant and equipment	(71,357)	(13,693)	—
Undistributed earnings of affiliates	(4,462)	(24,924)	(16,979)
Other	(11,949)	(3,064)	(6,508)
Total deferred tax liabilities	**$(279,017)**	**$(41,681)**	**$(23,487)**
Net deferred tax assets, current	$ 53,964	$ 9,358	$ 4,542
Net deferred tax assets, long term	5,575	23,492	26,641
Net deferred tax liabilities, current	(508)	(1,371)	—
Net deferred tax liabilities, long term	(230,986)	(25,425)	(13,205)

The Group does not record a deferred tax liability related to undistributed earnings of its subsidiaries, as it intends to permanently reinvest these earnings.

27. POSTRETIREMENT BENEFITS

MGTS has historically provided certain benefits to employees upon their retirement and afterwards. Currently such benefits include bonus payments of a fixed amount to retiring employees with at least five years of service (5,700 RUR or 11,400 RUR per employee, or approximately 180 and 360 USD, respectively, at the exchange rate as of December 31, 2003, depending on actual years of service); lifetime payments of a fixed amount to employees retiring with at least fifteen years of service (1,200 RUR per employee, or approximately 40 USD at the exchange rate as of December 31, 2003, for the year 2003); and discounted telephone service to employees retiring with at least thirty years of service. An employee is withdrawn from the benefit plan if their employment with MGTS is discontinued prior to retirement.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The assumed discount rate used in determining net periodic cost is 8% per annum. The future benefit payments to retirees under the defined benefit plan are expected as follows:

	(000's)
2004	$1,469
2005	423
2006	397
2007	373
2008	352
2009–2013	1,291
Thereafter	592
Total	**$4,897**

MGTS's defined benefit plan is unfunded. For the years ended December 31, 2003, 2002 and 2001 the net periodic benefit costs recognized and the contributions paid by MGTS under the plan were not material.

28. DEFERRED REVENUE

Deferred revenue is comprised of property, plant and equipment contributions and grants received by the Group and for the years ended December 31, 2003, 2002 and 2001 was as follows:

	(000's)		
	2003	2002	2001
Deferred revenue at the beginning of the year	$ 89,894	$73,043	$49,383
Contributions received during the year	26,183	24,539	27,822
Currency translation effect	9,705	—	—
	125,782	97,582	77,205
Deferred revenue amortized	(10,419)	(7,688)	(4,162)
Deferred revenue at the end of the year	**$115,363**	**$89,894**	**$73,043**

In 2000 the Group was awarded a grant for construction of a manufacturing facility for production of medicines (vaccines and infusion dissolvents) in the Moscow region. The grant facility of $20.1 million was received in full during 2001 and 2000. The grant is repayable to the grantor (state organization) during the period to 2010. These contributions are accounted for as deferred revenues.

29. SHARE CAPITAL

At January 1, 2001, Sistema had 4,016 voting common shares authorized and 324 shares issued and outstanding with a par value of 2,500 RUR.

In March 2002, Sistema effected a split of all outstanding shares into 8,100,000 shares with a par value of 0.1 RUR. The number of authorized common shares was increased to 68,325,000. The computations of basic and diluted earnings per share for all periods presented were adjusted retroactively to reflect the increase in the number of common shares outstanding as a result of the stock split.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

30. SEGMENT INFORMATION

The Group's operating segments are: Telecommunications, Technology, Insurance, Banking and Other. The Group's management evaluates performance of the segments based on both operating income and net income before minority interests and cumulative effect of a change in accounting principle.

An analysis and reconciliation of the Group's business segment information to the respective information in the consolidated financial statements for the years ended December 31, 2003, 2002 and 2001 is as follows:

	For the year ended December 31, 2003					
	Telecom-munica-tions	Techno-logy	Insurance	Banking	Corporate and Other	Total
Net sales to external customers[a]	3,246,813	57,609	169,569	47,192	238,732	3,759,915
Intersegment sales	755	28,333	18,360	10,321	10,926	68,695
Income/(loss) from equity affiliates	439	—	(509)	490	45	465
Interest income	22,834	—	—	—	6,634	29,468
Interest expense	(161,911)	(2,772)	—	—	(41,719)	(206,402)
Net interest revenue[a]	—	—	—	2,697	—	2,697
Depreciation and amortization	(506,644)	(2,862)	(3,115)	(620)	(7,735)	(520,976)
Goodwill impairment	(19,251)	—	—	—	—	(19,251)
Operating income/(loss)	1,103,282	(3,348)	17,111	2,567	(16,131)	1,103,481
Income tax expense	(293,983)	1,571	(3,858)	(3,116)	8,453	(290,933)
Investments in affiliated companies	56,298	666	—	3,875	21,665	82,504
Segment assets	5,204,668	103,568	239,273	595,516	651,718	6,794,743
Capital expenditures	1,152,216	9,209	7,310	2,994	41,160	1,212,889

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

	For the year ended December 31, 2002					
	Telecom-munica-tions	Techno-logy	Insurance	Banking	Corporate and Other	Total
Net sales to external customers[a]	482,506	58,521	137,357	31,244	179,878	889,506
Intersegment sales	217	17,649	3,378	5,416	1,216	27,876
Income from equity affiliates	122,638	—	—	1,585	402	124,625
Interest income	1,944	—	—	—	3,885	5,829
Interest expense	(37,652)	(3,607)	—	—	(14,912)	(56,171)
Net interest revenue[b]	—	—	—	7,219	—	7,219
Depreciation and amortization	(62,357)	(2,919)	(1,800)	(287)	(4,679)	(72,042)
Operating income/(loss)	279,837	5,533	2,583	8,804	(1,507)	295,250
Income tax expense	(34,288)	(3,427)	(704)	(1,069)	(3,910)	(43,398)
Investments in affiliated companies	538,222	—	697	6,092	6,464	551,475
Segment assets	1,478,924	63,446	165,150	283,045	338,393	2,328,958
Capital expenditures	128,694	5,448	5,945	1,577	49,060	190,724

	For the year ended December 31, 2001					
	Telecom-munica-tions	Techno-logy	Insurance	Banking	Corporate and Other	Total
Net sales to external customers[a]	$ 421,156	$29,879	$89,001	$17,190	$163,310	$ 720,536
Intersegment sales	—	—	959	1,882	7,766	10,607
Income from equity affiliates	96,328	—	(9)	—	316	96,635
Interest income	877	—	—	—	1,141	2,018
Interest expense	(34,272)	(321)	—	—	(7,026)	(41,619)
Net interest revenue[b]	—	—	—	6,236	—	6,236
Depreciation and amortization	(53,646)	(1,909)	(623)	(379)	(3,421)	(59,978)
Operating income/(loss)	236,002	(639)	(13,959)	5,979	15,179	242,562
Income tax expense	(26,830)	(1,821)	3,012	(1,163)	(2,368)	(29,170)
Investments in affiliated companies	415,075	—	732	3,215	4,256	423,278
Segment assets	1,284,568	41,642	119,786	325,237	187,151	1,958,384
Capital expenditures	170,113	1,715	10,920	883	22,334	205,965

(a) Interest income and expenses of the Insurance and Banking Segments are presented as revenues from financial services in the Group's consolidated financial statements.

(b) The Banking Segment derives a majority of its revenue from interest. In addition, management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing that segment. Therefore, only the net amount is disclosed.

The reconciliation of segment interest income, interest expense and segment assets to the respective information in the consolidated financial statements and the reconciliation of segment operating income to the consolidated income from continuing operations before income tax, minority interests and cumulative effect of a change in accounting principle are as follows:

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

	2003	2002	2001
		(000's)	
Total segment interest income	$ 29,468	$ 5,829	$ 2,018
Intersegment eliminations	(10,127)	(4,207)	(206)
Consolidated interest income	**$ 19,341**	**$ 1,622**	**$ 1,812**
Total segment interest expense	$ (206,402)	$ (56,171)	$ (41,619)
Intersegment eliminations	8,056	3,060	1,882
Consolidated interest expense	**$ (198,346)**	**$ (53,111)**	**$ (39,737)**
Total segment operating income	$1,103,481	$295,250	$242,562
Intersegment eliminations	2,262	520	(1,676)
Interest income	19,341	1,622	1,812
Interest expense	(198,346)	(53,111)	(39,737)
Currency exchange and translation (loss)/gain	(3,015)	5,113	2,482
Consolidated income from continuing operations before income tax, minority interests and cumulative effect of a change in accounting principle	**$ 923,723**	**$249,394**	**$205,443**

	2003	2002	2001
		(000's)	
Total segment assets	$6,794,743	$2,328,958	$1,958,384
Intersegment eliminations	(2,513)	(627)	—
Consolidated segment assets	**$6,792,230**	**$2,328,331**	**$1,958,384**

For the year ended December 31, 2003 the Group's revenues derived from Ukraine were $450.3 million. Long-lived assets of the Group's entity domiciled in Ukraine were $648.8 million as of December 31, 2003.

During the years ended December 31, 2003, 2002 and 2001 the Group did not have revenues from transactions with a single external customer amounting to 10% or more of the Group's consolidated revenues.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

31. RELATED PARTY TRANSACTIONS

The Group provides services to and purchases services from affiliates and companies related by means of common control. During the years ended December 31, 2003, 2002 and 2001 the Group entered into transactions with related parties as follows:

	2003	2002	2001
		(000's)	
Telecommunication services provided	—	$(58,931)	$(56,473)
Consulting services provided	$(10,768)	(17,177)	(14,157)
Revenues from financial services	(11,730)	(7,154)	(6,211)
Financial services related costs	—	8,618	3,596
Interest expense	1,457	2,113	—
Insurance premium received	(4,659)	(2,229)	(1,700)
Claims paid	9,201	1,902	3,612
Purchases of goods for resale	—	6,543	3,606
Advertising expenses	16,002	—	—
Other	829	(2,542)	(1,728)

Related party balances as of December 31, 2003, 2002 and 2001 are disclosed in the corresponding notes to the financial statements.

32. COMMITMENTS AND CONTINGENCIES

Operating Leases—The Group leases land, buildings and office space mainly from municipal organizations through contracts, which expire in various years through 2023.

Future minimum rental payments under capital and operating leases in effect as of December 31, 2003, are as follows:

	Capital leases	Operating leases
	(000's)	
2004	$12,476	$23,048
2005	3,826	11,447
2006	1,076	9,657
2007	32	7,378
2008	33	5,426
Thereafter	275	41,712
Less: amount representing interest	(1,388)	—
Total	**$16,330**	**$98,668**

Capital Commitments—As of December 31, 2003, MTS had executed non-binding purchase agreements in the amount of approximately $266.1 million to subsequently acquire property, plant and equipment.

In December 2003, MGTS signed an agreement to acquire telecommunications equipment and related services from a foreign vendor. The vendor financing amounting to $4.6 million will bear interest of LIBOR + 3% and be repayable in 7 equal quarterly installments starting February 2004.

In December 2003, MGTS announced its long-term investment program for the period from 2004 till 2012 providing for extensive capital expenditures including expansion and full digitalization of the Moscow telephone network. The program was approved by the resolution of Moscow City Government in December 2003. Capital expenditures under the investment program are currently estimated to be approximately $1.6 billion during the years 2004-2012 and include reconstruction of 350 local telephone stations and installation of 4.3 million of new phone numbers.

In July 2003, Sistema-Hals entered into an agreement with Siemens Real Estate to develop an office building in Moscow, which will become Siemens AG headquarters in Russia. Under this agreement Sistema-Hals is responsible for obtaining all necessary permits, planning and overall control of the construction process. The building is expected to be completed in late 2005. The cost of the project is approximately Euro 66.8 million (equivalent of $83.5 million as of December 31, 2003).

Disposition of Subsidiaries—In December 2003, the Group co-founded Skylink, a new mobile operator developing cellular network in CDMA-450 standard. The Group agreed to contribute its interests in P-Com and MCC to the share capital of Skylink in exchange for 50% ownership in Skylink. Transfer of shares is expected to be completed in 2004. Assets and liabilities of P-Com as of December 31, 2003 amounted to $59.0 million and $42.5 million, respectively. The carrying value of the Group's equity investment in MCC was $4.9 million as of December 31, 2003.

Operating Licenses—When MTS commenced its operations in 1994, licenses generally contained certain provisions for unspecified fees to be paid for utilization of frequencies. Most of MTS current licenses now provide for payments to be made for finance telecommunication infrastructure improvements, which in the aggregate could total approximately $110.2 million, as of December 31, 2003. However, a decision on the terms and conditions of such payments has not been finalized. Accordingly, MTS has not made any payments to date pursuant to any of current operating licenses. Further, management believes that MTS will not be required to make any such payments. If such payments would be required in the future, management believes that it would be limited to purchasing certain equipment for its own use in the related license area. In relation to these uncertainties, the Group has not recorded a contingent liability in the consolidated financial statements.

Each of the Group's telecommunication licenses, except the licenses covering the Moscow license area, contains a requirement for service to be commenced and for subscriber number and territorial coverage targets to be achieved by a specified date. The Group has met these targets or received extensions to these dates in those regional license areas in which the Group has not commenced operations. The management believes that the Group is in compliance with all material terms of our licenses.

The Group's telecommunication licences do not provide for automatic renewal. The Group has limited experience with the renewal of its existing licenses. However, management believes that licenses required for the Group's operations will be renewed upon expiration.

Issued Guarantees—As of December 31, 2003, MTS has issued guarantees on behalf of MTS-Belarus, an equity investee, for the total amount of $14.5 million. The guarantees expire by August 2005.

MGTS is a guarantor under the credit facility with a limit of $4.2 million provided to RTK-Leasing, by Vneshtorgbank. The facility is to be settled prior to July 2004. The guarantee amounted to $1.5 million and $3.1 million as of December 31, 2003 and 2002, respectively.

In December 2002 MTU-Inform and Alfabank signed a guarantee agreement. According to the agreement MTU-Inform guaranteed a loan of $4.0 million provided to Golden Line by Alfabank. The loan matures in November, 2005. In addition, MTU-Inform pledged equipment with a fair value of $4.7 million.

In December 2003 MTU-Inform pledged telecommunication equipment with the fair value of $17.4 million under a loan provided by MBRD to Skylink. The amount of the loan as of December 31, 2003 is $15.7 million. The loan is to be settled in December 2004.

Additionally, MBRD and JSFC Sistema guaranteed loans for several companies, including related parties, which totaled $7.5 million as of December 31, 2003.

These guarantees would require payment of the Group only in the event of default on payment by the respective debtor. Under these guarantees the Group could be potentially liable for a maximum amount of $66.0 million in case of the borrower's default under the obligations. As of December 31, 2003, no event of default has occurred under any of the guarantees issued by the Group.

Legal Proceedings—In the ordinary course of business, the Group may be party to various legal and tax proceedings, and 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 upon the financial condition, results of operations or liquidity of the Group.

Minimum Capital Requirements—The Law on insurance in Russia sets minimum share capital requirements for insurance organizations, depending on the type of insurance premiums they are writing. The minimum capital requirement for insurance organizations conducting reinsurance operations is set at 120.0 million RUR (equivalent of $4.0 million as of December 31, 2003). As of December 31, 2003, Rosno's statutory share capital amounted to 432.0 million RUR (equivalent of $14.7 million as of December 31, 2003).

The Central Bank of Russia sets minimum share capital requirements for banks. Effective December 1, 2003, the minimum capital requirement is set at Euro 5.0 million for each newly-founded bank. As of December 31, 2003, MBRD's share capital amounted to 400.0 million RUR (equivalent of $13.6 million as of December 31, 2003).

Contingencies—The Russian economy, while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of an emerging market. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be subject to the government's continued actions with regard to legal, and economic reforms.

On January 1, 2004, a new Law on telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. The Group cannot predict with any certainty how the new law will affect it. The new law creates a new interconnect pricing regime in 2004 that should be more transparent and unified and it creates a universal service charge calculated as a percentage of revenue which will be introduced from 2005. The new law may increase the regulation of the Group's operations and until the time when appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

In recent years, the Russian government has initiated revisions of the Russian tax system. Effective January 1, 1999, the first part of the Tax Code was enacted. Effective January 1, 2001, the second part of the Tax Code was enacted and effective January 1, 2002 new regulations, relating to federal income tax were enacted. The new tax system is generally intended to reduce the number of taxes, the overall tax burden on businesses, and to simplify the tax laws.

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax ("VAT"), corporate income tax (income tax), and payroll (social) taxes, together with others. The government's policy on implementation of these regulations is often inconsistent or nonexistent.

The tax authorities are currently challenging the application by MGTS, the subsidiary of the Group, of certain provision of the tax legislation, including application of the investment allowance for income tax purposes in 2001. The tax inspection assessment amounted to the equivalent of $5.1 million at the rate current at balance sheet date. The Group will contest the assessment on the grounds that application of the investment allowance was in compliance with tax laws in effect at the time. No accrual has been made in the accompanying financial statements with respect of this claim.

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues.

In February 2003, a fire occurred in one of MGTS' switching stations, damaging approximately 40,000 telephone lines. In addition to disrupting part of MGTS' network, equipment of certain alternative fixed-line communications providers was also affected, including that of Telmos, MTU-Inform and MTU-Intel. In particular, 40,000 out of Telmos' 50,000 telephone lines were damaged. Damages from the fire were recorded in other operating expenses in amount of $8.6 million. The Group entered in coverage litigation with a third party insurer seeking compensation of damages in amount of $5.4 million. The trial is suspended until completion of the expert examination. Due to the uncertainty of the Group receiving compensation, the Group has not recorded a receivable from the insurer in the financial statements as of December 31, 2003.

33. SUBSEQUENT EVENTS

Additional Debt Issuance

In January 2004, the Group issued $350.0 million of 8.875% notes, due in January 2011. The notes are issued through a subsidiary of the Group domiciled in Luxembourg. JSFC Sistema is a guarantor of the notes. Interest payments on the notes are due semi-annually in January and July of each year, commencing July 2004. On or prior to January 2007, the Group may redeem up to 35% of the notes with the net proceeds of offerings of JSFC Sistema's common equity at 108.9% of the principal amount. The notes are listed on the London Stock Exchange.

In April 2004, MTS entered into a short-term loan facility with Credit Suisse First Boston International in the amount of $200.0 million. Amounts outstanding under the loan facility agreement bear interest at LIBOR + 2.3% per annum. In May 2004 the Group used the proceeds from the facility to redeem all of the outstanding $300.0 million floating rate notes, issued in August 2003 in the principal amount plus accrued interest thereon to the date of redemption.

In April 2004, MGTS issued 5-year RUR-denominated bonds in the amount of RUR 1,500 million (approximately $50.9 million). The bonds carry a coupon of 10% per annum. MGTS made an unconditional offer to repurchase the bonds at par value in April 2006.

Acquisition of Companies

In March 2004, MTS acquired an additional 11% shares in SCS-900. The value of consideration equals $8.5 million. SCS provides mobile telecommunication services in the Novosibirsk region and Altay Republic.

In April 2004, MTS acquired an additional 40% stake in FECS-900, increasing its ownership in the company to 100%. The value of consideration equals $8.3 million. FECS-900 provides mobile telecommunication services in the Khabarovsk region.

In April 2004, MTS acquired an additional 7.5% stake in MSS, increasing its ownership in the company to 91.0%. The value of consideration paid equals $2.2 million. MSS provides mobile telecommunication services in the Omsk region.

Other

In March 2004, at the open tender organized by the State Committee for Radio Frequencies and the Ministry of Defense MTS acquired additional GSM-900/1800 frequency licenses to operate in 11 new regions of Russia. MTS has also received GSM-900 license extensions to existing licenses in several regions. The term of the GSM-900/1800 license for the Moscow Region has been extended until December 2008. Total purchase consideration paid for the licenses and extensions identified above was less than $0.1 million.

In May 2004, the Group announced completion of the operational merger of its three digital operators, including MTU-Inform, Comstar and Telmos. The completion of the legal merger is expected in 2005. The merged company will operate under the name of "Comstar United Telesystems".

In June 2004, the General Prosecutor of Ukraine filed a claim against MTS and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to MTS. The complaint also seeks an order that would prohibit MTS from alienating 51% of its stake in UMC until the claim is resolved. As of the date of these statements MTS has started the process of evaluating the claim. The Company believes that it acquired UMC in full compliance with Ukrainian law and intends to vigorously defend its acquisition of UMC.

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

SEPTEMBER 30, 2004 (unaudited) and DECEMBER 31, 2003
(Amounts in thousands of U.S. dollars, except share amounts)

	Notes	September 2004	December 2003
ASSETS			
CURRENT ASSETS:			
Cash and cash equivalents	5	$ 308,547	$ 283,165
Short-term investments	6	178,964	278,850
Loans to customers and banks, net	7	291,629	364,982
Insurance-related receivables	8	95,230	69,855
Accounts receivable, net	9	292,956	182,251
Other receivables and prepaid expenses, net	10	540,328	567,125
Inventories	11	228,275	166,203
Deferred tax assets, current portion	24	68,334	53,964
Total current assets		2,004,263	1,966,395
Property, plant and equipment, net	12	3,990,929	3,368,121
Advance payments for non-current assets	31	161,782	52,969
Long-term receivables		1,208	1,223
Long-term investments	13	54,554	41,393
Investments in affiliated companies	14	194,643	150,936
Goodwill	2	114,630	71,998
Licenses, net	15	692,460	669,988
Other intangible assets, net	16	435,128	446,381
Debt issuance costs, net	2	24,025	17,251
Deferred tax assets	24	5,307	5,575
TOTAL ASSETS		$7,678,929	$6,792,230

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (continued)

SEPTEMBER 30, 2004 (unaudited) and DECEMBER 31, 2003
(Amounts in thousands of U.S. dollars, except share amounts)

	Notes	September 2004	December 2003
LIABILITIES AND SHAREHOLDERS' EQUITY			
CURRENT LIABILITIES:			
Accounts payable		$ 331,752	$ 234,871
Bank deposits and notes issued	17	239,819	173,748
Insurance-related liabilities	18	240,613	180,986
Taxes payable		151,556	117,142
Deferred tax liabilities, current portion	24	5,252	508
Accrued expenses, subscriber prepayments and other current liabilities	19	643,323	607,083
Short-term notes payable	20	60,556	349,083
Current portion of long-term debt	22	497,654	844,106
Total current liabilities		2,170,525	2,507,527
LONG-TERM LIABILITIES:			
Capital lease obligations	21	2,138	4,943
Long-term debt	22	1,974,840	1,475,921
Subscriber prepayments, net of current portion	23	133,209	103,059
Deferred tax liabilities	24	223,761	230,986
Postretirement benefit obligation	25	14,349	8,590
Total long-term liabilities		2,348,297	1,823,499
Deferred revenue	26	121,878	115,363
TOTAL LIABILITIES		4,640,700	4,446,389
Minority interests in equity of subsidiaries		1,703,634	1,356,557
Commitments and contingencies	30	—	—
SHAREHOLDERS' EQUITY:			
Share capital (68,325,000 shares authorized, 8,100,000 shares issued and outstanding with par value of 90 RUR and 0.1 RUR as of September 30, 2004 and December 31, 2003, respectively)	27	25,090	171
Additional paid-in capital	3, 4	198,882	189,934
Retained earnings		1,089,898	783,258
Accumulated other comprehensive income		20,725	15,921
TOTAL SHAREHOLDERS' EQUITY		1,334,595	989,284
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY		$7,678,929	$6,792,230

See notes to consolidated financial statements.

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (unaudited)

(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Notes	September 2004	September 2003
Sales		$ 3,914,312	$2,456,687
Revenues from financial services		221,608	151,910
TOTAL REVENUES		4,135,920	2,608,597
Cost of sales, exclusive of depreciation and amortization shown separately below		(1,440,155)	(848,130)
Financial services related costs, exclusive of depreciation and amortization shown separately below		(149,378)	(97,279)
TOTAL COST OF SALES		(1,589,533)	(945,409)
Selling, general and administrative expenses		(679,629)	(489,282)
Depreciation and amortization		(540,679)	(354,330)
Goodwill impairment		—	(19,251)
Other operating expenses, net		(30,614)	(39,296)
Equity in net income of investees		12,942	1,295
Loss on disposal of interests in subsidiaries		(1,862)	(941)
OPERATING INCOME		1,306,545	761,383
Interest income		17,370	14,743
Interest expense, net of amounts capitalized		(163,316)	(132,057)
Currency exchange and translation gain		9,496	3,671
Income from continuing operations before income tax, minority interests and cumulative effect of a change in accounting principle		1,170,095	647,740
Income tax expense	24	(326,141)	(200,343)
Income from continuing operations before minority interests and cumulative effect of a change in accounting principle		843,954	447,397
Minority interests		(471,761)	(303,454)
Income from continuing operations before cumulative effect of a change in accounting principle		372,193	143,943
Gain from discontinued operations (net of income tax effect of $3,248)		—	9,952
Gain on disposal of discontinued operations (net of income tax effect of nil)		—	22,500
Cumulative effect of a change in accounting principle (net of income tax effect of nil)	2	(35,472)	—
NET INCOME		$ 336,721	$ 176,395
Other comprehensive income/(loss):			
Unrealized gain on securities available for sale, net of income tax effect of nil		(86)	2,095
Translation adjustment, net of minority interest of $3,168 and $12,032 and income tax effect of nil	2	4,890	18,568
Income tax effect of changes in the functional currency, net of minority interest of $17,184		—	(22,449)
Comprehensive income		$ 341,525	$ 174,609
Weighted average number of common shares outstanding		8,100,000	8,100,000
Earnings (loss) per share, basic and diluted:			
Income from continuing operations before cumulative effect of a change in accounting principle		$ 45.9	$ 17.8
Gain from discontinued operations		—	4.0
Cumulative effect of a change in accounting principle		(4.4)	—
Net income		41.6	21.8

See notes to consolidated financial statements.

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (unaudited)
(Amounts in thousands of U.S. dollars)

	September 2004	September 2003
OPERATING ACTIVITIES:		
Net income	$ 336,721	$ 176,395
Adjustments to reconcile net income to net cash provided by operations:		
Gain from discontinued operations	—	(9,952)
Depreciation and amortization	540,679	354,330
Goodwill impairment	—	19,251
Loss on disposal of property, plant and equipment	1,219	12,299
Gain on disposal of discontinued operations	—	(22,500)
Loss on disposal of interests in subsidiaries	1,862	941
Cumulative effect of a change in accounting principle	35,472	—
Minority interests	471,761	303,454
Equity in net income of investees	(12,942)	(1,295)
Provision for deferred income taxes	(31,410)	(41,206)
Provision for doubtful accounts receivable	15,179	30,313
(Recovery of allowance)/Allowance for loan losses	(1,452)	7,569
Inventory obsolescence charge	4,874	976
Changes in operating assets and liabilities, net of effects from purchase of businesses:		
Trading securities	22,503	(10,732)
Loans to banks	54,626	(73,133)
Insurance-related receivables	(25,497)	(12,037)
Accounts receivable	(54,598)	(98,432)
Other receivables and prepaid expenses	46,019	(82,982)
Inventories	(64,259)	(42,017)
Accounts payable	37,045	7,996
Insurance-related liabilities	59,627	39,254
Taxes payable	33,390	(43,880)
Accrued expenses, subscriber prepayments and other liabilities	19,552	171,754
Postretirement benefit obligation	5,759	1,432
Net cash provided by operations	$ 1,496,130	$ 687,798

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (unaudited)
(Amounts in thousands of U.S. dollars)

	September 2004	September 2003
INVESTING ACTIVITIES:		
Purchase of property, plant and equipment	$ (978,732)	$ (685,011)
Purchase of intangible assets	(84,594)	(81,913)
Purchase of businesses, net of cash acquired	(196,860)	(1,019,439)
Proceeds from disposal of subsidiaries, net of cash disposed	649	32,929
Purchase of long-term investments	(68,394)	(44,797)
Purchase of short-term investments	(40,926)	(60,790)
Proceeds from sale of short-term investments	107,266	131
Proceeds from sale of property, plant and equipment	5,050	3,597
Net increase in loans to customers	(30,615)	(40,579)
Net cash used in investing activities	(1,287,156)	(1,895,872)
FINANCING ACTIVITIES:		
(Principal payments on)/proceeds from short-term borrowings, net	(282,226)	602,824
Net increase/(decrease) in deposits from customers	80,009	(39,795)
Net (decrease)/increase in bank promissory notes issued	(14,947)	50,357
Proceeds from grants	2,913	2,840
Proceeds from long-term borrowings, net of debt issuance costs	623,774	887,197
Principal payments on long-term borrowings	(513,319)	(211,915)
Principal payments on capital lease obligations	(5,953)	(15,668)
Payments to shareholders of subsidiaries	(68,681)	(51,290)
Dividends paid	(5,162)	—
Net cash (used in)/provided by financing activities	$ (183,592)	$1,224,550
INCREASE IN CASH AND CASH EQUIVALENTS	$ 25,382	$ 16,476
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	283,165	157,267
CASH AND CASH EQUIVALENTS, END OF PERIOD	$ 308,547	$ 173,743
CASH PAID DURING THE PERIOD FOR:		
Interest, net of amounts capitalized	$ 189,909	$ 106,340
Income taxes	262,353	165,342
NON-CASH INVESTING AND FINANCING ACTIVITIES:		
Property, plant and equipment contributed free of charge	$ 9,134	$ 14,298
Equipment acquired through vendor financing	10,711	15,911
Equipment acquired under capital leases	3,148	8,411

In addition, non-cash investing activities during the nine months ended September 30, 2004 and 2003 included acquisitions and dispositions of subsidiaries and affiliates, as described in Notes 3 and 4.

See notes to consolidated financial statements.

JSFC SISTEMA AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (unaudited)

(Amounts in thousands of U.S. dollars)

	Share capital	Additional paid-in capital	Retained earnings	Accumulated other comprehensive income/(loss)	Total
Balances at January 1, 2003	**$ 171**	**$200,931**	**$ 396,211**	**$ (2,533)**	**$ 594,780**
Capital transactions of subsidiaries	—	(10,943)	—	—	(10,943)
Unrealized gain on securities available for sale, net of income tax of nil	—	—	—	2,095	2,095
Translation adjustment, net of minority interest of $12,032 and income tax of nil (Note 2)	—	—	—	18,568	18,568
Income tax effect of changes in the functional currency, net of minority interest of $17,184	—	—	—	(22,449)	(22,449)
Net income	—	—	176,395	—	176,395
Balances at September 30, 2003	**$ 171**	**$189,988**	**$ 572,606**	**$ (4,319)**	**$ 758,446**
Balances at January 1, 2004	**$ 171**	**$189,934**	**$ 783,258**	**$ 15,921**	**$ 989,284**
Capital transactions of subsidiaries, net of minority interest of $2,628 and income tax of nil (Note 4)	—	8,948	—	—	8,948
Unrealized gain on securities available for sale, net of income tax of nil	—	—	—	(86)	(86)
Translation adjustment, net of minority interest of $3,168 and income tax of nil (Note 2)	—	—	—	4,890	4,890
Dividends declared (Note 27)	—	—	(5,162)	—	(5,162)
Increase of par value of shares (Note 27)	24,919	—	(24,919)	—	—
Net income	—	—	336,721	—	336,721
Balances at September 30, 2004	**$25,090**	**$198,882**	**$1,089,898**	**$ 20,725**	**$1,334,595**

See notes to consolidated financial statements.

1. DESCRIPTION OF BUSINESS

The financial statements of JSFC Sistema and subsidiaries (the "Group") reflect the consolidation of separate financial statements of operating entities related by means of direct or indirect ownership of their voting stock by the Group's holding company, JSFC Sistema. Most of the consolidated entities and the parent company are incorporated in the Russian Federation ("RF").

The controlling shareholder of JSFC Sistema is Vladimir P. Evtushenkov. Minority holdings are owned by certain top executives and former top executives of the Group.

The principal activities of the significant entities of the Group are as follows:

Operating entities	Short name	Principal activity
JSFC Sistema	JSFC Sistema	Investing and financing activities
Telecommunications Segment:		
MTS and subsidiaries	MTS	Wireless and fixed line telecommunication services, data transmission and internet services
MGTS and subsidiaries	MGTS	
Comstar and subsidiaries	Comstar	
MTU-Inform and subsidiaries	MTU-Inform	
Telmos	Telmos	
MTU-Intel and subsidiary	MTU-Intel	
Technology Segment:		
CSC and subsidiaries	CSC	Production and marketing of integrated circuits, wafers, electronic devices and consumer electronics, research and development
Kvazar-Micro and subsidiaries	Kvazar-Micro	IT and systems integration, computer hardware and software distribution
Insurance Segment:		
Rosno and subsidiaries	Rosno	Medical, property, casualty, life and personal insurance and reinsurance, administration of state medical insurance programs
Banking Segment:		
Moscow Bank for Reconstruction and Development and subsidiaries	MBRD	Banking activities, securities transactions and foreign currency transactions

Operating entities	Short name	Principal activity
Other businesses:		
Detsky Mir and subsidiaries	Detsky Mir	Retail trading in Moscow and other Russian cities
Detsky Mir-Center	DM-Center	
VAO Intourist and subsidiaries	Intourist	Sale of tour packages in the RF and abroad
Sistema-Hals and subsidiaries	Sistema-Hals	Development and marketing of real estate projects in Moscow
Sistema Mass Media and subsidiaries	Sistema Mass Media	Production and distribution of periodicals, publishing activities, broadcasting, advertising
Concern RTI Systems and subsidiaries	Concern RTI	Manufacturing of radiotechnical equipment, research and development
ECU GEST HSA and subsidiaries	ECU GEST	Investing in real estate projects, financing activities

2. SUMMARY OF 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. The accompanying financial statements differ from the financial statements prepared for statutory purposes in Russia in that they reflect certain adjustments, appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP, which are not recorded in the accounting books of the Group's entities.

These interim consolidated financial statements are unaudited but include all adjustments, consisting of normal recurring adjustments, which the Group's management considers necessary for a fair presentation of the financial position as of interim dates, operating results and cash flows for the interim periods. The results of operations for the interim periods shown are not necessarily indicative of the results for any future interim period or for the entire fiscal year.

Principles of Consolidation

The consolidated financial statements include the accounts of JSFC Sistema, as well as entities, where JSFC Sistema has operating and financial control through direct or indirect ownership of a majority voting interest. The consolidated financial statements also include accounts of variable interest entities where the Group is a primary beneficiary. All significant intercompany transactions, balances and unrealized gains (losses) on transactions have been eliminated.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The beneficial ownership interest of JSFC Sistema and proportion of voting power of the Group in the significant subsidiaries as of September 30, 2004 and December 31, 2003 are as follows:

	Ownership interest		Proportion of voting power	
Operating entities	**September 30, 2004**	**December 31, 2003**	**September 30, 2004**	**December 31, 2003**
MTS	51%(1)	51%(1)	51%	51%
Ukrainian Mobile Communications (“UMC”), subsidiary of MTS	51%(1)	51%(1)	100%	100%
Telecom XXI, subsidiary of MTS	51%(1)	51%(1)	100%	100%
Kuban-GSM, subsidiary of MTS	51%(1)	51%(1)	100%	100%
Telecom-900, subsidiary of MTS	51%(1)	51%(1)	100%	100%
SCS-900, subsidiary of MTS	50%(1)	45%(1)	100%	89%
FECS-900, subsidiary of MTS	51%(1)	30%(1)	100%	60%
Uraltel, subsidiary of MTS	51%(1)	51%(1)	100%	100%
Recom, subsidiary of MTS	27%(1)	27%(1)	54%	54%
BM-Telecom, subsidiary of MTS	51%(1)	51%(1)	100%	100%
TAIF Telcom, subsidiary of MTS	27%(1)	27%(1)	53%	53%
Dontelecom, subsidiary of MTS	51%(1)	51%(1)	100%	100%
Sibchallenge, subsidiary of MTS	51%(1)	51%(1)	100%	100%
Tomsk Cellular Communications, subsidiary of MTS	51%(1)	51%(1)	100%	100%
Primtelefon, subsidiary of MTS	51%(1)	Affiliate	100%	Affiliate
Uzdunrobita, subsidiary of MTS	37%(1)	—	74%	—
MGTS	56%	56%	56%	56%
Comstar	77%(1)	77%(1)	100%	100%
MTU-Inform	76%(1)	76%(1)	99%	99%
Telmos	62%(1)	62%(1)	80%	80%
MTU-Intel	87%(1)	87%(1)	100%	100%
Golden Line, subsidiary of MTU-Intel	87%(1)	87%(1)	100%	100%
Personal Communications (“P-Com”)	Affiliate	63%(1)	Affiliate	83%
Rosno	49%(1)	47%	51%	51%
MBRD	82%(1)	59%(1)	86%	86%
Intourist	91%	91%	91%	91%
Detsky Mir	75%(1)	71%	75%	75%
DM-Center	100%	100%	100%	100%
NIIME and Plant Micron (“Micron”), subsidiary of CSC	62%(1)	58%(1)	75%	71%
STROM telecom, subsidiary of CSC	55%(1)	81%(1)	67%	100%
Kvazar-Micro	50%(1)	—	51%	—
Sistema-Hals	100%(1)	99%(1)	100%	100%
Nasha Pressa	100%(1)	100%(1)	100%	100%
Concern RTI	100%	100%	100%	100%
ECU GEST	99%	99%	99%	99%

(1) Including indirect ownership.

Accounts of newly-acquired subsidiaries have been consolidated in the Group's financial statements from the beginning of the year, when control was acquired, with pre-acquisition earnings of an interest purchased during the year included in minority interest in the consolidated statement of operations.

Consolidation of Variable Interest Entities—In December 2003, Financial Accounting Standards Board ("FASB") issued a revision to Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46R" or the "Interpretation"). FIN 46R clarifies the application of Accounting Research Bulletin ("ARB") No. 51, "Consolidated Financial Statements", to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public companies, to the end of the first reporting period ending after March 15, 2004, except that all public companies must at minimum apply the provisions of the Interpretation to entities that were previously considered "special-purpose entities" under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003.

Following the adoption of FIN 46R, the Group reevaluated the relationships with its related parties: Promtorgcenter, Notris, Laminea, Finescort-M, Kuntsevo-Invest, Holdbestfinance, Putney Assets and Mosdachtrest. Kuntsevo-Invest and Mosdachtrest are engaged in construction activities of the Group; Promtorgcenter, Notris, Laminea, Finescort-M, Holdbestfinance and Putney Assets possess shareholdings and provide financing through intercompany loans to other entities of the Group. Mosdachtrest was accounted for under equity method for the periods prior to January 1, 2004. The Group determined these entities were variable interest entities and that it was their primary beneficiary. Accordingly, the Group has consolidated these companies effective January 1, 2004. All intercompany balances have been eliminated in consolidation and the results of these VIEs have been included in the Group's consolidated statement of operations and statement of cash flows for the nine months ended September 30, 2004. In accordance with the provisions of FIN 46R, the Group recorded a charge for the cumulative effect of this accounting change of $35.5 million, net of income tax of nil, in the nine months ended September 30, 2004. This charge reflects the cumulative impact to the Group's results of operations had these VIEs been consolidated since their inception.

Use of Estimates—The preparation of 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 at the date of the financial statements and the reported amounts of revenues and expenses of the reporting period. Actual results could differ from those estimates.

Concentration of Business Risk—The Group's principal business activities are within the RF. Laws and regulations affecting businesses operating in the RF are subject to rapid changes, which could impact the Group's assets and operations.

Foreign Currency Translation—The Group follows a translation policy in accordance with Statement on Financial Accounting Standards ("FAS") No. 52, "Foreign Currency Translation". Due to a highly inflationary economy in the RF in 2002, the U.S. dollar (the Group's reporting currency) has been designated as the Group's functional currency. Accordingly, all foreign currency amounts were translated into U.S. dollars ("USD") using the remeasurement method.

Starting from January 1, 2003, the Russian economy ceased to be considered highly inflationary for accounting purposes. Management has determined that for the fiscal year beginning January 1, 2003 the functional currency of MGTS, Rosno, Kuban-GSM, Micron, Detsky Mir, DM-Center, Sistema Mass Media and Concern RTI is the Russian Ruble ("RUR"). Accordingly, the reporting currency amounts for these subsidiaries were translated into their functional currency at the exchange rate current at January 1, 2003. These amounts became the new accounting basis for the non-monetary assets and liabilities. The functional currency of UMC is the Ukrainian Hryvnia ("UAH") and the functional currency of STROM telecom is the Czech Krona. Management believes that USD is still the appropriate functional currency for the other subsidiaries of the Group due to pervasive use of the U.S. dollar in their operations.

The Group has selected the USD as its reporting currency and translates financial statements of subsidiaries with functional currencies other than USD. Assets and liabilities are translated at the exchange rates current at the balance sheet date, while income and expense items are translated at average rates of exchange prevailing during the period. The resulting translation adjustment in amount of $4.9 million and $18.6 million, net of minority interest of $3.2 million and $12.0 million, was recorded as a separate component of other comprehensive income for the nine months ended September 30, 2004 and 2003, respectively.

The Ruble is not a fully convertible currency outside of the territory of the Russian Federation. The translation of RUR denominated assets and liabilities into USD for the purpose of these financial statements does not indicate that the Group could or will in the future convert the reported values of the assets and liabilities in USD.

Revenue Recognition—The Telecommunications Segment of the Group earns revenues from provision of wireless telecommunication services, local telephone and data transmission services and usage of its local exchange networks and facilities. Segment revenues consist of (i) usage charges, (ii) monthly subscription fees, (iii) service activation and connection fees, (iv) revenues from use of prepaid phone cards, (v) charges for value-added telecommunication services, (vi) roaming fees charged to other operators for guest roamers utilizing the Group's network and (vii) equipment sales. The Group records revenues over the periods they are earned as follows:

(i) Revenues derived from wireless and local telephone usage and data transmission are recognized as the services are provided.

(ii) Monthly telephone and network service fees are recognized in the month during which the telephone services are provided to customers.

(iii) Upfront fees received for installation and activation of wireless, wireline and data transmission services ("connection fees") are deferred and recognized over the expected subscriber relationship period.

Effective January 1, 2004, MTS has changed its estimates of average subscriber lives. The effect of this change in estimate in the nine months ended September 30, 2004 was an increase in net income of approximately $4.3 million, or $0.5 per share.

The customer relationship period for residential wireline voice phone subscribers is 15 years. For all other categories of subscribers the customer relationship period is estimated at 3 to 5 years.

(iv) The Group recognizes revenues from the prepaid phone cards in the period when customer uses time under the phone card. Unused time on sold cards is not recognized as revenues until the related services have been provided to the customer or the prepaid phone card has expired. Revenues under prepaid service tariff plans, whereby a customer may purchase a package that allows a connection to the MTS network and a predetermined allotment of wireless phone calls and/or other services offered by the Group, are allocated between connection fees and service fees based on their relative fair values.

(v) Revenues derived from value-added telecommunication services are recognized in the period when the services are provided to customers.

(vi) The Group charges roaming per-minute fees to other wireless operators for their subscribers utilizing the Group's networks. Revenues derived from roaming services are recognized as the services are provided.

(vii) The Group sells handsets and accessories to customers who are entering into contracts for service and as separate distinct transactions. The Group recognizes revenues from the handsets and accessories when title passes to the customer. Estimated returns are recorded as a direct reduction of sales at the time the related sales are recorded. In Ukraine, the Group also from time to time sells handsets at prices below cost. The Group recognizes these subsidies in cost of equipment when sale is recorded.

Local telephone services, provided by MGTS, totaling approximately 5% and 6% of the consolidated revenues for the nine months ended September 30, 2004 and 2003 respectively, are regulated tariff services, and changes in rate structure is subject to Ministry of Antimonopoly Policy approval.

MGTS is required to grant discounts ranging from 20% to 100% on installation and monthly fees to certain categories of residential subscribers, such as pensioners, military veterans and disabled individuals, and is entitled to reimbursement from the federal budget for these discounts. Due to the lack of certainty of reimbursement, MGTS accounts for such revenues upon collection.

STROM telecom's arrangements with its customers typically include multiple elements, such as equipment and software developing, installation services and post-contract customer support. In accordance with the Statement of Position ("SOP") No. 97-2, "Software Revenue Recognition", the aggregate arrangement fee is allocated to each of the undelivered elements in an amount equal to its fair value with the residual of the arrangement fee allocated to the delivered elements. Fair values are based upon vendor-specific objective evidence. Fees allocated to each element of an arrangement are recognized as revenue when the following criteria have been met: (a) a written contract for the delivery of an element has been executed, (b) the Group has delivered the product to the customer, (c) the fee receivable is fixed or determinable, and (d) collectibility of the resulting receivable is deemed probable. If evidence of fair value of the undelivered elements of the arrangement does not exist, all revenue from the arrangement is deferred until such time evidence of fair value does exist, or until all elements of the arrangement are delivered. Fees allocated to post-contract customer support are recognized as revenue ratably over the support period. Fees allocated to other services are recognized as revenue as services are performed.

Premiums on written non-life insurance of the Insurance Segment are recognized on a pro-rata basis over the term of the related policy coverage, normally not exceeding 1 year. The unearned premium provision represents that portion of premiums written relating to the unexpired term of the policy. Premiums from traditional life and annuity policies with life contingencies are recognized as revenue when due from the policyholder.

Interest income of the Banking Segment is recognized on accrual basis. Loans are placed on non-accrual status when interest or principal is delinquent for a period in excess of 90 days, except when all amounts due are fully secured by cash or marketable securities and collection proceedings are in process. Interest income is not recognized where recovery is doubtful. Loans are written off against allowance for loan losses in case of uncollectibility of loans and advances, including through repossession of collateral.

Revenues on construction contracts are recognized under the completed-contract method.

The other Group's entities recognize revenues when products are shipped or when services are rendered to customers.

In arrangements where the Group acts as an agent, including travel agency arrangements and arrangements to administer construction projects, only the net agency fee is recognized as revenue.

Cash and Cash Equivalents—Cash and cash equivalents include cash on hand, amounts on deposit in banks, cash invested temporarily in various instruments with maturities of three months or less at time of purchase and minimum reserve deposits with the Central Bank of Russian Federation. Short-term interbank loans originated by MBRD with original maturities of three months or less are included in loans to customers and banks.

Financial Instruments—The Group's financial instruments include cash, short-term and long-term investments, receivables, payables and debt. Except as described below, the estimated fair value of such financial instruments as of September 30, 2004 approximated their carrying value as reflected in the consolidated balance sheet. The fair value of the Group's publicly traded long-term notes as of September 30, 2004, ranged from 94.0% to 106.0% of the principal amount. As of September 30, 2004, fair value of other fixed rate debt, including capital lease obligations and variable rate debt approximated carrying value.

The Group accounts for derivative instruments in accordance with FAS No. 133 "Accounting for Derivative Instruments and Hedging Activities". This statement requires that all derivatives, including some embedded derivatives, be measured at fair value and recognized as either assets or liabilities on balance sheets. Changes are recorded in comprehensive income, depending on the designated use of the instruments. During the nine months ended September 30, 2004 and 2003, the Group did not enter into significant derivative contracts.

MBRD also enters into sale and purchase back agreements ("repos") and purchase and sale back agreements ("reverse repos") in the normal course of its business. A repo is an agreement to transfer a financial asset to another party in exchange for cash or other consideration and a concurrent obligation to reacquire the financial assets at a future date for an amount equal to the cash or other consideration exchanged plus interest. Assets sold under repos are retained in the financial statements and a consideration received is recorded in liabilities as collateralized deposit received. A reverse repo is an agreement to purchase assets and resell them at a future date with accrued interest received. Assets purchased under reverse repos are recorded in the financial statements as cash received on deposit which is collateralized by securities or other assets. During the nine months ended September 30, 2004 and 2003, the Group did not enter into material repo or reverse repo agreements.

Accounts Receivable—Accounts receivable are stated at their net realizable value after deducting an allowance for doubtful accounts. Such provisions reflect either specific cases of delinquencies or defaults or estimates based on evidence of collectibility.

Loans to Customers and Banks—Loans to customers and banks arise out of operations of Banking Segment. The determination of the allowance for losses in respect of loans provided by MBRD is based on an analysis of the loan portfolio and reflects the amount, which, in the judgment of management of the Group, is adequate to provide for losses inherent in the loan portfolio. A specific provision is made as a result of a detailed appraisal of risk assets. In addition, a general provision is carried to cover risks, which although not specifically identified, are present in any portfolio of banking assets.

Management's evaluation of the allowance is based on MBRD's past loss experience, known and inherent risks in the portfolio, adverse situations that may affect the borrower's ability to repay, the estimated value of any underlying collateral and current economic conditions. It should be understood that estimates of loan losses involve an exercise of judgment. While it is possible that in particular periods MBRD may sustain losses, which are substantial relative to the allowance for loan losses, it is the judgment of management that the allowance for loan losses is adequate to absorb losses inherent in the loan portfolio.

Insurance-related Receivables—Insurance-related receivables include receivables arising from insurance operations and advances to health care providers under voluntary and obligatory medical insurance programs. Receivables arising from insurance operations consist of outstanding direct premiums due from policyholders, outstanding assumed premiums due from ceding companies and receivables due from claims ceded.

Policy Acquisition Costs—Policy acquisition costs represent costs of the acquisition or renewal of insurance policies by Rosno. They are deferred as an asset and are amortized over the period for which costs are expected to be recoverable out of associated revenues. Deferred acquisition costs are included in other receivables and prepaid expenses, net of the unexpired risk provision, that is recognized when unearned premiums are insufficient to meet claims and expenses, which may be incurred after the end of the financial year.

Subscriber Acquisition Costs—Subscriber acquisition costs represent the direct costs paid for each new subscriber. The Group expenses these costs as incurred.

Inventories—Inventories are stated at the lower of cost or market. The cost of MGTS's inventories (including mostly spare parts) is computed on an average cost basis. Cost of goods for resale held by retail businesses of the Group is determined using the retail method. Other subsidiaries of the Group account for their inventories using the first-in-first out ("FIFO") cost method.

Cost of raw materials includes cost of purchase, customs duties, transportation and handling costs. Work-in-progress and finished goods are stated at production cost which includes direct production expenses and manufacturing overheads. Project costs include the accumulated costs of projects contracted with third parties, net of related progress billings. The entities of the Group periodically assess their inventories for obsolete or slow moving stock.

Value-Added Taxes—Value-added taxes ("VAT") related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales. VAT related to purchase transactions that are not reclaimable as of the balance sheet dates are recorded in other receivables and prepaid expenses.

Property, Plant and Equipment—For subsidiaries acquired by the Group through business combinations accounted for by the purchase method, property, plant and equipment ("PP&E") were assigned their fair values at the acquisition date. If fair values of the identifiable net assets of the acquired entities exceeded acquisition cost, the fair values of non-current assets held by the acquired entities at the acquisition date, including PP&E, were reduced by such excess. All subsequent additions to PP&E have been recorded at cost.

Cost includes major expenditures for improvements and replacements, which extend useful lives of the assets or increase their revenue generating capacity. Repairs and maintenance are charged to the statement of operations as incurred.

Capital leases are recorded at the lower of the fair market value of the asset or the present value of future minimum lease payments.

Depreciation is computed under the straight-line method utilizing estimated useful lives of the assets as follows:

Buildings	20–50 years
Leasehold improvements	Lesser of the estimated useful life or the term of the lease
Switches and transmission devices	17–31 years
Network and base station equipment	5–12 years
Other plant, machinery and equipment	3–15 years

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.

Construction-in-progress and equipment for installation are not depreciated until an asset is placed into service.

Maintenance and repair costs are expensed as incurred, while upgrades and improvements are capitalized.

Goodwill and Other Intangible Assets—Goodwill represents the excess of the cost of business acquired over the fair value of identifiable net assets at the date of acquisition. Goodwill is reviewed annually for impairment or whenever it is determined that the impairment indicators exist. The Group determines whether an impairment has occurred by assigning goodwill to the reporting unit identified in accordance with FAS No. 142 "Goodwill and Other Intangible Assets", and comparing the carrying amount of the reporting unit to the fair value of the reporting unit. If a goodwill impairment has occurred, the Group recognizes a loss for the difference between the carrying amount and the implied fair value of goodwill. No impairment of goodwill was identified in the nine months ended September 30, 2004.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The carrying amount of goodwill attributable to each reportable operating segment with goodwill balances and changes therein, are as follows:

	Telecommunications	Corporate and Other	Total
		(000's)	
Balance as of January 1, 2003	$ 19,347	$635	$ 19,982
Purchase price allocation	70,267	—	70,267
Impairment charge	(19,251)	—	(19,251)
Balance as of September 30, 2003	70,363	635	70,998
Purchase price allocation	1,000	—	1,000
Balance as of December 31, 2003	71,363	635	71,998
Purchase price allocation	42,632	—	42,632
Balance as of September 30, 2004	**$113,995**	**$635**	**$ 114,630**

Costs of licenses for providing telecommunications services are capitalized as a result of purchase price allocated to licenses acquired in business combinations (Note 3) and licenses purchased directly from government organizations, which require license payments. As the Group and the telecommunications industry do not have sufficient experience with the renewal of licenses, license costs are being amortized, subject to periodic review for impairment, on the straight-line basis over the initial term of the license without consideration of possible future renewals commencing from the date such license area becomes commercially operational.

Other intangible assets represent acquired customer base, trademarks, roaming contracts with other telecommunications operators, telephone numbering capacity, rights to use premises and various purchased software costs. Trademarks and telephone numbering capacity with unlimited contractual life are not amortized, but are reviewed, at least annually, for impairment in accordance with the provisions of FAS No. 142.

Acquired customer base is amortized over the estimated average subscriber life. Deferred telephone numbering capacity costs with limited contractual life and the rights to use premises are being amortized over their contractual lives, which vary from five to twenty years. Software costs and other intangible assets are being amortized over three to five years. All finite-life intangible assets are being amortized using the straight-line method.

Investments—The Group's share in net assets and net income of certain entities, where the Group holds 20% to 50% of voting shares and has the ability to exercise significant influence over their operating and financial policies ("affiliates") is included in the consolidated net assets and operating results using the equity method of accounting. Due to the Group's day-to-day involvement in the affiliates' business activities, the Group's share of their income is recorded within the operating income.

Investments in corporate shares where the Group owns more than 20% of voting shares, but does not have the ability or intent to control or exercise significant influence over operating and financial policies, including investments in NIIDAR, a Research and Development Institute of Long-Distance Radio Communications, operating under governmentally imposed restrictions, as well as investments in corporate shares where the Group owns less than 20% of share capital, are accounted for at cost of acquisition. Management periodically assesses realizability of the carrying values of such investments and records impairment charges, if required.

Trading securities held by the Group are stated at market value. Unrealized holding gains and losses for trading securities are included in earnings.

The Group also purchases promissory notes for investing purposes. These notes are carried at cost and the discount against the nominal value is accrued over the period to maturity. A provision is made, based on management assessment, for notes that are considered uncollectible.

Debt Issuance Costs—Debt issuance costs are amortized using the effective interest method over the terms of the related loans. Debt issuance costs amounted to $24.0 million and $17.3 million, net of accumulated amortization of $10.2 million and $5.8 million as of September 30, 2004 and December 31, 2003, respectively.

Impairment of Long-lived Assets—The Group periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with FAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets". Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, the Group compares undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, the Group records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. For the nine months ended September 30, 2004, no such impairments have been identified.

Bank Deposits and Notes Issued—Bank deposits and notes issued arise out of operations of the Banking Segment and include deposits from banks and customers and promissory notes issued.

Insurance-related Liabilities—Insurance-related liabilities arise out of operations of the Insurance Segment and include the unearned premium provision, loss provision for outstanding claims, undisbursed funds of the Moscow Government Fund for Obligatory Medical Insurance ("MGFOMS"), accumulated under an obligatory medical insurance program, prepaid insurance and reinsurance premiums and liabilities under deposit type insurance contracts (policies in force under which the Group does not assume insurance risk).

Rosno provides for losses on outstanding claims on an individual case basis for the estimated cost of claims notified but not settled as at the balance sheet date. Provision is also made for the ultimate cost of claims, including claims incurred but not reported, or not fully reported. This provision is actuarially determined by line of business, and includes assumptions based on prior years claims experience. The loss provision for life insurance is actuarially determined based upon mortality, morbidity and interest rate assumptions applied to all life insurance policies in force as at year-end.

Unexpired risk provision is recognized when unearned premiums are insufficient to meet claims and expenses, which may be incurred after the end of the financial year. The Group does not consider anticipated investment income in making determination whether a premium deficiency exist.

MGFOMS carries out an obligatory medical insurance program to provide RF citizens with free of charge medical services via certain appointed insurers, including Rosno. Rosno has contracted with MGFOMS to administer a portion of this plan. Rosno receives advances from MGFOMS and makes payments to medical centers in respect of services provided by them to policyholders. Any funds received from MGFOMS by Rosno, which are not paid out for medical services, are retained and recorded as a liability. These funds may be spent by the Group only on the provision of the medical facilities and care, as presently defined under the program.

Deferred Revenue—Telecommunication equipment and transmission devices, installed at the newly constructed properties in Moscow, have been historically transferred to MGTS free of charge. These assets are capitalized by the Group at their market value at the date of transfer. Simultaneously deferred revenue is recorded in the same amount, which is amortized as a reduction expense in the consolidated statement of operations over the contributed assets' life.

Deferred grant revenue represents funds contributed to the Group, which usage is restricted. Deferred grants are released to income when the conditions of the grant are substantially met.

Income Taxes—Income taxes have been computed in accordance with RF laws. Income tax rate in the RF equals 24%. In July 2004, amendments to Russian income tax legislation were enacted to increase, effective January 1, 2005, the income tax rate on dividends paid within Russia to 9% (previously 6%). The foreign subsidiaries of the Group are paying income taxes in their jurisdictions. Income tax rate in the Ukraine and in the Czech Republic equals 25% and 31%, respectively.

Deferred income taxes are accounted for under the liability method and reflect the tax effect of all significant temporary differences between the tax basis of assets and liabilities and their reported amounts in the accompanying consolidated financial statements. A valuation allowance is provided for deferred tax assets if it is more likely than not these items will either expire before the Group will be able to realize the benefit, or the future deductibility is uncertain.

Stock-Based Compensation—The Group accounts for stock options issued to employees, non-employee directors and consultants of MTS following the requirements of FAS No. 123, "Accounting for Stock-Based Compensation" and FAS No. 148 "Accounting for Stock Based Compensation—Transition and Disclosure, an amendment to FASB Statement No. 123." Under the requirements of these statements, the Group elected to use the intrinsic method to value options on the measurement date as a method for accounting for compensation to employees and non-employee directors. Starting January 1, 2004, the Group uses the binomial model to calculate the pro-forma effect of the application of the fair value method of accounting for stock options. The effect of the change of the method of calculation from the Black-Scholes model to the binomial model did not have a material effect on the pro forma numbers.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

If the Group had elected to recognize compensation costs based on the fair values of options at the date of the grant, net income and earnings per share amounts for the nine months ended September 30, 2004 and 2003 would have been as follows:

	September 30, 2004	September 30, 2003
	(000's)	
Net income as reported	$336,721	$176,395
Pro forma effect of the application of fair value method of accounting for stock options	(359)	(394)
Pro forma net income	336,362	176,001
Earnings per share, basic and diluted		
As reported	$ 41.6	$ 21.8
Pro forma	$ 41.5	$ 21.7

Retirement and Post-Retirement Benefits—In Russia, all social contributions, including contributions to the pension fund, are substituted with a unified social tax ("UST") calculated by the application of a regressive rate from 35.6% to 2% of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 28% to 2%, respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

In Ukraine, the subsidiaries of the Group are required to contribute a specified percentage of each employee payroll up to a fixed limit to pension fund, unemployment fund and social security fund. The contributions are expensed as incurred.

During the nine months ended September 30, 2004 and 2003, the Group managed a defined contribution plan to provide eligible employees with additional income upon retirement. The Group's contributions to the plan totaled $0.6 million and $1.0 million for the nine months ended September 30, 2004 and 2003, respectively.

In addition, MGTS has historically offered its employees certain benefits upon and after retirement. The cost of such benefits is recognized during an employee's years of active service (Note 25).

The Group accounts for pension plans following the requirements of FAS No. 87 "Employers' Accounting for Pensions."

In December 2003, FASB issued a revision to FAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits, an amendment of FASB Statements No. 87, 88, and 106" ("FAS No. 132R"). FAS No. 132R revised employers' disclosure about pension plans and other postretirement benefit plans. It requires additional disclosures about the plan assets, benefit obligations, cash flows and net periodic benefit cost of defined benefit plans and other defined postretirement plans. It does not change the measurement or recognition of those plans required by previous Financial Accounting Board Standards. Following the adoption of FAS No. 132R, the Group included the required disclosures in its consolidated financial statements as of September 30, 2004 (Note 25).

Borrowing Costs—Borrowing costs were recognized as an expense in the period in which they were incurred. Borrowing costs for assets that require a period of time to get them ready for their intended use are capitalized and amortized over the related assets' estimated useful lives. The capitalized borrowing costs for the nine months ended September 30, 2004 and 2003 amounted to $23.2 million and $3.1 million, respectively.

Advertising Costs—Advertising costs are expensed as incurred. Advertising costs for the nine months ended September 30, 2004 and 2003 were $111.4 million and $78.7 million, respectively, and were reflected as a component of selling, general and administrative expenses in the accompanying consolidated statements of operations.

Earnings per Share—Basic earnings per share ("EPS") have been determined using the weighted average number of shares outstanding during the nine months ended September 30, 2004 and 2003. Diluted EPS reflect the potential dilution of MTS' stock options, granted to employees. There are 3,615,985 MTS' stock options outstanding as at September 30, 2004.

Distributions to Shareholders—Distributable retained earnings of the Group are based on amounts extracted from statutory accounts of individual entities and may significantly differ from amounts calculated on the basis of U.S. GAAP.

New Accounting Pronouncements—In December 2004, the Financial Accounting Standards Board ("FASB") issued FAS No. 123R, "Share-Based Payment" ("FAS No. 123R"), a revision of FAS No. 123, "Accounting for Stock-Based Compensation". FAS No. 123R supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and requires all entities to recognize compensation cost in an amount equal to the fair value of share-based payments granted to employees. That cost will be recognized over the period during which an employee is required to provide service in exchange for an award of equity instruments. FAS No.123R is effective for interim periods beginning after June 15, 2005, at which time companies can select whether they will apply the standard retroactively by restating their historical financial statements or prospectively for new stock-based compensation arrangements and the unvested portion of existing arrangements. The Group does not anticipate the adoption of FAS No. 123R will have a material impact on its financial position, cash flows and results of operations.

In December 2004, the FASB issued FAS No. 153, "Exchanges of Nonmonetary Assets", an amendment of APB Opinion No. 29, "Accounting for Nonmonetary Transactions". FAS No. 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets set in the APB Opinion No. 29 and replaces it with a general exception for exchanges that do not have commercial substance. FAS No. 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. FAS No. 153 is effective prospectively for nonmonetary exchanges occurring after June 15, 2005. The Group does not anticipate the adoption of FAS No. 153 to have a material impact on its results of operations or financial position.

In November 2004, the FASB issued FAS No. 151, "Inventory Costs", an amendment of ARB No. 43, Chapter 4. FAS No. 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facility. FAS No. 151 is effective prospectively for inventory costs incurred during fiscal years beginning after June 15, 2005. The Group does not anticipate the adoption of FAS No. 151 to have a material impact on its results of operations or financial position.

In September 2004, the Emerging Issues Task Force ("EITF") issued a final consensus on EITF Issue No. 04-1, "Accounting for Preexisting Relationships between the Parties to a Business Combination". In this issue the EITF reached a consensus that a business combination between two parties having a preexisting relationship is a multiple-element transaction with one element being the business combination and the other element being the settlement of the preexisting relationship. This Issue requires certain additional disclosures for business combinations between parties with a preexisting relationship. EITF Issue No. 04-1 is effective for reporting periods beginning after October 13, 2004. The Group does not anticipate that the adoption of EITF Issue No. 04-1 will have a material impact on its financial position or results of operations.

In November 2003, the EITF reached a final consensus on Issue No. 03-10, "Application of EITF Issue No. 02-16, 'Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor', by Resellers to Sales Incentives Offered to Consumers by Manufacturers." The consensus was reached that consideration received by a reseller from the vendor in exchange for vendor sales incentives tendered by consumers should not be reported as a reduction of the cost of the reseller's purchases from the vendor but instead should be shown as revenue. EITF Issue No. 03-10 is effective for reporting periods beginning after November 25, 2003. The adoption of Issue No. 03-10 did not have a material impact on the Group's results of operations or financial position.

In March 2004, the EITF reached a consensus on Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share". This Issue defines participating security and clarifies some practical issues related to including participating securities in the calculation of EPS. EITF Issue No. 03-6 is effective for reporting periods beginning after March 31, 2004. The adoption of Issue No. 03-6 did not have a material impact on the Group's financial position or results of operations.

In September 2004, the U.S. Securities and Exchange Commission ("SEC") staff issued the EITF Topic D-108, "Use of the Residual Method to Value Acquired Assets Other Than Goodwill", which requires the companies to use the direct value method to determine the fair value of their intangible assets acquired in business combinations completed after September 29, 2004.

Historically, the Group used residual method to determine the fair value of the telecommunication licenses acquired in business combinations, except for purchase of Uzdunrobita, where the fair value of licenses acquired was determined using the direct method. Under the new accounting guidance, the Group will use the direct method to measure the fair value of licenses acquired in the future business combinations. The Group does not anticipate impact from adoption of the above SEC guidance to be material to its consolidated results of operations or financial position.

In July 2004, the EITF issued EITF No. 02-14, "Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock." A consensus was reached regarding an investor that has the ability to exercise significant influence over the operating and financial policies of the investee. This type of investor should apply the equity method of accounting only when it has an investment(s) in common stock and/or an investment that is in-substance common stock. The Task Force also reached a consensus on the definition of in-substance common stock and related guidance. EITF No. 02-14 is effective for reporting periods beginning after September 15, 2004.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The Group is evaluating whether the adoption of EITF No. 02-14 will have a material impact on its financial position or results of operations.

In October 2004, the EITF reached a consensus on EITF Issue No. 04-10, "Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds". EITF No. 04-10 provided additional guidance on when operating segments that are below the 10% threshold can be aggregated. EITF Issue No. 04-10 states that segments can only be aggregated if they have similar economic characteristics and if they are similar in areas such as production processes, types of customers, distribution channels and the products themselves are similar. The consensus reached by EITF No. 04-10 is effective for fiscal years ending after October 13, 2004. The Group is evaluating whether the adoption of EITF No. 04-10 will have a material impact on its financial statements disclosures.

Reclassifications—Certain other reclassifications of prior years' amounts have been made to conform to the presentation adopted for the nine months ended September 30, 2004.

3. ACQUISITIONS

Acquisition of Primtelefon

In June 2004, MTS purchased 50.0% of Far Eastern mobile operator Primtelefon ("Primtelefon") for cash consideration of $31.0 million, increasing the Group's voting power in Primtelefon to 100%. Primtelefon holds licenses to provide GSM 900/1800 mobile cellular communications in the Far East region. Primtelefon's subscriber base as at the date of acquisition was approximately 216,000.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

	(000's)
Current assets	$11,041
Non-current assets	16,809
License costs	21,891
Current liabilities	(7,488)
Non-current liabilities	(5,671)
Deferred taxes	(5,582)
Purchase price	**$31,000**

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 7 years and customer base is amortized over the average remaining subscriber's life of approximately 41 months.

Acquisition of Uzdunrobita

In July 2004, MTS entered into an agreement to acquire 74.0% of Uzbekistan mobile operator JV Uzdunrobita ("Uzdunrobita") for a cash consideration of $121.2 million, including transaction costs of $0.2 million. The acquisition was completed on August 1, 2004. Uzdunrobita holds licenses to provide GSM-1800 mobile communication services in the whole territory of Uzbekistan, which has a population of approximately 25.2 million. Uzdunrobita's subscriber base as of the date of acquisition was approximately 230,000 people.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

MTS also entered into call and put option agreements with the existing shareholders of Uzdunrobita to acquire the remaining 26.0% of common shares of the company. The exercise period for the call and put option is 48 months from the acquisition date. The call and put option agreements stipulate a minimum purchase price of $37.7 million plus 5% per annum commencing from the acquisition date. Fair value of the option was $3.6 million at September 30, 2004.

The acquisition was accounted for using the purchase method. The purchase price allocation for the acquisition was as follows:

	(000's)
Current assets	$ 5,950
Non-current assets	67,293
License costs	40,861
Customer base	958
Trademark	3,622
Goodwill	41,290
Current liabilities	(14,705)
Non-current liabilities	(1,356)
Deferred taxes	(6,384)
Minority interest	(16,308)
Purchase price	**$121,221**

Goodwill is mainly attributable to economic potential of the market assuming low penetration level as of the date of acquisition. License costs are amortized over the remaining contractual terms of the licenses of approximately 12 years and customer base is amortized over the average remaining subscriber's life of approximately 39 months. Trademark will be amortized based on the estimated useful life of approximately 53 months.

Acquisition of Kvazar-Micro Corporation B.V

In July 2004, the Group purchased 51.0% of Kvazar-Micro Corporation B.V. ("Kvazar-Micro") for a cash consideration of $28.0 million, including a contribution to the share capital of Kvazar-Micro of $18.0 million. Kvazar-Micro business is based in Ukraine and includes distribution of computer hardware and software, IT and systems integration. Through acquisition of Kvazar-Micro, the Group added IT and systems integration business division to its Technology segment.

The acquisition was accounted for using the purchase method. The preliminary purchase price allocation was as follows:

	(000's)
Current assets	$58,933
Non-current assets	3,083
Trademark	3,211
Customer base and distribution agreements	9,796
Current liabilities	(43,485)
Non-current liabilities	(3,538)
Purchase price	**$28,000**

Customer base and distribution agreements acquired are amortized over the remaining contractual terms of approximately 12 months. The purchase price allocation for Kvazar-Micro acquisition has not been yet finalized at the date of these statements.

Other Acquisitions

In March 2004, MTS acquired 11% stake in SCS-900 for cash consideration of $8.5 million, increasing the Group's voting power in SCS-900 to 99.5%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by $2.6 million.

In April 2004, MTS acquired 40% stake in FECS-900 for cash consideration of $8.3 million, increasing the Group's voting power in FECS-900 to 100.0%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by $4.1 million.

License costs are amortized over the remaining contractual terms of the respective license, ranging from 6 to 10 years at the date of the first acquisition.

In April 2004, MTS acquired additional 7.5% stake in MSS, a mobile operator in the Omsk region, for $2.2 million in cash. This acquisition increased the Group's voting power in MSS to 91%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by $1.1 million.

In April and May of 2004, MTS acquired the remaining stakes in the following subsidiaries:

— 35% of MTS-NN (a service provider in Nizhny Novgorod) for $0.5 million, and

— 49% of Novitel (handsets dealer in Moscow) for $1.3 million.

Both acquisitions increased the Group's voting power in the respective companies to 100%. The acquisitions were accounted for using the purchase method of accounting. The allocation of purchase price increased recorded goodwill by $1.8 million.

In August 2004, MTS acquired the remaining stakes in Astrakhan Mobile and Volgograd Mobile, increasing the Group's voting power in these subsidiaries to 100%. The acquisition price was $1.1 million and $2.9 million, respectively. Astrakhan Mobile holds a AMPS/DAMPS-800 and GSM-1800 licenses covering Astrakhan region (population of approximately 1.0 million) and Volgograd Mobile holds a AMPS/DAMPS-800 and GSM-1800 licenses covering Volgograd region (population of approximately 2.7 million). As of July 31, 2004, the two companies provided AMPS/DAMPS services to around 10 thousand subscribers. As the result of the allocation of purchase price for the first and second stakes in both companies the Group recorded license cost of $16.5 million.

In August 2004, MTS acquired from the remaining 49% stake in UDN-900 for $6.4 million in cash. This acquisition increased the Group's voting power in UDN-900 to 100%. The allocation of purchase price increased recorded license cost by $0.3 million. UDN-900 provides GSM-900 services under the MTS brand in Udmurtia Republic (population of 1.6 million). UDN's subscriber base as of July 31, 2004 was 219,760.

In September 2004, the Group acquired 29.8% stake in Mezhregionalny Transit Telecom ("MTT"), operator of a nation-wide transit network providing telecommunications services and network interconnection for mobile and fixed network operators throughout Russia, for cash consideration of $39.8 million, increasing its ownership interest in MTT to 44.8%.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

During the nine months ended September 30, 2004, Rosno repurchased 3.4% of its outstanding shares from a director of the Group for the total cash consideration of $5.6 million. The transaction resulted in a reduction of additional paid-in capital by $1.3 million, net of minority interest of $2.6 million. Later in the same period the Group acquired from Rosno 1.75% of its shares for $2.8 million in cash. The remaining treasury shares were sold by Rosno to Allianz AG.

Pro forma results of operations

The following pro forma financial data for the nine months ended September 30, 2004 and 2003 give effect to the acquisitions of Primtelefon, SCS-900, FECS-900, Kvazar-Micro, Uzdunrobita and acquisitions made during the year ended December 31, 2003, including MTS, UMC, Kuban-GSM, TAIF Telcom, Sibchallenge, TSS and Comstar, as if they had occurred as of January 1, 2003:

	Nine months ended September 30, 2004	Nine months ended September 30, 2003
	(000's)	
Net revenues	$4,135,920	$2,866,671
Income from continuing operations before cumulative effect of a change in accounting principle	376,099	141,539
Net income	340,627	173,991
Earnings per share, basic and diluted:	$ 42.1	$ 21.5

The pro forma information is based on various assumptions and estimates. The pro forma information is not necessarily indicative of the operating results that would have occurred if the Group's acquisitions had been consummated at the beginning of the respective period, nor is it necessarily indicative of future operating results. The pro forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions.

4. DISPOSITIONS AND CAPITAL TRANSACTIONS OF SUBSIDIARIES

In July 2004, the Group sold 33.0% of common shares of its subsidiary STROM telecom to a third party for a cash consideration of $2.0 million. The transaction resulted in recognition of loss from disposal of $1.2 million.

In August 2004, the Group sold 83.5% of common shares of its subsidiary P-Com to Sky Link, the Group's affiliate, for promissory notes of $16.0 million. The transaction resulted in recognition of loss from disposal of $1.9 million. Revenues of P-Com were excluded from the Group's consolidated revenues effective January 1, 2004 and the Group's share in the earnings of P-Com for the nine months ended September 30, 2004 was recorded using the equity method of accounting. P-Com's revenues for the nine months ended September 30, 2003 were $38.0 million.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

In August 2004, the Group sold its interest in Sofora, a subsidiary operating in media business, to a third party for cash consideration of $1.1 million. The transaction resulted in recognition of gain from disposal of $1.3 million. Sofora's assets and operations were not material for the Group.

During the nine months ended September 30, 2004, the Group sold its interests in Petrovskoye Podvorye and Ordynka to related parties. These transactions resulted in an increase of additional paid-in capital by approximately $10.3 million, net of minority interests of $2.6 million.

5. CASH AND CASH EQUIVALENTS

Cash equivalents amounting to $38.2 million and $56.1 million as of September 30, 2004 and December 31, 2003, respectively, are comprised primarily of term deposits with banks and bank promissory notes with original maturities less than 90 days. Within this amount, $9.5 million and $44.3 million, respectively, represent the Group's deposits with East-West United Bank, an affiliate of the Group.

Also included in cash as of September 30, 2004 and December 31, 2003 are $12.5 million and $45.7 million, respectively, which represent the MBRD's minimum reserve deposit, required by the Central Bank of Russian Federation.

6. SHORT-TERM INVESTMENTS

Short-term investments as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Trading securities:		
RF Eurobonds	—	$ 54,394
Corporate bonds	$ 40,601	19,696
Municipal bonds	—	4,012
Corporate shares	13,003	2,250
Other trading securities	15,243	10,998
	68,847	91,350
Other short-term investments:		
Credit linked notes	—	38,170
Promissory notes from third parties	30,402	95,881
Promissory notes from related parties	19,695	20,946
Bank deposits with original maturities exceeding 90 days	58,337	24,040
Other short-term investments	1,683	8,463
	110,117	187,500
Total	**$178,964**	**$278,850**

Corporate bonds denominated in RUR represent bonds issued by major Russian companies with maturity dates from 2004 to 2009 and coupon rates of 8-17% per annum.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

Corporate shares are liquid publicly traded shares of Russian companies. They are reflected at period-end market value based on last traded prices obtained from Moscow Interbank Currency Exchange ("MICEX").

The weighted average interest rate on promissory notes from third parties as of September 30, 2004 and December 31, 2003 was 12% and 8%, respectively, while promissory notes from related parties are mostly interest-free. Most of the notes mature within 1 year from the latest balance sheet date.

The effective interest rates on bank deposits with original maturities exceeding 90 days as of September 30, 2004 were 4% for RUR-denominated deposits and 7% on deposits in USD. Included in bank deposits as of September 30, 2004 are deposits with East-West United Bank, a related party, of $25.8 million bearing interest of 7%.

7. LOANS TO CUSTOMERS AND BANKS, NET

Loans to customers and banks, net of an allowance for loan losses, as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Loans to customers	$211,617	$231,918
Loans to banks	92,892	147,518
	304,509	379,436
Less allowance for loan losses	(12,880)	(14,454)
Total	**$291,629**	**$364,982**

Loans to customers as of September 30, 2004 and December 31, 2003 include loans to related parties of $38.6 million and $151.6 million, respectively.

8. INSURANCE-RELATED RECEIVABLES

Insurance-related receivables as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Receivables from insurance operations	$72,292	$44,612
Advances to health care providers	22,938	25,243
Total	**$95,230**	**$69,855**

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

9. ACCOUNTS RECEIVABLE, NET

Accounts receivable, net of provision for doubtful accounts, as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Trade receivables	$338,355	$211,333
Less: provision for doubtful accounts	(45,399)	(29,082)
Total	**$292,956**	**$182,251**

Included in trade receivables as of September 30, 2004 and December 31, 2003 are receivables for services provided to the Group's affiliates in the amounts of $52.5 million and $4.3 million, respectively. Management anticipates no losses in respect of receivables from related parties.

10. OTHER RECEIVABLES AND PREPAID EXPENSES, NET

Other receivables and prepaid expenses, net of provision for doubtful accounts, as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Recoverable VAT	$258,668	$278,441
Receivables for sale of oil assets	—	153,500
Advances to suppliers	110,811	58,266
Prepaid expenses	64,953	15,897
Deferred policy acquisition costs	24,303	9,410
Other taxes prepaid	28,518	11,728
Receivables for sale of Micron shares	4,798	4,759
Receivables for sale of STROM telecom shares	2,000	—
Other	51,229	39,406
Less: provision for doubtful accounts	(4,952)	(4,282)
Total	**$540,328**	**$567,125**

Policy acquisition costs' amortization charge for the nine months ended September 30, 2004 and 2003 were $30.0 million and $17.3 million, respectively.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

11. INVENTORIES

Inventories as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Raw materials and spare parts	$ 45,940	$ 53,421
Work-in-progress	44,602	15,643
Finished goods and goods for resale	100,765	60,488
Project costs—construction, net of progress billings	36,968	36,651
Total	**$228,275**	**$166,203**

Inventories with book value of $2.8 million and $1.9 million as of September 30, 2004 and December 31, 2003, respectively, were pledged as collateral in respect of loans from banks.

12. PROPERTY, PLANT AND EQUIPMENT, NET

Property, plant and equipment, net of accumulated depreciation, as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Land	$ 28,587	$ 3,894
Buildings and leasehold improvements	531,644	439,838
Switches, transmission devices, network and base station equipment	2,850,804	2,223,603
Other plant, machinery and equipment	434,865	412,519
Construction in-progress and equipment for installation	905,435	764,178
	4,751,335	3,844,032
Less: accumulated depreciation	(760,406)	(475,911)
Total	**$3,990,929**	**$3,368,121**

Depreciation expense for the nine months ended September 30, 2004 and 2003 amounted to $327.9 million and $227.5 million, respectively.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

13. LONG-TERM INVESTMENTS

Long-term investments as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Loans, promissory notes and deposits with related parties	$23,154	$14,279
Loans, promissory notes and deposits with third parties	15,397	6,836
Mutual investment funds	10,160	9,616
Other	5,843	10,662
Total	**$54,554**	**$41,393**

Loans and promissory notes from related parties are mostly RUR denominated and interest-free. Majority of such loans and promissory notes mature from 2004 to 2006.

14. INVESTMENTS IN AFFILIATED COMPANIES

Investments in affiliated companies as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004		December 31, 2003	
	Voting power, (%)	Carrying value	Voting power, (%)	Carrying value
		(000's)		
Primtelefon	Consolidated		50%	$ 31,174
Astrakhan Mobile and Volgograd Mobile	Consolidated		50%	5,806
Mosdachtrest	Consolidated		44%	4,024
MTT (Note 3)	45%	$ 39,778	15%	30
MTS Belarus	49%	21,597	49%	5,884
Sky Link (Note 4)	50%	16,011	50%	—
East-West United Bank	35%	11,118	30%	8,382
Kosmos TV	50%	7,170	50%	7,239
ZETA Telecom	49%	6,924	49%	7,390
MCC	24%	650	24%	4,862
Loans to MTS Belarus	—	53,718	—	51,481
Loans to Sky Link	—	19,108	—	—
Loans to Astrakhan Mobile and Volgograd Mobile	—	—	—	6,850
Acquired debt of Kosmos TV	—	6,336	—	6,333
Other investments and loans to investees	Various	12,233	Various	11,481
Total		**$194,643**		**$150,936**

Investments in affiliates include $53.7 million in loans to MTS Belarus bearing interest at 3% to 11% per annum. Based on projected cash flows of MTS Belarus, the Group has concluded that no impairment of the Group's investments in MTS Belarus is required as of September 30, 2004.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

During the nine months ended September 30, 2004, the Group acquired 5% share in East-West United Bank for cash consideration of $1.7 million. This transaction increased the Group's voting power in East-West United Bank to 35%.

15. LICENSES, NET

Licenses, net of accumulated amortization, as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Operating licenses	$ 905,220	$ 773,073
Less: accumulated amortization	(212,760)	(103,085)
Total	**$ 692,460**	**$ 669,988**

Amortization expense for licenses for the nine months ended September 30, 2004 and 2003 amounted to $109.7 million and $74.4 million, respectively. Based on the licenses existing at September 30, 2004, the estimated amortization expense for the remainder of the year ending December 31, 2004 is $40.1 million. The estimated amortization expense for each of the five succeeding years and thereafter is as follows:

	(000's)
2005	$145,237
2006	140,792
2007	113,096
2008	76,269
2009	39,152
Thereafter	137,785
	$652,331

Actual amortization expense to be reported in future periods could differ from these estimates as a result of new licenses acquisitions, changes in useful lives and other relevant factors.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

16. OTHER INTANGIBLE ASSETS, NET

Intangible assets, other than goodwill and licenses, net of accumulated amortization, as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004			December 31, 2003		
	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
Amortized intangible assets:						
Acquired customer base	$144,250	$ (65,531)	$ 78,719	$137,747	$(28,877)	$108,870
Numbering capacity with finite contractual life, rights to use premises, software and other	401,941	(119,437)	282,504	319,498	(53,007)	266,491
	546,191	(184,968)	361,223	457,245	(81,884)	375,361
Unamortized intangible assets:						
Numbering capacity with indefinite contractual life	28,561	—	28,561	28,855	—	28,855
Trademarks	45,344	—	45,344	42,165	—	42,165
Total intangible assets	**$620,096**	**$(184,968)**	**$435,128**	**$528,265**	**$(81,884)**	**$446,381**

Amortization expense recorded on other intangible assets for the nine months ended September 30, 2004 and 2003 amounted to $103.1 million and $52.4 million, respectively. Based on the amortizable intangible assets (excluding licenses) existing at September 30, 2004, the estimated amortization expense for the remainder of the year ending December 31, 2004 is $36.8 million. The estimated amortization expense for each of the five succeeding years and thereafter is as follows:

	(000's)
2005	$139,057
2006	87,495
2007	46,590
2008	27,637
2009	4,870
Thereafter	18,727
	$324,376

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.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

17. BANK DEPOSITS AND NOTES ISSUED

Bank deposits and notes issued as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Deposits repayable on demand	$ 89,899	$ 57,981
Term deposits	116,546	67,446
Promissory notes issued	33,374	48,321
Total	**$239,819**	**$173,748**

Bank deposits and notes issued as of September 30, 2004 and December 31, 2003 include deposits from and promissory notes issued to related parties for $22.8 million and $30.2 million, respectively.

18. INSURANCE-RELATED LIABILITIES

Insurance-related liabilities as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Unearned premium provision, net of reinsurance	$117,630	$ 72,511
Loss provision, net of reinsurance	66,733	39,349
Undisbursed MGFOMS funds	30,754	38,140
Other insurance-related liabilities	25,496	30,986
Total	**$240,613**	**$180,986**

Usage of MGFOMS funds, in the amount of $30.8 million, accumulated and undisbursed by Rosno as of September 30, 2004 is limited to payments for medical facilities and care provided to RF citizens by medical centers under MGFOMS's obligatory medical insurance program.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

19. ACCRUED EXPENSES, SUBSCRIBERS PREPAYMENTS AND OTHER CURRENT LIABILITIES

Accrued expenses and other current liabilities as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Subscriber prepayments, current portion (Note 23)	$290,733	$255,988
Payables for purchase of oil assets	—	96,530
Payroll and other accrued expenses	118,167	39,836
Accrued interest on loans	63,623	50,726
Customers' advances	54,552	38,586
Payables for purchase of UMC shares	—	27,500
Current portion of capital lease obligations (Note 21)	4,789	11,387
Dividends payable	51,985	10,841
Tax and legal contingencies	21,843	27,179
Other	37,631	48,510
Total	**$643,323**	**$607,083**

20. SHORT-TERM NOTES PAYABLE

Short-term notes payable as of September 30, 2004 and December 31, 2003 consisted of the following:

	Currency	Annual interest rate (Actual at September 30, 2004)	September 30, 2004	December 31, 2003
			(000's)	
Commerzbank Eurasia	USD	LIBOR+5.0% (7.4%)	$20,000	$ 10,000
Sberbank	RUR	10.0%–15.0%	8,422	3,828
Credit Linked Notes	USD	—	—	100,000
Credit Suisse First Boston	USD	—	—	35,000
Trust Bank	USD	—	—	25,000
Deutsche Bank	USD	—	—	15,280
AVAL Bank	UAH	—	—	10,890
Loans and promissory notes payable to related parties	Various	Various	15,985	134,574
Other	Various	Various	16,149	14,511
Total			**$60,556**	**$349,083**

Commerzbank Eurasia—In November 2003, Sistema-Hals entered into a loan agreement with Commerzbank Eurasia for the amount of $20.0 million. The loan bears interest at LIBOR+5% (7.4% as of September 30, 2004) and is due in March 2005. The loan is guaranteed by JSFC Sistema.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

Sberbank—The Group has entered into several short-term loans with Sberbank. The outstanding balance under the loans as of September 30, 2004 was $8.4 million. The loans bear interest of 10%-15%. The Sberbank loans are secured by pledge of PP&E with the carrying value of approximately $8.2 million as of September 30, 2004.

21. CAPITAL LEASE OBLIGATIONS

Capital lease obligations as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Capital lease obligations	$ 6,927	$ 16,330
Less: current portion of capital lease obligations (Note 19)	(4,789)	(11,387)
Total	**$ 2,138**	**$ 4,943**

During 2001-2003 the Group entered several lease agreements for telecommunications equipment and vehicles. Most of the agreements expire in 2004–2006 and assume transfer of ownership for leased assets to the Group at the end of the lease term. JSFC Sistema guaranteed $5.3 million under the lease agreements entered by the Group's subsidiaries.

The net book value of leased assets comprised $20.3 million and $23.2 million as of September 30, 2004 and December 31, 2003, respectively. Interest expense, recorded within income from continuing operations, was $1.4 million and $3.3 million for the nine months ended September 30, 2004 and 2003, respectively. Future minimum payments under the lease agreements are disclosed in Note 30.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

22. LONG-TERM DEBT

Long-term debt as of September 30, 2004 and December 31, 2003 consisted of the following:

	Currency	Annual interest rate (Actual at September 30, 2004)	September 30, 2004	December 31, 2003
			(000's)	
Sistema Finance Notes	USD	10.3%	$ 348,808	$ 348,561
Sistema Capital Notes	USD	8.9%	350,000	—
MTS Finance Notes due 2010	USD	8.4%	400,000	400,000
MTS Finance Notes due 2008	USD	9.8%	398,883	400,000
MTS Finance Notes due 2004	USD	11.0%	299,928	299,640
Floating Rate Notes due 2004	USD	—	—	298,196
Sistema Finance Investments Bonds	RUR	15.0%	41,076	40,747
MGTS Bonds	RUR	10%–12.3%	84,479	52,643
Micron Bonds	RUR	15.0%	6,002	7,541
TAIF Telcom Bonds	RUR	—	—	4,074
Total Corporate Bonds			**1,929,176**	**1,851,402**
Syndicated Loan	USD	LIBOR+2.5% (4.7%)	200,000	—
Hermes Credit Facility	EUR	EURIBOR+0.7% (2.9%)	56,578	55,550
ING-Bank (Eurasia)	USD	LIBOR+2.3%–4.2% (4.3%–6.2%)	53,333	60,000
Vendor Financing	Various	Various	26,547	25,033
Raiffeisenbank	USD	LIBOR+5.0%–7.0% (7.4%–9.4%)	23,966	33,036
Commerzbank (Eurasia)	USD	LIBOR+1.4%–3.5% (3.8–5.9%)	21,367	19,958
HSBC	USD	LIBOR+2.8% (4.7%) LIBOR+4.9% (7.1%) EURIBOR+5.6% (7.5%)	20,000	25,000
Vneshtorgbank	USD, EUR	(7.5%), 13%	19,882	17,297
Sberbank	RUR	11.0%–12.0%	18,033	34,732
Ericsson Project Finance	USD	LIBOR+4.0% (6.0%)	17,100	23,400
Citibank	USD	LIBOR+1.6% (4.0%)	13,160	18,616
Dresdner Bank	USD	LIBOR+3.4% (5.6%)	10,000	15,400
Nordea Bank Sweden	USD	LIBOR+0.4% (2.6%)	8,124	—
Deutsche Telecom	USD	—	—	57,981
International Moscow Bank	RUR	—	—	10,864
TDC Mobile International	USD	—	—	6,838
Loans from related parties	Various	Various	14,853	31,898
Other	Various	Various	40,375	33,022
			2,472,494	2,320,027
Less amounts maturing within one year			(497,654)	(844,106)
Total			**$1,974,840**	**$1,475,921**

Corporate Bonds—In January 2004, Sistema Capital, a wholly-owned subsidiary of the Group domiciled in Luxembourg, issued $350.0 million of 8.875% notes, due in January 2011. The notes are fully and unconditionally guaranteed by JSFC Sistema. Interest payments on the notes are due semi-annually in January and July of each year, commencing July 2004. On or prior to January 2007, the Group may redeem up to 35% of the notes with the net proceeds of offerings of JSFC Sistema's common equity at 108.9% of the principal amount. The notes are listed on the London Stock Exchange. In January 2007, the holders of the notes may require Sistema Capital to redeem their notes at 100% of the principal amount thereof, together with accrued interest. In addition, these notes provide the holders with a right to require Sistema Capital to redeem all of the notes outstanding at 101% of the principal amount of the notes plus accrued interest upon any change in control.

In April 2003, Sistema Finance, a wholly-owned subsidiary of the Group, issued $350.0 million 10.25% notes, due in April 2008, at 99.52% of par. These notes are secured by 193,473,900 shares of common stock of MTS. The notes are listed on the Luxembourg Stock Exchange. JSFC Sistema is a guarantor of the notes. Interest on the notes is payable semi-annually in arrears. On or prior to April 14, 2006, the Group may redeem up to 35% of the notes with the net proceeds of offerings of JSFC Sistema's common equity at 110.25% of par. These notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, restrictions on mergers or consolidations, limitations on liens and dispositions of assets and limitations on transactions with affiliates. In addition, these notes provide the holders with a right to require Sistema Finance to redeem all of the notes outstanding at 101% of the principal amount of the notes plus accrued interest upon any change in control.

In October 2003, MTS Finance ("MTS Finance"), a wholly-owned subsidiary of the Group, issued $400.0 million notes bearing interest at 8.375% at par. The cash proceeds, net of issuance costs of approximately $4.6 million, amounted to $395.4 million. These notes are fully and unconditionally guaranteed by MTS and will mature in October 2010. MTS Finance is required to make interest payments on the notes semi-annually in arrears in April and October of each year, commencing April 2004. The notes are listed on the Luxembourg Stock Exchange. These notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, limitations on MTS's ability to enter into sale-leaseback transactions, restriction on any merger, consolidation or disposition of assets, restrictions on the sales of any licenses. In addition, these notes provide the holders a right to require MTS Finance to redeem all of the notes outstanding at 101% of the principal amount of the notes plus accrued interest upon any change in control.

In January 2003, MTS Finance issued $400.0 million 9.75% notes at par. These notes are fully and unconditionally guaranteed by MTS and mature in January 2008. MTS Finance is required to make interest payments on the notes semi-annually in arrears in January and July, commencing July 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes were $400.0 million and related debt issuance costs of $3.9 million were capitalized.

In December 2001, MTS Finance issued $250.0 million 10.95% (effective interest rate of 11.25%) notes at the price of 99.254%. Proceeds received from the notes, net of underwriting discount, were $248.1 million. Related debt issuance costs in the amount of $3.9 million were capitalized. In March 2002, MTS Finance issued additional $50.0 million 10.95% (effective interest rate of 10.25%) notes at a price of 101.616%. Proceeds received from these notes, including the offering premium, were $50.8 million. Related debt issuance costs in the amount of $0.6 million were capitalized. MTS Finance made interest payments on the notes semi-annually in arrears in June and December of each year, commencing in June 2002. The notes were listed on the Luxembourg Stock Exchange. In May 2002 these notes were registered with the SEC under the Securities Act of 1933. All the notes were fully and unconditionally guaranteed by MTS and were fully repaid in December 2004.

In August 5, 2003, MTS Finance issued $300.0 million notes bearing interest at a rate of 3 months LIBOR+4% at the price of 99%. These notes were fully and unconditionally guaranteed by MTS and matured in August 2004. MTS Finance was required to make interest payments on the notes quarterly, commencing November 2003. The notes were listed on the Luxembourg Stock Exchange. Proceeds received from the notes, net of underwriting discount, were $297.0 million and related debt issuance costs of $1.8 million were capitalized. In May 2004, the Group redeemed all outstanding floating rate notes, mentioned above, in the principal amount plus accrued interest thereon to the date of redemption.

In November 2002, Sistema Finance Investments, a wholly-owned subsidiary of the Group, issued RUR denominated bonds with face value of 1,200.0 million RUR (equivalent of $41.1 million as of September 30, 2004). The bonds were traded on MICEX and carried a coupon rate of 17.75% during the first year of trading and of 15% during the second year. The notes were fully repaid in November 2004.

In July 2004, Sistema Finance Investments issued RUR denominated bonds with face value of 2,000.0 million RUR (equivalent of $68.5 million as of September 30, 2004). The bonds carried a coupon rate of 11%. As of September 30, 2004 the Group had repurchased 100% of the second issue of Sistema Finance Investments bonds.

In February 2003, MGTS issued 2-year RUR denominated bonds in the amount of 1,000 million RUR (equivalent of $34.2 million as of September 30, 2004). The bonds carry coupon of 12.3% during the first year of trading and 17.0% during the second year.

In April 2004, MGTS issued 5-year RUR-denominated bonds in the amount of RUR 1,500 million (equivalent of $51.3 million as of September 30, 2004). The bonds carry a coupon of 10% per annum. MGTS made an unconditional offer to repurchase the bonds at par value in April 2006.

In July 2003, Micron issued RUR denominated bonds with face value of RUR 300.0 million (equivalent of $10.3 million as of September 30, 2004) due in January 2005. Interest is payable semiannually. The interest rate is set at 15% per annum, and two-thirds of the interest payments are covered by the municipal government. As of September 30, 2004 the Group had repurchased on the open market approximately 42% of the Micron bonds issued.

Syndicated Loan—In July 2004, MTS entered into a $500.0 million syndicated loan agreement with international financial institutions: ING Bank N.V., ABN AMRO Bank N.V., HSBC Bank PLC, Raiffeisen Zentralbank Oesterreich AG, Bank Austria Creditanstalt AG, Commerzbank AG and others. The credit facility bears interest LIBOR+2.5% per annum (4.7% as of September 30, 2004) and matures in 3 years. The proceeds were used by MTS for corporate purposes, including refinancing of its existing indebtedness. In September 2004, MTS extended total amount available under the syndicated loan facility for an additional $100.0 million to total amount of $600.0 million. Issuance costs of $10.2 million related to the syndicated loan facility have been capitalized. As of September 30, 2004, $200.0 million was outstanding under this credit facility. The loan facility is subject to certain restrictive covenants including, but not limited to, certain financial ratios of MTS. As of September 30, 2004, MTS is in compliance with all existing covenants.

Hermes Credit Facility—In December 2003, UMC entered into Hermes Credit Facility with ING BHF Bank and Commerzbank to finance the acquisition of GSM equipment from Siemens AG. The aggregate amount available under this credit facility is EUR 47.4 million (equivalent of $58.4 million as of September 30, 2004). The loan is fully and unconditionally guaranteed by MTS and bears interest at EURIBOR+0.7% (2.9% as of September 30, 2004). The amount outstanding is redeemable in 10 equal semi-annual installments, commencing July 2004. The balance outstanding as of September 30, 2004 was $56.6 million.

ING Bank (Eurasia)—In September 2003, UMC entered into a $60.0 million syndicated credit facility with ING Bank (Eurasia), Standard Bank and Commerzbank AG with an interest rate of LIBOR+2.3%–4.2% (4.3%–6.2% as of September 30, 2004). The loan is fully and unconditionally guaranteed by MTS. The proceeds were used by UMC to refinance its existing indebtedness. The loan is payable in 8 equal quarterly installments starting from September 2004. As of September 30, 2004, the balance outstanding under this credit facility was $53.3 million.

Vendor Financing—Foreign suppliers of telecommunications equipment provide non-collateralized commercial credit (vendor financing) to the Group denominated in various currencies on short-term and long-term bases, mostly interest free.

Raiffeisenbank—In September 2002, MGTS entered into a credit line with Raiffeisenbank limited to $15.0 million. The equipment with fair value of $23.9 million was pledged under this credit line as of September 30, 2004. In addition, MGTS is required to maintain monthly gross cash flows with the bank of not less than $1.5 million. The loan bears interest of LIBOR+5% (7.4% as of September 30, 2004) and matures in 2007. As of September 30, 2004, approximately $7.5 million was outstanding under this credit line.

In November 2002, JSFC Sistema entered into a credit line with Raiffeisenbank (Austria) limited to $20.0 million. The building with fair value of $22.7 million was pledged under this credit line as of September 30, 2004. In addition, the Group is required to maintain monthly gross cash flows with the bank of not less than $1.5 million. The loan bears interest of LIBOR+7% per annum (9.4% as of September 30, 2004) and matures in 2007. As of September 30, 2004, approximately $16.5 million was outstanding under this credit line.

Commerzbank (Eurasia)—InvestSvyazHolding, a subsidiary of the Group, entered into a number of credit line facilities with Commerzbank (Eurasia) for a total amount of $21.6 million. The loan bears interest of LIBOR+1.4%-3.5% per annum (3.8%–5.9% as of September 30, 2004). As of September 30, 2004, approximately $21.4 million was outstanding under these credit line facilities. The facilities are fully and unconditionally guaranteed by MTS.

HSBC—In October 2003, TAIF Telcom entered into a $25.0 million credit facility with HSBC Bank LLC, which is fully and unconditionally guaranteed by MTS. The facility bears interest at LIBOR+2.8% (4.7% as of September 30, 2004) and is redeemable in ten equal quarterly installments commencing June 2004. As of September 30, 2004, the outstanding balance of the facility was $20.0 million.

Vneshtorgbank—The loans provided by Vneshtorgbank are collateralized by pledge of equipment with fair value of $9.5 million and by a pledge of 4% of MGTS common shares. Loans bear fixed interest rates and the weighted average interest rate on the loans outstanding as of September 30, 2004 was 8.2% per annum. The loans mature in 2005–2010.

Sberbank—In September 2004, MGTS received a loan from Sberbank in the amount of $10.3 million. The loan bears interest of 11% and matures in March 2007. Equipment with fair value of $29.0 million was pledged to collateralize the outstanding balance under the loan as of September 30, 2004. The total balance outstanding under several other loans the Group received from Sberbank was $7.7 million as of September 30, 2004.

Ericsson Project Finance—In December 1996, Rosico entered into a credit agreement with Ericsson Project Finance AB, which provided for a credit facility with an aggregate principal amount of $60.0 million. The loan bears interest of LIBOR plus 4% per annum (6.0% as of September 30, 2004). The loan is collateralized by a pledge of 16.8% of MGTS voting shares held by the Group. In February 2003, Ericsson Project Finance AB assigned all of its rights and obligations under the loan to Salomon Brothers Holding Company, Inc. As of September 30, 2004, the loan balance was $17.1 million.

Citibank—In July 2003, MGTS received loan from Citibank for the purchase of equipment in the amount of $7.1 million. In addition, in May and August 2004, MGTS received loans from Citibank for the purchase of equipment in the total amount of $6.1 million. All loans bear interest of LIBOR+1.6% (4.0% as of September 30, 2004). The loans are collateralized by pledged of equipment with fair value of $9.5 million and by deposit in Citibank and guaranteed by Export Guarantee and Insurance Corporation, Czech Republic. As of September 30, 2004, approximately $13.2 million was outstanding under these loans.

Dresdner Bank—In October 2002, MSS, a subsidiary of MTS, entered into a credit agreement with Dresdner Bank to borrow up to $10.0 million. As of September 30, 2004, $10.0 million was outstanding under this agreement. Borrowings under this agreement bear interest of LIBOR+3.2%–3.4% (5.4%–5.6% as of September 30, 2004) per annum. The loan was fully and unconditionally guaranteed by MTS. In October 2004 the loan was fully repaid.

Nordea Bank Sweden—In September 2003, Primtelefon entered into a long-term loan facility with Nordea Bank Sweden for the total amount of $9.8 million. Amounts outstanding under the loan agreement bear interest at LIBOR+0.4% and mature in October 2006. The loan is fully and unconditionally guaranteed by MTS. As of September 30, 2004, the amount outstanding under the loan was $8.1 million.

International Moscow Bank—As of September 30, 2004 Kuban-GSM had an open credit facility with International Moscow Bank for $12.0 million.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The schedule of repayments of long-term debt over the five-year period beginning on September 30, 2004 is as follows:

	(000's)
Year ended September 30,	
2005	$ 497,654
2006	88,888
2007	625,064
2008	418,862
2009	415,353
Thereafter	426,673
Total	**$2,472,494**

23. SUBSCRIBER PREPAYMENTS

Subscriber prepayments as of September 30, 2004 and December 31, 2003 consisted of the following:

	September 30, 2004	December 31, 2003
	(000's)	
Current portion (Note 19)		
Connection fees	$ 68,983	$ 60,609
Advances and customers' deposits	221,750	195,379
	290,733	255,988
Non-current portion		
Connection fees	133,209	103,059
Total	**$423,942**	**$359,047**

24. INCOME TAX

The Group's provision for income taxes is as follows for the nine months ended September 30, 2004 and 2003:

	September 30, 2004	September 30, 2003
	(000's)	
Current provision	$357,551	$241,549
Deferred benefit	(31,410)	(41,206)
Total income tax expense	**$326,141**	**$200,343**

The provision for income taxes is different from that which would be obtained by applying the statutory income tax rate (24% in 2003 and 2002) to net income from continuing operations before income tax, minority interests and cumulative effect of a change in accounting principle. The items causing this difference are as follows:

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

	September 30, 2004	September 30, 2003
	(000's)	
Income tax provision computed on income from continuing operations before taxes at statutory rate	$280,817	$155,458
Adjustments due to:		
Change in valuation allowance	158	944
Non-deductible items	24,085	35,238
Taxable losses not carried forward	24,550	21,553
Currency exchange and translation differences	2,683	(4,238)
Effect of rates different from standard	(6,152)	(8,612)
Income tax expense	**$326,141**	**$200,343**

The tax effects of temporary differences that give rise to the deferred tax assets and liabilities are presented below:

	September 30, 2004	December 31, 2003
	(000's)	
Deferred tax assets		
Subscriber and customer prepayments	$ 71,230	$ 40,014
Property, plant and equipment	30,155	21,191
Deferred revenues	23,094	19,070
Allowance for doubtful accounts	13,911	20,338
Accrued expenses	23,608	3,434
Tax losses carried forward	7,694	8,795
Other	7,757	3,362
	177,449	116,204
Less: valuation allowance	(8,984)	(9,142)
Total deferred tax assets	**168,465**	**107,062**
Deferred tax liabilities		
Intangible assets	(199,031)	(191,249)
Property, plant and equipment	(110,204)	(71,357)
Undistributed earnings of affiliates	(6,314)	(4,462)
Other	(8,288)	(11,949)
Total deferred tax liabilities	**$(323,837)**	**$(279,017)**
Net deferred tax assets, current	$ 68,334	$ 53,964
Net deferred tax assets, long-term	5,307	5,575
Net deferred tax liabilities, current	(5,252)	(508)
Net deferred tax liabilities, long-term	(223,761)	(230,986)

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

The Group does not record a deferred tax liability related to undistributed earnings of its subsidiaries, as it intends to permanently reinvest these earnings.

Deferred tax assets relating to tax losses carried forward in amount of $7.7 million as of September 30, 2004 expire in 2008 and are attributable to MSS and Rosico, subsidiaries of MTS.

25. POSTRETIREMENT BENEFITS

MGTS has historically provided certain benefits to employees upon their retirement and afterwards. Currently such benefits include bonus payments of a fixed amount to retiring employees with at least five years of service (RUR 12,300 or RUR 24,600 ($421 or $842 at the exchange rate current as of September 30, 2004), depending on actual years of service); lifetime payments of a fixed amount to employees retiring with at least fifteen years of service (RUR 3,900 per year, per employee, or approximately $134 at the exchange rate as of for the nine months ended September 30, 2004); and discounted telephone service to employees retiring with at least thirty years of service. An employee is withdrawn from the benefit plan if his/her employment with MGTS is discontinued prior to retirement.

The assumed discount rate used in determining net periodic cost is 8% per annum. The future benefit payments to retirees under the defined benefit plan are expected as follows:

	(000's)
Year ended September 30,	
2005	$5,580
2006	560
2007	515
2008	475
2009	438
2010–2014	1,206
Thereafter	1,155
Total	**$9,929**

MGTS's defined benefit plan is unfunded. For the nine months ended September 30, 2004 and, 2003 the net periodic benefit costs recognized and the contributions paid by MGTS under the plan were not material.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

26. DEFERRED REVENUE

Deferred revenue is comprised of property, plant and equipment contributions and grants received by the Group and as of September 30, 2004 and December 31, 2003 was as follows:

	September 30, 2004	December 31, 2003
	(000's)	
Deferred revenue at the beginning of the period	$115,363	$ 89,894
Contributions received during the period	12,047	26,183
Currency translation effect	685	9,705
	128,095	125,782
Deferred revenue amortized	(6,217)	(10,419)
Deferred revenue at the end of the period	**$121,878**	**$115,363**

In 2000 the Group was awarded a grant for construction of a manufacturing facility for production of medicines (vaccines and infusion dissolvents) in the Moscow region. The grant facility of $20.1 million was received in full during 2001 and 2000. The grant is repayable to the grantor (state organization) during the period to 2010. These contributions are accounted for as deferred revenues.

27. SHARE CAPITAL

At January 1, 2004, JSFC Sistema had 68,325,000 voting common shares authorized and 8,100,000 shares issued and outstanding with a par value of 0.1 RUR.

In July 2004, JSFC Sistema increased the par value of its shares to 90.0 RUR. As a result of this transaction, the share capital of the Group increased and retained earnings decreased by $24.9 million.

In June 2004, JSFC Sistema declared dividends for the year ended December 31, 2003, amounting to $5.2 million.

28. SEGMENT INFORMATION

The Group's operating segments are: Telecommunications, Technology, Insurance, Banking and Other. The Group's management evaluates performance of the segments based on both operating income and net income before minority interests and cumulative effect of a change in accounting principle.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

An analysis and reconciliation of the Group's business segment information to the respective information in the consolidated financial statements for the nine months ended September 30, 2004 and 2003 is as follows:

	For the nine months ended September 30, 2004					
	Telecommunications	Technology	Insurance	Banking	Corporate and Other	Total
Net sales to external customers[a]	3,350,379	282,291	186,660	34,948	281,642	4,135,920
Intersegment sales	—	37,525	14,500	14,272	1,454	67,751
Income/(loss) from equity affiliates	12,129	—	203	1,028	(418)	12,942
Interest income	25,055	96	—	—	5,252	30,403
Interest expense	(124,392)	(4,485)	—	—	(44,657)	(173,534)
Net interest revenue[b]	—	—	—	14,498	—	14,498
Depreciation and amortization	(529,710)	(2,249)	(2,903)	(839)	(4,978)	(540,679)
Operating income/(loss)	1,291,462	13,913	14,372	14,687	(11,263)	1,323,171
Income tax expense	(308,725)	(5,638)	(4,276)	(4,393)	(3,109)	(326,141)
Investments in affiliated companies	167,571	586	232	4,820	21,434	194,643
Segment assets	6,134,456	251,829	308,737	376,960	625,856	7,697,838
Cash and cash equivalents	170,819	28,501	38,293	35,526	35,408	308,547
Indebtedness[c]	(1,666,304)	(36,882)	(2,239)	—	(834,552)	(2,539,977)
Capital expenditures	1,030,684	6,789	6,223	4,414	38,209	1,086,319

(a) Interest income and expenses of the Insurance and Banking segments are presented as revenues from financial services in the Group's consolidated financial statements.

(b) The Banking segment derives a majority of its revenue from interest. In addition, management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing that segment. Therefore, only the net amount is disclosed.

(c) Represents the sum of short-term and long-term debt and capital lease obligations.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

	For the nine months ended September 30, 2003					
	Telecommunications	Technology	Insurance	Banking	Corporate and Other	Total
Net sales to external customers[a]	2,272,764	38,986	118,159	33,752	144,937	2,608,598
Intersegment sales	—	24,696	15,019	6,311	8,202	54,228
Income/(loss) from equity affiliates	1,204	—	(235)	428	(102)	1,295
Interest income	14,976	—	—	—	5,310	20,286
Interest expense	(106,829)	(2,326)	—	—	(28,318)	(137,473)
Net interest revenue[b]	—	—	—	6,211	—	6,211
Depreciation and amortization	(345,861)	(2,084)	(2,148)	(465)	(3,772)	(354,330)
Goodwill impairment	(19,251)	—	—	—	—	(19,251)
Operating income/(loss)	769,408	(351)	10,479	6,174	(19,767)	765,943
Income tax expense	(197,693)	14	(1,788)	(1,160)	284	(200,343)
Investments in affiliated companies	132,321	640	253	8,612	12,347	154,173
Segment assets	4,923,164	91,419	208,232	401,224	493,372	6,117,411
Cash and cash equivalents	83,537	2,050	16,721	48,797	22,638	173,743
Indebtedness[c]	(1,589,599)	(33,768)	(3,235)	—	(776,595)	(2,403,197)
Capital expenditures	773,992	6,029	5,802	2,124	17,597	805,544

(a) Interest income and expenses of the Insurance and Banking segments are presented as revenues from financial services in the Group's consolidated financial statements.

(b) The Banking segment derives a majority of its revenue from interest. In addition, management primarily relies on net interest revenue, not the gross revenue and expense amounts, in managing that segment. Therefore, only the net amount is disclosed.

(c) Represents the sum of short-term and long-term debt and capital lease obligations.

The reconciliation of segment operating income to the consolidated income from continuing operations before income tax, minority interests and cumulative effect of a change in accounting principle and reconciliation of segment assets to the consolidated segment assets are as follows:

	September 30, 2004	September 30, 2003
	(000's)	
Total segment operating income	$1,323,171	$ 765,943
Intersegment eliminations	(16,626)	(4,560)
Interest income	17,370	14,743
Interest expense	(163,316)	(132,057)
Currency exchange and translation gain	9,496	3,671
Consolidated income from continuing operations before income tax, minority interests and cumulative effect of a change in accounting principle	**$1,170,095**	**$ 647,740**
Total segment assets	$7,697,838	$6,117,411
Intersegment eliminations	(18,909)	(9,117)
Consolidated segment assets	**$7,678,929**	**$6,108,294**

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

For the nine months ended September 30, 2004 and 2003 the Group's revenues derived from Ukraine were $792.8 million and $307.7 million. Long-lived assets of the Group's entities domiciled in Ukraine were $763.1 million and $648.8 million as of September 30, 2004 and December 31, 2003, respectively.

For the nine months ended September 30, 2004 and 2003, the Group did not have revenues from transactions with a single external customer amounting to 10% or more of the Group's consolidated revenues.

29. RELATED PARTY TRANSACTIONS

The Group provides services to and purchases services from affiliates and companies related by means of common control. During the nine months ended September 30, 2004 and 2003, the Group entered into transactions with related parties as follows:

	September 30,	
	2004	2003
	(000's)	
Sale of goods	$(104,545)	$ —
Insurance premium received	(57,557)	(31,671)
Telecommunication services provided	(21,452)	(6,414)
Revenues from financial services	(6,632)	(8,474)
Consulting services provided	(1,361)	(9,932)
Claims paid	11,026	10,296
Interest expense	4,199	1,128
Finance services related costs	1,510	—
Purchase of goods for resale	2,612	—
Telecommunication services purchased	—	3,500
Other	2,166	1,051

Related party balances as of September 30, 2004 and December 31, 2003 are disclosed in the corresponding notes to the financial statements.

30. COMMITMENTS AND CONTINGENCIES

Operating Leases—The Group leases land, buildings and office space mainly from municipal organizations through contracts, which expire in various years through 2049.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

Future minimum rental payments under capital and operating leases in effect as of September 30, 2004, are as follows:

	Capital leases	Operating leases
	(000's)	
Year ended September 30,		
2005	$4,937	$ 47,616
2006	1,805	27,546
2007	479	22,009
2008	67	17,222
2009	66	11,247
Thereafter	262	24,997
Less: amount representing interest	(689)	—
Total	**$6,927**	**$150,637**

Capital Commitments—As of September 30, 2004, MTS had executed non-binding purchase agreements in the amount of approximately $331.0 million to subsequently acquire property, plant and equipment.

In December 2003, MGTS announced its long-term investment program for the period from 2004 till 2012 providing for extensive capital expenditures including expansion and full digitalization of the Moscow telephone network. The program was approved by the resolution of the Moscow City Government in December 2003. Capital expenditures under the investment program are currently estimated to be approximately $1.6 billion during the years 2004–2012 and include reconstruction of 350 local telephone stations and installation of 4.3 million of new phone numbers. The Group expects to finance approximately 50% of the capital expenditures under the investment program.

In July 2003, Sistema-Hals entered into an agreement with Siemens Real Estate to develop an office building in Moscow, which will become Siemens AG headquarters in Russia. Under this agreement Sistema-Hals is responsible for obtaining all necessary permits, planning and overall control of the construction process. The building is expected to be completed in late 2005. The cost of the project is estimated at approximately Euro 66.8 million (equivalent of $82.2 million as of September 30, 2004).

During 2004, Organizator, a subsidiary of Sistema-Hals, signed an agreement with Government of Moscow to administrate construction of a tunnel in the City of Moscow. Under the agreements signed by Organizator in relation to this project it is responsible for obtaining all permits, planning and oversight of design and construction work. The construction is financed by the City of Moscow and expected to be completed in 2007. The cost of the project is estimated at RUR 53,528.4 million ($1,832.1 million as of September 30, 2004).

Additionally, Sistema-Hals entered into construction agreements with various third party subcontractors for a total amount of $25.2 million.

Operating Licenses—When MTS commenced its operations in 1994, licenses generally contained certain provisions for unspecified fees to be paid for utilization of frequencies. Most of MTS current licenses now provide for payments to be made for finance telecommunication infrastructure improvements, which in the aggregate could total approximately $103.6 million, as of September 30, 2004. However, a decision on the terms and conditions of such payments has not been finalized. Accordingly, MTS has not made any payments to date pursuant to any of current operating licenses. Furthermore, management believes that MTS will not be required to make any such payments. Should such payments be required in the future, management believes that it would be limited to purchasing certain equipment for its own use in the related license area. In relation to these uncertainties, the Group has not recorded a contingent liability in the consolidated financial statements.

Each of the Group's telecommunication licenses, except the licenses covering the Moscow license area, contains a requirement for service to be commenced and for subscriber number and territorial coverage targets to be achieved by a specified date. The Group has met these targets or received extensions to these dates in those regional license areas in which the Group has not commenced operations. The management believes that the Group is in compliance with all material terms of its licenses.

The Group's telecommunication licenses do not provide for automatic renewal. The Group has limited experience with the renewal of its existing licenses. However, management believes that the licenses required for the Group's operations will be renewed upon expiration.

Issued Guarantees—As of September 30, 2004, MTS has issued guarantees for MTS-Belarus, an equity investee, for the total amount of $25.0 million. Under these guarantees the Group could be potentially liable for a maximum amount of $46.6 million in case of the borrower's default under the obligations. The guarantees expire by April 2007.

In December 2002, MTU-Inform and Alfabank signed a guarantee agreement. According to the agreement MTU-Inform guaranteed a loan of $4.0 million provided to Golden Line by Alfabank. The loan matures in November, 2005. In addition, MTU-Inform pledged equipment with a fair value of $4.7 million.

In July 2004, MTU-Inform issued guarantees to MBRD on behalf of Skylink for the total amount of $21.1 million.

Additionally, MBRD guaranteed loans for several companies, including related parties, which totaled $1.4 million as of September 30, 2004.

These guarantees would require payment by the Group only in the event of default on payment by the respective debtor. Under these guarantees the Group could be potentially liable for a maximum amount of $49.9 million in case of the borrower's default under the obligations. As of September 30, 2004, no event of default has occurred under any of the guarantees issued by the Group.

Legal Proceedings—In the ordinary course of business, the Group may be 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 upon the financial condition, results of operations or liquidity of the Group.

In June 2004, the General Prosecutor of Ukraine filed a claim against MTS and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to MTS. The complaint also seeks an order that would prohibit MTS from alienating 51% of its stake in UMC until the claim is resolved. In August 2004, the Kiev Commercial Court rejected a claim of General Prosecutor of Ukraine against MTS. No appellation was filed to the Court by the office of General

Prosecutor of Ukraine within an established period. As of the date of these statements an office of General Prosecutor of Ukraine filed a request to the Constitutional Court of Ukraine to clear out terms of the State Privatization Plan for 2000-2002 and respond whether Ukrtelecom had a right to sell 51% stake in UMC. The Group believes that it acquired a stake in UMC in full compliance with Ukrainian law and, if required, intends to vigorously defend its acquisition of UMC.

Minimum Capital Requirements—The Law on insurance in Russia sets minimum share capital requirements for insurance organizations, depending on the type of insurance premiums they are writing. The minimum capital requirement for insurance organizations conducting reinsurance operations is set at 120.0 million RUR (equivalent of $4.0 million as of December 31, 2003). As of December 31, 2003, Rosno's statutory share capital amounted to 432.0 million RUR (equivalent of $14.7 million as of December 31, 2003).

The Central Bank of Russia sets minimum share capital requirements for banks. Effective December 1, 2003, the minimum capital requirement is set at Euro 5.0 million for each newly-founded bank. As of December 31, 2003, MBRD's share capital amounted to 400.0 million RUR (equivalent of $13.6 million as of December 31, 2003).

Contingencies—The Russian economy, while deemed to be of market status from 2002, continues to display certain traits consistent with that of an emerging market. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be subject to the government's continued actions with regard to legal, and economic reforms.

On January 1, 2004, a new Law on telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. The Group cannot predict with any certainty how the new law will affect it. The new law creates a new interconnect pricing regime in 2004, which should be more transparent and unified and it creates a universal service charge calculated as a percentage of revenue which will be introduced from 2005. The new law may increase the regulation of the Group's operations and until such time as appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

In recent years, the Russian government has initiated revisions of the Russian tax system. Effective January 1, 1999, the first part of the Tax Code was enacted. Effective January 1, 2001, the second part of the Tax Code was enacted and effective January 1, 2002 new regulations, relating to federal income tax were enacted. The new tax system is generally intended to reduce the number of taxes, the overall tax burden on businesses, and to simplify the tax laws.

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax ("VAT"), corporate income tax (income tax), and payroll (social) taxes, together with others. The government's policy on implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that is more significant than typically found in countries with more developed tax systems.

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of September 30, 2004, tax declarations of the Group for the preceding three fiscal years were open to further review.

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated financial statements; however, the risk remains that relevant authorities could take a different position with regard to interpretive issues.

Importation of Goods—The Group utilizes third parties to import goods into the CIS countries. This results in significant savings of customs duties and related taxes for certain subsidiaries of the Group. There is a risk that the third parties' import transactions may be challenged by regulatory authorities and determined as inappropriate. The impact that this determination may potentially have on the Group's net income and financial position can not be quantified at this stage due to the lack of precedent for such determinations and uncertainty in the calculations of penalties and interest. No contingent liabilities have been recorded in the Group's financial statements in relation to these transactions.

31. SUBSEQUENT EVENTS

Additional Debt Issuance

In October 2004 MTS obtained two committed credit facilities in an aggregate amount of approximately $121.0 million to finance further expansion of the Group's network. These funds will be used to purchase telecommunication equipment and software from Siemens AG and Alcatel SEL AG for the technical upgrade and expansion of the network. The arrangers and lenders of the credit facility are HSBC Bank plc and ING BHF-BANK AG. Euler Hermes Kreditversicherungs-AG, the German credit export agency, is providing export credit cover in respect to both facilities. The facilities mature in approximately 9 years and have cost of financing of LIBOR plus 1.9% per annum.

In December 2004, MTS signed an agreement with EBRD for $150.0 million loan. The loan has a term of 7 years repayable starting from December 2005 on a biannual basis in equal installments. Interest rate is 3.1% over LIBOR. The proceeds of the loan will be used by MTS to finance regional expansion in Russia.

In November 2004, MTS signed a loan agreement with ABN AMRO Bank N.V. (Stockholm branch) for $56.6 million and EUR 8.4 million. These funds will be used to purchase telecommunication equipment from Ericsson AB for expansion of the network. The loan is repayable on a biannual basis in equal installments over 9 years and has an interest rate of USD LIBOR/EURIBOR plus 0.35% per annum.

In October 2004, MTS Finance signed a loan agreement with Credit Suisse First Boston (London branch) for $140.0 million loan facility. These funds will be used for general corporate purposes. The loan is payable in two instalments of $70 million each due in three and six months after the draw date *i.e.*, in January and April 2005, respectively. Loan bears an interest rate at LIBOR plus 2.20% (4.44% at September 30, 2004). The loan is fully and unconditionally guaranteed by OJSC MTS.

Interest rate swap agreements

In December 2004, MTS signed two interest rate swap agreements with ABN AMRO Bank N.V and with HSBC Bank PLC. MTS agreed with ABN AMRO to pay a fixed rate of 3.27% and receive a variable interest of LIBOR on $100.0 million for the period from October 7, 2004 up to July 27, 2007. MTS agreed with HSBC Bank PLC to pay a fixed rate of 3.25% and receive a variable interest of LIBOR on $150.0 million for the period from October 7, 2004 up to July 27, 2007. These instruments are used to hedge MTS' exposure to variability of future cash flows caused by the change in LIBOR related to the syndicated loan described in Note 22.

Acquisitions

In October 2004, MTS completed transaction to exercise its call option in respect of a 47.3% stake in common shares and 50% of preferred shares of TAIF Telcom, increasing the Group's voting power in TAIF Telcom to 100%. The value of consideration equaled $63.0 million. TAIF Telcom provides GSM 900/1800 services under the MTS brand in the Republic of Tatarstan (population 3.8 million), located in the Volga region of Russia. As of September 30, 2004, the prepayment for TAIF Telcom's shares in amount of $63.0 million is recorded within advance payments for non-current assets.

In October 2004, Rosno acquired from RAO UES 100% stake in Leader. The value of consideration equaled $3.0 million. Leader is an insurance company, selling primarily property insurance to energy companies. During 2002-2004 the Group assumed reinsurance from Leader and performed operational management of this company.

In November 2004, the Group acquired from Vneshtorgbank 14% stake in East West United Bank, increasing its ownership to 49%. The value of consideration equaled $5.3 million. East West United Bank is a bank incorporated in Luxembourg.

In November 2004, MTS won a government tender to acquire 76% stake in Gorizont RT, a cellular operator in the Republic of Saha (Yakutia) in the Far-East region of Russia, for a cash consideration of $52.2 million. Gorizont RT is the sole mobile services provider in the region with a population of 949.3 thousands. The company's subscriber base is approximately 100 thousands.

In November 2004, MTS signed an agreement to acquire 100% in US-based MCT Sibi Corp., which owns a 93.5% stake in Sibintertelecom, mobile phone operator in the Chita region and Aginsk-Buryatsk Autonomous District in the Far-East region of Russia, for a cash consideration of $37.3 million. Sibintertelecom is the sole mobile services provider in two regions with a total population of 1.23 million. The company's subscriber base is approximately 100 thousands.

In December 2004, MTS acquired a 52.5% stake in Telesot-Alania. The value of consideration equaled $6.2 million. Telesot-Alania is a GSM 900/1800 mobile phone operator in the Republic of North Ossetia with a total population of 710 thousand. The company's subscriber base is approximately 54 thousands.

The purchase price allocation for these acquisitions has not been yet finalized at the date of these statements.

Other

In October 2004, common shares of JSFC Sistema were listed on Russian Trading System (RTS) Stock Exchange and Moscow Stock Exchange. Trading in the shares will commence within six months from the listing date.

In November 2004, shareholders of Intourist approved an issue of 35,258,088,110 shares of common stock in a closed subscription. The shares of the new issue will be acquired by the existing shareholders for a price of RUR 0.19 per share (approximately $0.007).

In November 2004, shareholders of MBRD approved an issue of 130,000 shares of common stock in a closed subscription. The shares of the new issue will be acquired by the existing shareholders for a price of RUR 4,600 per share (approximately $160).

In December 2004, T-Mobile, a shareholder of MTS, disposed of 15.1% of common shares of MTS in the open market. As a result of the sale, the Group received a right to cancel, with a prior written notice to T-Mobile, the shareholders' agreement between the Group and T-Mobile signed in 2003. Under the shareholders' agreement, certain actions of MTS require T-Mobile's approval, including new issuances of MTS shares, actions which would dilute T-Mobile's shareholding in MTS and acquisitions by MTS with a value between 25% and 50% of the balance sheet value of MTS' total assets, in accordance with Russian accounting standards.

The Group and T-Mobile agreed that until the earlier of 180 calendar days after completion date of an initial public offering by the Group or August 15, 2005, T-Mobile will not sell, offer to sell, pledge, or enter into any other agreements involving its remaining 10.1% stake in MTS, without the Group's prior written consent.

REPORT OF INDEPENDENT REGISTERED ACCOUNTING FIRM

To the Shareholders of OJSC Mobile TeleSystems:

We have audited the accompanying consolidated balance sheets of Mobile TeleSystems, a Russian Open Joint-Stock Company, and subsidiaries (the "Group") as of December 31, 2003, 2002 and 2001, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Group's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2003, 2002 and 2001, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the consolidated financial statements, the Group changed its method of accounting for subscriber acquisition costs in 2001.

/s/ ZAO Deloitte & Touche CIS

March 26, 2004, except for Note 24,
as to which the date is June 15, 2004

Moscow, Russia

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

AT DECEMBER 31, 2003, 2002 and 2001
(Amounts in thousands of U.S. dollars, except share amounts)

	December 31,		
	2003	2002	2001
CURRENT ASSETS:			
Cash and cash equivalents (Note 5)	$ 90,376	$ 34,661	$ 219,629
Short-term investments (Note 6)	245,000	30,000	85,304
Trade receivables, net (Note 7)	99,951	40,501	24,258
Accounts receivable, related parties (Note 18)	3,356	3,569	2,377
Inventory (Note 8)	67,291	41,386	26,184
Prepaid expenses	46,679	26,537	22,712
Deferred tax asset, current portion (Note 15)	44,423	12,223	5,802
VAT receivable	209,629	154,061	82,216
Other current assets	33,774	15,392	8,374
Total current assets	840,479	358,330	476,852
PROPERTY, PLANT AND EQUIPMENT, net of accumulated depreciation of $532,268, $299,216 and $168,989, respectively (Note 9)	2,256,076	1,344,633	856,056
LICENSES, net of accumulated amortization of $257,024, $143,402 and $79,568, respectively (Notes 4 and 21)	703,103	386,919	298,827
OTHER INTANGIBLE ASSETS AND GOODWILL, net of accumulated amortization of $148,052, $78,889 and $52,953, respectively (Note 10)	312,677	138,090	84,778
DEBT ISSUANCE COSTS, net of accumulated amortization of $4,586, $2,898 and $1,209, respectively (Note 12)	9,431	2,957	3,997
INVESTMENTS IN AND ADVANCES TO ASSOCIATES (Note 20)	103,585	34,034	740
DEFERRED TAX ASSET, net of current portion (Note 15)	—	—	6,238
Total assets	$4,225,351	$2,264,963	$1,727,492

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS (Continued)

AT DECEMBER 31, 2003, 2002 and 2001
(Amounts in thousands of U.S. dollars, except share amounts)

	December 31, 2003	December 31, 2002	December 31, 2001
CURRENT LIABILITIES:			
Accounts payable, related parties (Note 18)	$ 31,904	$ 4,968	$ 6,142
Trade accounts payable	168,039	117,623	106,068
Deferred connection fees, current portion (Note 11)	21,467	22,210	21,419
Subscriber prepayments and deposits	191,768	110,950	63,741
Debt, current portion (Note 12)	103,312	67,098	18,825
Notes payable, current portion (Note 12)	597,836	—	—
Capital lease obligation, current portion (Notes 13 and 18)	9,122	21,232	14,401
Income tax payable	11,128	3,987	23,078
Accrued liabilities (Note 14)	143,789	73,919	51,626
Other payables	19,604	2,225	3,357
Total current liabilities	1,297,969	424,212	308,657
LONG-TERM LIABILITIES:			
Notes payable, net of current portion (Note 12)	800,000	298,943	248,976
Debt, net of current portion (Note 12)	142,418	59,971	35,942
Capital lease obligation, net of current portion (Notes 13 and 18)	7,646	7,241	7,696
Deferred connection fees, net of current portion (Note 11)	25,177	19,694	25,993
Deferred taxes (Note 15)	180,628	87,485	67,505
Total long-term liabilities	1,155,869	473,334	386,112
Total liabilities	2,453,838	897,546	694,769
COMMITMENTS AND CONTINGENCIES (Note 22)	—	—	—
MINORITY INTEREST	47,603	65,373	14,444
SHAREHOLDERS' EQUITY:			
Common stock: (2,096,975,792 shares with a par value of 0.1 rubles authorized and 1,993,326,138 shares issued as of December 31, 2003, 2002 and 2001, 345,244,080 of which are in the form of ADS (Note 1)	50,558	50,558	50,558
Treasury stock (9,929,074 as of December 31, 2003 and 9,966,631 as of December 31, 2002 and 2001 common shares at cost) (Note 17)	(10,197)	(10,206)	(10,206)
Additional paid-in capital	559,911	558,102	555,794
Unearned compensation (Note 17)	(869)	(212)	—
Shareholder receivable (Note 12)	(27,610)	(34,412)	(38,958)
Accumulated other comprehensive income (Note 2)	7,595	—	—
Retained earnings	1,144,522	738,214	461,091
Total shareholders' equity	1,723,910	1,302,044	1,018,279
Total liabilities and shareholders' equity	$4,225,351	$2,264,963	$1,727,492

The accompanying notes to consolidated financial statements are an integral part of these statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001

(Amounts in thousands of U.S. dollars, except share and per share amounts)

	2003	2002	2001
NET REVENUES:			
Service revenues	$ 2,435,717	$ 1,274,287	$ 830,308
Connection fees	29,372	24,854	21,066
Equipment sales	81,109	62,615	41,873
	2,546,198	1,361,756	893,247
COST OF SERVICES AND PRODUCTS, exclusive of depreciation shown separately below (including related party amounts of $37,680, $31,607 and $30,537, respectively):			
Interconnection and line rental	187,270	113,052	75,278
Roaming expenses	113,838	83,393	68,387
Cost of equipment	173,071	90,227	39,828
	474,179	286,672	183,493
OPERATING EXPENSES (including related party amounts of $11,002, $9,602 and $8,882, respectively) (Note 19):	406,722	229,056	134,598
SALES AND MARKETING EXPENSES (including related party amounts of $23,668, $12,140 and $8,707, respectively):	326,783	171,977	107,729
DEPRECIATION AND AMORTIZATION	415,916	209,680	133,318
IMPAIRMENT OF INVESTMENT (Note 20)	—	—	10,000
Net operating income	922,598	464,371	324,109
CURRENCY EXCHANGE AND TRANSLATION (GAINS) LOSSES	(693)	3,474	2,264
OTHER EXPENSES/(INCOME) (including related party amounts of $6,161, $5,141 and $2,978, respectively):			
Interest income (Note 6)	(18,076)	(8,289)	(11,829)
Interest expense	106,551	44,389	6,944
Other expense (income), net	3,420	(2,454)	(2,672)
Total other expenses (income), net	91,895	33,646	(7,557)
Income before provision for income taxes and minority interest	831,396	427,251	329,402
PROVISION FOR INCOME TAXES (Note 15)	242,480	110,417	98,128
MINORITY INTEREST	71,677	39,711	7,536
NET INCOME before cumulative effect of a change in accounting principle	517,239	277,123	223,738
Cumulative effect of a change in accounting principle, net of income taxes of $9,644 (Note 3)	—	—	(17,909)
NET INCOME	$ 517,239	$ 277,123	$ 205,829
Weighted average number of common shares outstanding	1,983,374,949	1,983,359,507	1,983,359,507
Earnings per share, basic and diluted:			
Net income before cumulative effect of a change in accounting principle	$ 0.261	$ 0.140	$ 0.113
Net income	$ 0.261	$ 0.140	$ 0.104

The accompanying notes to consolidated financial statements are an integral part of these statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001

(Amounts in thousands of U.S. dollars)

	2003	2002	2001
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	$ 517,239	$ 277,123	$ 205,829
Adjustments to reconcile net income to net cash provided by operating activities:			
Minority interest	71,677	39,475	7,536
Depreciation and amortization	415,916	209,680	133,318
Amortization of deferred connection fees	(29,372)	(24,854)	(20,027)
Equity in net loss of associates	(2,670)	—	—
Cumulative effect of a change in accounting principle	—	—	17,909
Gain on debt extinguishment	—	—	(2,780)
Inventory obsolescence expense	3,307	5,614	2,543
Provision for doubtful accounts	32,633	7,047	3,219
Deferred taxes	(43,001)	(18,989)	(39,964)
Non-cash expenses associated with stock bonus and stock option plans	213	23	—
Impairment of investment	—	—	10,000
Changes in operating assets and liabilities:			
Increase in trade receivables	(64,597)	(18,945)	(7,181)
Decrease/(Increase) in accounts receivable, related parties	213	(1,360)	(3,091)
Increase in inventory	(14,737)	(18,186)	(4,129)
Increase in prepaid expenses	(11,029)	(2,634)	(8,552)
Increase in VAT receivable	(50,230)	(64,154)	(59,618)
(Increase)/Decrease in other current assets	(8,122)	(7,422)	1,613
(Decrease)/Increase in accounts payable, related parties	(1,417)	81	1,049
Increase/(Decrease) in trade accounts payable	2,673	(16,058)	20,470
Increase in subscriber prepayments and deposits	76,861	46,064	49,980
Increase/(Decrease) in income tax payable	7,141	(19,778)	10,753
Increase in accrued liabilities and other payables	63,286	20,045	19,324
Net cash provided by operating activities	965,984	412,772	338,201
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisitions of subsidiaries, net of cash acquired	(667,206)	(143,396)	(75,858)
Purchases of property, plant and equipment	(839,165)	(502,054)	(396,667)
Purchases of intangible assets	(119,606)	(72,218)	(44,533)
Purchases of short-term investments	(215,000)	—	(110,000)
Proceeds from sale of short-term investments	—	55,304	195,602
Investments in and advances to associates	(69,110)	(35,557)	(10,067)
Net cash used in investing activities	(1,910,087)	(697,921)	(441,523)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of notes	1,097,000	50,808	248,135
Notes issuance cost	(9,556)	(649)	(3,856)
Capital lease obligation principal paid	(22,646)	(1,804)	(7,947)
Dividends paid	(110,864)	—	(2,959)
Proceeds from loans	712,716	52,851	13,577
Loan principal paid	(677,374)	(7,008)	(13,683)
Payments from Sistema	8,269	6,619	14,325
Net cash provided by financing activities	997,545	100,817	247,592
Effect of exchange rate changes on cash and cash equivalents	2,273	(636)	(469)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS:	55,715	(184,968)	143,801
CASH AND CASH EQUIVALENTS, beginning of year	34,661	219,629	75,828
CASH AND CASH EQUIVALENTS, end of year	$ 90,376	$ 34,661	$ 219,629
SUPPLEMENTAL INFORMATION:			
Income taxes paid	$ 286,016	$ 147,346	$ 129,418
Interest paid	$ 79,824	$ 43,438	$ 4,096
Non-cash investing activities:			
Additions to network equipment and software under capital lease	$ 10,928	$ 18,917	$ 34,072
Payable related to business acquisition (Note 4)	$ 27,500	$ —	$ —

The accompanying notes to consolidated financial statements are an integral part of these statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001
(Amounts in thousands of U.S. dollars, except share amounts)

	Common Stock		Treasury Stock		Accumulated Other Comprehensive Income	Additional Paid-in Capital	Unearned Compen-sation	Share-holder Receivable	Retained Earnings	Total
	Shares	Amount	Shares	Amount						
BALANCES, December 31, 2000	1,993,326,138	$50,558	(9,966,631)	$(10,206)	$ —	$552,030	$ —	$(49,519)	$ 258,221	$ 801,084
Receivable from Sistema (Note 12):							—			
Increases for interest	—	—	—	—	—	3,764	—	(3,764)	—	—
Payments from Sistema	—	—	—	—	—	—	—	14,325	—	14,325
Net income	—	—	—	—	—	—	—	—	205,829	205,829
Dividends declared	—	—	—	—	—	—	—	—	(2,959)	(2,959)
BALANCES, December 31, 2001	1,993,326,138	50,558	(9,966,631)	(10,206)	—	555,794	—	(38,958)	461,091	1,018,279
Receivable from Sistema (Note 12):										
Increases for interest	—	—	—	—	—	2,073	—	(2,073)	—	—
Payments from Sistema	—	—	—	—	—	—	—	6,619	—	6,619
Issuance of stock options (Note 17)	—	—	—	—	—	235	(235)	—	—	—
Amortization of deferred compensation (Note 17)	—	—	—	—	—	—	23	—	—	23
Net income	—	—	—	—	—	—	—	—	277,123	277,123
BALANCES, December 31, 2002	1,993,326,138	50,558	(9,966,631)	(10,206)	—	558,102	(212)	(34,412)	738,214	1,302,044
Receivable from Sistema (Note 12):										
Increases for interest	—	—	—	—	—	807	—	(807)	—	—
Payments from Sistema	—	—	—	—	—	—	—	7,609	—	7,609
Issuance of stock options (Note 17)	—	—	—	—	—	1,002	(1,002)	—	—	—
Stock options exercised (Note 17)	—	—	37,557	9	—	—	—	—	—	9
Amortization of deferred compensation (Note 17)	—	—	—	—	—	—	345	—	—	345
Dividends declared (Note 1)	—	—	—	—	—	—	—	—	(110,931)	(110,931)
Cumulative translation adjustment net of income taxes	—	—	—	—	7,595	—	—	—	—	7,595
Net income	—	—	—	—	—	—	—	—	517,239	517,239
BALANCES, December 31, 2003	1,993,326,138	$50,558	(9,929,074)	$(10,197)	$7,595	$559,911	$ (869)	$(27,610)	$1,144,522	$1,723,910

The accompanying notes to consolidated financial statements are an integral part of these statements.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

1. DESCRIPTION OF BUSINESS

Business of the Group

OJSC Mobile TeleSystems and its subsidiaries ("MTS" or the "Group") is the leading provider of wireless telecommunication services in the Russian Federation ("RF") and Ukraine in terms of the number of subscribers and revenues. The Group has operated primarily in the GSM standard since 1994.

Open Joint-Stock Company Mobile TeleSystems ("MTS OJSC" or the "Company") was created on March 1, 2000, through the merger of Closed Joint-Stock Company Mobile TeleSystems ("MTS CJSC") and RTC CJSC, a wholly-owned subsidiary. MTS CJSC was formed in 1993 to design, construct and operate a cellular telecommunications network in Moscow and the Moscow region. The development of the network was achieved through green-field build-out in the regions for which the company was granted 900 or 1800 MHz ("GSM-900" and "GSM-1800") cellular licenses or through the acquisition of majority stakes in local GSM operators (see Note 21 Operating Licenses and Note 4 Businesses Acquired).

The Company's shares are traded in the form of American Depositary Shares ("ADS"). Each ADS represents 20 shares of common stock of the Company. In July 2000, The Company issued a total of 17,262,204 ADS, representing 345,244,080 common shares.

Ownership

As of December 31, 2003, 2002 and 2001, MTS' shareholders of record and their respective percentage direct interests were as follows:

	2003	2002	2001
Joint-Stock Financial Corporation "Sistema" ("Sistema")	41.0%	35.0%	35.0%
T-Mobile Worldwide Holding GmbH ("T-Mobile")	25.4%	36.4%	36.4%
VAST, Limited Liability Company ("VAST")	3.1%	3.1%	3.1%
Invest-Svyaz-Holding, Closed Joint-Stock Company	8.0%	8.0%	8.0%
ADS Holders	17.4%	17.4%	17.4%
GDR Holders	5.0%	—	—
All executive officers and directors	0.1%	0.1%	0.1%
	100.0%	100.0%	100.0%

Sistema owns 51.0% equity interest in VAST, a limited liability company incorporated under the laws of the Russian Federation; the remaining 49.0% interest is held by ASVT, a Russian open joint-stock company. Sistema's effective ownership in MTS was 50.6%, 44.6% and 44.6% at December 31, 2003, 2002 and 2001, respectively.

In March 2003, Sistema and T-Mobile (together, "the Shareholders") entered into a call option agreement, pursuant to which T-Mobile granted Sistema the option to acquire from it 199,332,614 shares of MTS, representing 10.0% of outstanding common stock of MTS. On April 26, 2003, Sistema exercised its option with T-Mobile to purchase an additional 6.0% of the outstanding common stock of MTS and purchased T-Mobile's 49.0% interest in Invest-Svyaz-Holding, bringing its interest in Invest-

Svyaz-Holding to 100.0%. Concurrently with this transaction, T-Mobile sold its holding of 5.0% in MTS on the open market in the form of Global Depositary Receipts (“GDRs”) listed on the London Stock Exchange.

In April 2003, Sistema issued $350.0 million 10.25% notes, due in 2008. These notes are collateralized by 193,473,900 shares of common stock of MTS OJSC.

On June 30, 2003, the Group approved cash dividends of $1.12 per ADS ($0.056 per share) for a total of $111.0 million. As of the date of these statements, dividends in the amount of $96.7 million, net of tax in the amount of $10.5 million, were paid.

On November 28, 2003, common shares of MTS OJSC were included by the Board of Moscow Interbank Currency Exchange (“MICEX”) into the MICEX “B” Quotation List.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NEW ACCOUNTING PRONOUNCEMENTS

Accounting principles

MTS maintains its accounting books and records in Russian rubles for its subsidiaries located in the Russian Federation and Ukrainian hryvnas for Ukrainian Mobile Communications (“UMC”) based on local accounting and tax legislation. The accompanying consolidated financial statements have been prepared in order to present MTS’ financial position and its results of operations and cash flows in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) and expressed in terms of U.S. dollars.

The accompanying consolidated financial statements differ from the financial statements used for statutory purposes in that they reflect various adjustments, not recorded on the entities’ books, which are appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP. The principal adjustments are related to revenue recognition, foreign currency translation, deferred taxation, consolidation, and depreciation and valuation of property and equipment and intangible assets.

Basis of consolidation

Wholly-owned subsidiaries and majority-owned subsidiaries where the Company has operating and financial control are consolidated. Those ventures where the Company exercises significant influence, but does not exercise operating and financial control are accounted for by the equity method. All significant intercompany accounts and transactions are eliminated upon consolidation. The Company’s share in net income of unconsolidated associates was insignificant for each of the three years in the period ended December 31, 2003, and is included in other income in the accompanying consolidated statements of operations. Results of operations of subsidiaries acquired are included in the consolidated statements of operations from the date of their acquisition.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

As of December 31, 2003, 2002 and 2001, MTS has investments in the following significant operating and holding entities:

	Accounting Method	December 31, 2003	2002	2001
Rosico[1]	Consolidated	—	100.0%	100.0%
ACC	Consolidated	100.0%	100.0%	100.0%
Telecom XXI	Consolidated	100.0%	100.0%	100.0%
Telecom-900	Consolidated	100.0%	100.0%	81.0%
SCS-900	Consolidated	88.5%	51.0%	41.3%
FECS-900	Consolidated	60.0%	60.0%	48.6%
Uraltel	Consolidated	99.8%	53.2%	43.1%
MTS Finance[2]	Consolidated	100.0%	100.0%	100.0%
BM Telecom	Consolidated	100.0%	100.0%	—
Kuban-GSM	Consolidated	100.0%	52.7%	—
Dontelecom	Consolidated	100.0%	100.0%	—
MTS-Barnaul	Consolidated	100.0%	100.0%	—
BIT	Consolidated	100.0%	100.0%	—
MTS-Capital	Consolidated	100.0%	—	—
UMC	Consolidated	100.0%	—	—
Sibchallenge	Consolidated	100.0%	—	—
TSS	Consolidated	100.0%	—	—
Volgograd Mobile	Equity	50.0%	—	—
Astrakhan Mobile	Equity	50.0%	—	—
Mar Mobile GSM	Consolidated	100.0%	—	—
Primtelefon	Equity	50.0%	—	—
MSS	Consolidated	83.5%	83.5%	83.5%
ReCom	Consolidated	53.9%	53.9%	53.9%
TAIF Telcom	Consolidated	52.7%	—	—
UDN-900	Consolidated	51.0%	51.0%	51.0%
Novitel	Consolidated	51.0%	51.0%	51.0%
MTS Belarus	Equity	49.0%	49.0%	—

(1) On June 9, 2003, the Group's wholly owned subsidiary, Rosico, merged into MTS OJSC pursuant to a shareholders' resolution approving the transaction.

(2) Represents beneficial ownership.

Translation methodology

Effective January 1, 2003, the Russian economy ceased to be considered hyperinflationary. Management believes that the U.S. dollar is the appropriate functional currency because the majority of its revenues, costs, property and equipment purchased, and debt are either priced, incurred, payable or otherwise measured in U.S. dollars. Each of the legal entities domiciled in Russia, Ukraine and Belarus maintains its records and prepares its financial statements in the local currency, principally either Russian ruble, Ukrainian hryvna or Belarusian ruble, in accordance with the requirements of local statutory accounting and tax legislation.

Translation (re-measurement) of financial statements denominated in local currencies into U.S. dollars has been performed in accordance with the provisions of Statement of Financial Accounting Standard (''SFAS'') No. 52 ''Foreign currency translation''.

For subsidiaries of the Group where functional currency is the U.S. dollar, monetary assets and liabilities have been translated at the period end exchange rates. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows have been translated at historical rates. Translation differences resulting from the use of these rates have been accounted for as currency translation gains and losses in the accompanying consolidated statements of operations.

For UMC and Kuban-GSM where functional currency is the local currency, Ukrainian hryvna and Russian ruble, respectively, a ''new cost basis'' for all non-monetary assets has been established as of January 1, 2003. All year end balance sheet items have been translated into U.S. dollars at the period end exchange rate. Revenues and expenses have been translated at period average exchange rate. Cumulative translation adjustments in the amount of $7,595, net of income taxes were recorded directly in the consolidated statement of shareholders' equity.

Management 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 at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Examples of significant estimates include the allowance for doubtful accounts, the recoverability of intangible assets and other long-lived assets, and valuation allowances on deferred tax assets.

Cash and cash equivalents

Cash represents cash on hand and in MTS' bank accounts and short-term investments having original maturities of less than three months.

Short-term investments

Short-term investments represent investments in time deposits, which have original maturities in excess of three months but less than twelve months. These investments are being accounted for at cost.

Allowance for doubtful accounts

MTS provides an allowance for doubtful accounts based on management's periodic review of accounts receivable from customers and other receivables.

Prepaid expenses

Prepaid expenses are primarily comprised of advance payments made for inventory and services to vendors.

Inventory

Inventory, accounted for at lower of cost, determined by the first-in, first-out, or FIFO method, or market, consists of telephones and accessories, held for sale and spare parts, to be used for equipment maintenance within next twelve months and other inventory items.

Telephones and accessories, held for sale, are written down to their market values based on specific monthly reviews of significant inventoried items and are expensed as cost of equipment.

Value-added taxes (VAT)

Value-added taxes related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales.

Property, plant and equipment

Property, plant and equipment with a useful life of more than one year are capitalized at historical cost and depreciated on a straight-line basis over their expected useful lives as follows:

Network and base station equipment	5–12 years
Leasehold improvements	shorter of 10 years or lease term
Office equipment and computers	5 years
Buildings	50 years
Vehicles	4 years

Construction in progress and equipment held for installation are not depreciated until the constructed or installed asset is ready for its intended use.

Maintenance and repair costs are expensed as incurred, while upgrades and improvements that extend useful lives are capitalized.

License costs

License costs are capitalized as a result of (a) purchase price allocated to licenses acquired in business combinations (see Note 4 Businesses Acquired) and (b) licenses purchased directly from government organizations, which require license payments.

The Group's current operating licenses do not provide for automatic renewal upon expiration, as the Group and the industry do not have sufficient experience with the renewal of licenses, license costs are being amortized, subject to periodic review for impairment, on a straight-line basis over three to ten years starting from the date such license area becomes commercially operational.

Upon adoption of SFAS No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002, the Group reclassified $22.0 million relating to the 1998 acquisition of Rosico from goodwill to licenses.

Other intangible assets and Goodwill

Intangible assets represent various purchased software costs, telephone numbering capacity, acquired customer base and rights to use premises. A significant portion of the rights to use premises was contributed by shareholders to the Group's charter capital. Telephone numbering capacity costs with finite contractual life are being amortized over five to ten years and the rights to use premises are being amortized over ten years.

Software costs are amortized over four years. Acquired customer base is amortized over the estimated average subscriber life from 30 to 70 months. Other intangible assets are being amortized over three to four years. All finite-life intangible assets are being amortized using the straight-line method.

Telephone numbering capacity with unlimited contractual life is not amortized, but is reviewed, at least annually, for impairment in accordance with the provisions of SFAS No. 142. Amortization of deferred numbering capacity costs starts immediately upon the purchase of numbering capacity.

Goodwill represents the excess of the cost of business acquired over the fair market value of identifiable net assets at the date of acquisition, primarily related to MTS acquisition of Rosico in 1998 and UMC (see Note 4 Businesses Acquired).

In 2001, goodwill was amortized on a straight-line basis over seven years. Amortization expense during the year ended December 31, 2001 amounted to $6.1 million.

Upon adoption of SFAS No. 142 on January 1, 2002, the Group stopped amortizing goodwill. Goodwill is reviewed annually, as of the beginning of the fourth quarter, for impairment or whenever it is determined that impairment indicators exist. The Company determines whether an impairment has occurred by assigning goodwill to the reporting unit identified in accordance with SFAS No. 142, and comparing the carrying amount of the reporting unit to the fair value of the reporting unit. If a goodwill impairment has occurred, the Company recognizes a loss for the difference between the carrying amount and the implied fair value of goodwill. To date, no impairment of goodwill has occurred.

Leasing arrangements

The Group accounts for leases based on the requirements of SFAS No. 13, "Accounting for Leases." Majority of the Group's operating leases are for the premises. Certain subsidiaries of the Group lease switches, base stations and other cellular network equipment as well as billing systems. For capital leases, the present value of future minimum lease payments at the inception of the lease is reflected as an asset and a liability in the balance sheet. Amounts due within one year are classified as short-term liabilities and the remaining balance as long-term liabilities.

Subscriber acquisition costs

Subscriber acquisition costs represent the direct costs paid for each new subscriber enrolled through MTS' independent dealers. MTS expenses these costs as incurred. Prior to 2001, these costs were capitalized to the extent of any revenues that had been deferred from the acquisition of a subscriber, such as connection fees charged to a subscriber to initiate call service, and amortized as a component of sales and marketing expense on a straight-line basis over the estimated average subscriber life (see also Note 3 Change in Accounting Principle).

Investments impairment

Management periodically assesses the realizability of the carrying values of the investments and if necessary records impairment losses to write the investment down to fair value.

For the three years in the period ended December 31, 2003, no such impairments have occurred, except as discussed in Note 20 Investments In and Advances to Associates.

Debt issuance costs

Debt issuance costs are amortized using the effective interest method over the terms of the related debt.

Impairment of long-lived assets

MTS periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, MTS compares undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, MTS records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. For the three years in the period ended December 31, 2003, no such impairments have occurred.

Subscriber prepayments

The Group requires the majority of its customers to pay in advance for telecommunication services. All amounts received in advance of service provided are recorded as a subscriber prepayment liability and are not recorded as revenues until the related services have been provided to the subscriber.

Revenue recognition

Revenues are recognized on an accrual basis, when services are actually provided or title to equipment passes to customer, regardless of when the resulting monetary or financial flow occurs.

MTS categorizes the revenue sources in the statements of operations as follows:

- Service revenues: (a) subscription fees, (b) usage charge, (c) value added service fees, (d) roaming fees charged to other operators for guest roamers utilizing MTS' network and (e) prepaid phone cards;
- Connection fees;
- Equipment sales: (a) sales of handsets, and (b) sales of accessories.

Subscription fees

MTS recognizes revenues related to the monthly network fees in the month that the wireless service is provided to the subscriber.

Usage charges and Value added services fees

Usage charges consist of fees based on airtime used by subscriber, the destination of the call and the service utilized.

Value-added service fees are based on usage of airtime or volume of data transmitted for value added services, such as short message services, internet usage and data services. MTS recognizes revenues related to usage charges and value added services in the period when services were rendered.

Roaming fees

MTS charges roaming per-minutes fees to other wireless operators for non-MTS subscribers utilizing MTS' network. Guest roaming fees were $153,271, $83,393 and $52,639 for the years ended December 31, 2003, 2002 and 2001, respectively.

Prepaid phone cards

MTS sells to subscribers prepaid phone cards, separately from the handset. These cards allow subscribers to make a predetermined allotment of wireless phone calls and/or take advantage of other services offered by the Group, such as short messages and sending or receiving faxes.

At the time that the prepaid phone card is purchased, MTS records the receipt of cash as a subscriber prepayment. The Group recognizes revenues from the phone cards in the period when subscriber uses time under the phone card. Unused time on sold phone cards is not recognized as revenues until the related services have been provided to the subscriber or the prepaid phone card has expired.

In 2002, MTS introduced a new line of prepaid service tariff plans, whereby a customer may purchase a package that allows a connection to the MTS network and a predetermined allotment of wireless phone calls and/or other services offered by the Group. Revenues under these plans are allocated between connection fees and service fees based on their relative fair values.

Connection fees

MTS defers initial connection fees from the moment of initial signing of the contract with subscribers over the estimated average subscriber life. The Group estimates that the average expected term of the subscriber relationship is 39 months in Russia and 47 months in Ukraine (see also Note 11 Deferred Connection Fees).

Equipment sales

MTS sells handsets and accessories to customers who are entering into contracts for service and as separate distinct transactions. The Group recognizes revenues from the handsets and accessories when title passes to the customer. MTS records estimated returns as a direct reduction of sales at the time the related sales are recorded.

In Ukraine, MTS also from time to time sells handsets at prices below cost. MTS recognizes these subsidies in cost of equipment when sale is recorded.

Expense recognition

Expenses incurred by MTS in relation to the provision of wireless communication services mainly relate to interconnection and line rental costs, roaming expenses, costs of handsets and other accessories sold, depreciation and amortization and maintenance of the network.

Calls made by subscribers from areas outside of territories covered by the Group licenses are subject to roaming fees charged by the wireless provider in those territories. These fees are recorded as roaming expenses, as MTS acts as the principal in the transaction with the subscriber and bears the risk of non-collection from the subscriber. Roaming fees are charged to MTS subscribers based on Group's existing tariffs and recorded as service revenues.

The costs of handsets and accessories, whether sold to subscribers through the distribution channel or as part of the service contract, are expensed when title passes to the customer. Any fees paid to dealers as commissions are recorded as a component of sales and marketing expenses.

Taxation

Deferred tax assets and liabilities are recognized for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and loss or tax credit carryforwards using enacted tax rates expected to be in effect at the time these differences are realized. Valuation allowances are recorded for deferred tax assets for which it is more likely that these assets will not be realized.

Advertising costs

Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2003, 2002 and 2001 were $102,018, $48,624 and $42,715, respectively, and are reflected as a component of sales and marketing expenses in the accompanying consolidated statements of operations.

Government Pension Fund

Subsidiaries of the Group contribute to the local state pension fund and social fund, on behalf of all its employees.

In Russia, starting from January 1, 2001 all social contributions, including contributions to the pension fund, were substituted with a unified social tax ("UST") calculated by the application of a regressive rate from 35.6% to 2% of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 28% to 2%, respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

In Ukraine, the subsidiary of the Group is required to contribute a specified percentage of each employee payroll up to a fixed limit to Pension Fund, Unemployment Fund and Social Security Fund.

Earnings per share

Basic earnings per share ("EPS") have been determined using the weighted average number of shares outstanding during the year. Diluted EPS reflect the potential dilution of stock options, granted to employees. There are 4,797,410 stock options outstanding as of December 31, 2003.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

The following is the reconciliation of the share component for basic and diluted EPS:

	December 31,		
	2003	2002	2001
Weighted average number of common share outstanding	1,983,374,949	1,983,359,507	1,983,359,507
Dilutive effect of stock options	1,727,131	405,946	30,133
Weighted average number of common shares and potential shares outstanding	1,985,102,080	1,983,765,453	1,983,389,640

Fair value of financial instruments

The fair market value of financial instruments, consisting of cash and cash equivalents, accounts receivable and accounts payable, which are included in current assets and liabilities, approximates the carrying value of these items due to the short term nature of these amounts. The fair value of our publicly traded long-term notes as of December 31, 2003 ranged from 103.6% to 110.2% of the principal amount. As of December 31, 2003, fair value of other fixed rate debt including capital lease obligation approximated its carrying value. The fair value of variable rate debt is equivalent to carrying value.

Comprehensive income

Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. The following is the reconciliation of comprehensive income, net of income taxes:

	2003	2002	2001
Net income	$517,239	$277,123	$205,829
Cumulative translation adjustment	7,595	—	—
Total comprehensive income	$524,834	$277,123	$205,829

Comparative information

Certain prior years amounts have been reclassified to conform to the current year presentation.

Stock-based compensation

MTS accounts for stock options issued to employees, non-employee directors and consultants following the requirements of SFAS No. 123, "Accounting for Stock-Based Compensation" and SFAS No. 148 "Accounting for Stock Based Compensation—Transition and Disclosure, an amendment to FASB Statement No. 123." Under the requirements of these statements, compensation to employees and non-employee directors is measured based on the intrinsic value of options on the measurement date, calculated as a difference between the fair market value of stock and exercise price at that date. Compensation to consultants is measured based on the fair value of options on the measurement date as determined using a Black-Scholes option-pricing model.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

If the Group had elected to recognize compensation costs based on the fair values of options at the date of the grant, net income and earning per share amounts would have been as follows:

	December 31,		
	2003	2002	2001
Net income as reported	$517,239	$277,123	$205,829
Pro-forma effect of the application of fair value method of accounting for stock options	(727)	(460)	(129)
Pro-forma net income	$516,512	$276,663	$205,700
Earnings per share—basic and diluted			
As reported	$ 0.261	$ 0.140	$ 0.104
Pro-forma	$ 0.260	$ 0.140	$ 0.104

Recently adopted accounting pronouncements

In June 2001, Financial Accounting Standard Board ("FASB") issued SFAS No. 143, "Accounting for Asset Retirement Obligations." SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation is recorded in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depreciated over the asset's useful life. Changes in the liability resulting from the passage of time will be recognized as operating expense. The Group adopted SFAS No. 143 effective January 1, 2003. The adoption of SFAS No. 143 did not have a material impact on the Group's financial position or results of operations.

In April 2002, FASB issued SFAS No. 145, "Rescission of FASB Statements Nos. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections". SFAS No. 4, "Reporting Gains and Losses from Extinguishments of Debt," addressed statement of operations classification of gains and losses from extinguishment of debt. SFAS No. 64 amended SFAS No. 4 and is no longer necessary due to the rescission of SFAS No. 4. SFAS No. 145 also amended SFAS No. 13 "Accounting for Leases," to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required sale-leaseback accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. Following the adoption of the requirements of SFAS No. 145 effective January 1, 2003, MTS reclassified a gain on the extinguishment of a credit facility with OJSC AB Inkombank of $2.8 million and the related income tax expense of $0.7 million from extraordinary gain on debt repayment to other income and income tax expense, respectively, in the consolidated statement of operations for the year ended December 31, 2001.

In June 2002, FASB issued SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities," which requires the recognition of a liability when incurred for costs associated with an exit or disposal activity. The fundamental conclusion reached by the FASB in this Statement is that an entity's commitment to a plan, by itself, does not create a present obligation to others that meets the definition of a liability. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. The Group adopted the provisions of SFAS No. 146 effective January 1, 2003. The adoption of SFAS No. 146 did not have a material impact on the Group's financial position or results of operations.

In November 2002, FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires that the guarantor recognizes, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing such guarantee. FIN 45 also requires additional disclosures about the guarantor's obligations under certain guarantees that it has issued. The Group adopted the initial recognition and measurement provisions of this interpretation on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not have a material impact on the Group's financial position or results of operations.

In November 2002, the Emerging Issues Task Force ("EITF") issued a final consensus on EITF Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." EITF Issue No. 00-21 provides guidance on when and how an arrangement involving multiple deliverables should be divided in separate units of accounting. The Group adopted the requirements of EITF Issue No. 00-21 prospectively for arrangements entered into after June 15, 2003. The adoption of EITF Issue No. 00-21 did not have a material impact on the Group's financial position or results of operations.

In April 2003, FASB issued SFAS No. 149, "Amendments of FASB Statements No. 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 clarifies under what circumstances a contract with an initial investment meets the characteristic of a derivative, clarifies when a derivative contains a financing component, amends the definition of an underlying and certain other existing pronouncements. The Group adopted the requirements of SFAS No. 149 for contracts entered into or modified and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on the Group's financial position or results of operations.

In May 2003, FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity". SFAS No. 150 requires issuers to classify as liabilities (or assets in some circumstances) certain classes of freestanding financial instruments that embody obligations for the issuer, including mandatory redeemable financial instruments, obligations to repurchase the issuer's equity shares by transferring assets and certain obligations to issue a variable number of shares. The Group adopted SFAS No. 150 effective July 1, 2003. The adoption of SFAS No. 150 did not have a material impact on the Group's financial position or results of operations.

New accounting pronouncements

In December 2003, the FASB issued a revision to Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46R" or the "Interpretation"). FIN 46R clarifies the application of ARB No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both.

Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public companies, to the end of the first reporting period ending after March 15, 2004, except that all public companies must at a minimum apply the provisions of the Interpretation to entities that were previously considered "special-purpose entities" under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

The Group is evaluating whether the adoption of FIN 46 will have a material impact on its financial position, cash flows and results of operations. The Group did not enter into any transactions under the scope of FIN 46R after February 1, 2003.

In December 2003, the Securities Exchange Commission ("SEC") issued Staff Accounting Bulletin ("SAB") No. 104, Revenue Recognition. SAB 104 updates portions of the interpretive guidance included in Topic 13 of the codification of Staff Accounting Bulletins in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The Group believes it is following the guidance of SAB 104.

3. CHANGE IN ACCOUNTING PRINCIPLE

Effective January 1, 2001, the Group changed its accounting principle regarding recognition of subscriber acquisition costs. Subscriber acquisition costs represent the direct costs paid for each new subscriber enrolled through MTS' independent dealers. Prior to the 2001, these costs were capitalized to the extent of any revenues that had been deferred from the acquisition of a subscriber, such as connection fees charged to a subscriber to initiate call service, and amortized as a component of sales and marketing expense on a straight-line basis over the estimated average subscriber life. MTS now expenses subscriber acquisition costs as incurred. This change of accounting principle was made to facilitate the comparison of MTS' results with other telecommunication companies.

As a cumulative effect of this change, the remaining balance of capitalized subscriber acquisition cost as of January 1, 2001 in the amount of $17,909 ($0.009 per basic and diluted share), net of $9,644 in taxes was expensed and included in income during the year ended December 31, 2001.

4. BUSINESSES ACQUIRED

Telecom XXI acquisition

In May 2001, MTS acquired 100% of the outstanding common stock of Telecom XXI, a Russian closed joint-stock company, for cash consideration of $49.7 million. Telecom XXI has GSM-900 and GSM-1800 licenses, covering northwest of Russia, including St. Petersburg and Leningrad region as well as Kaliningrad. Telecom XXI did not have any subscribers at the date of the acquisition. The Telecom XXI acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

Current assets	$ 849
Non-current asset	1,322
License costs	74,639
Current liabilities	(944)
Deferred taxes	(26,124)
Purchase price	$ 49,742

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

License costs are amortized over the remaining term of the license of approximately 7 years at the date of the acquisition.

Telecom-900 acquisition

In August 2001, MTS acquired 81% of the outstanding common stock of Telecom-900, a Russian closed joint-stock company, for a cash consideration of $26.8 million from Sistema. Telecom-900 is the holding company for three regional mobile phone operators, Siberia Cellular System 900 CJSC (“SCS-900”), Uraltel CJSC (“Uraltel”), and Far East Cellular Systems 900 CJSC (“FECS-900”). At the date of acquisition, these companies had approximately 96,000 subscribers and licenses to provide GSM 900/1800 mobile services in the Novosibirsk region, Altai Republic, Sverdlovsk region and Khabarovsk region.

Telecom-900 acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

Current assets	$ 12,136
Non-current assets	29,297
License costs	31,542
Current liabilities	(21,883)
Non-current liabilities	(10,626)
Deferred taxes	(7,754)
Minority interest	(5,900)
Purchase price	$ 26,812

In November 2002, MTS acquired the remaining 19% of Telecom-900 from Invest-Svyaz-Holding, a shareholder of the Group and a wholly owned subsidiary of Sistema, for a cash consideration of $6.9 million. The acquisition was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by $2.7 million.

On August 13, 2003, Telecom-900 completed the purchase of the 43.7% and 2.95% stakes in Uraltel for a cash consideration of $35.7 million. The transaction increased Telecom-900’s ownership in Uraltel to 99.85%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by $24.5 million.

In November 2003, the Group completed the purchase of the 30% stake in SCS-900 from Sibirtelecom for cash consideration of $28.6 million. The Group’s acquisition of this stake increased its ownership in SCS-900 to 81.0%. On December 29, 2003, the Group acquired for cash consideration of $9.3 million a 100% stake in ILIT LLC, a company which owns a 7.5% stake in SCS-900, increasing its ownership in SCS-900 to 88.5%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by $25.7 million.

License costs are amortized over the remaining contractual terms of the respective license, ranging from 6 to 10 years at the date of the first acquisition.

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

Kuban-GSM acquisition

In March 2002, MTS acquired 51% of Kuban-GSM, a Russian closed joint-stock company, for cash consideration of $71.4 million. At the date of acquisition, Kuban-GSM had approximately 500,000 subscribers. It operates in thirteen major cities throughout the south of the European part of the Russian Federation, including Sochi, Krasnodar and Novorossiisk. The Kuban-GSM acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

Current assets	$ 11,751
Non-current assets	80,848
License costs	62,549
Acquired customer base	3,561
Current liabilities	(31,289)
Non-current liabilities	(19,827)
Deferred taxes	(15,866)
Minority interest	(20,327)
Purchase price	$ 71,400

In October 2002, MTS exercised its option to buy additional 353 shares for $5.0 million payable in cash, increasing its ownership in Kuban-GSM to 52.7%. The acquisition of the additional interest was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by $4.4 million, increased customer base cost by $0.2 million, and decreased minority interest by $0.5 million.

In September 2003, the Group acquired 100.0% of Kubtelesot for cash consideration of $107.0 million. Kubtelesot owned 47.3% of Kuban-GSM, and the Group's purchase of this stake increased its ownership in Kuban-GSM to 100.0%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by $57.5 million, increased customer base cost by $8.4 million, and decreased minority interest by $59.0 million.

License costs are amortized over the remaining contractual term of the license of approximately 5 years at the date first of the acquisition. Acquired customer base is amortized over the average remaining subscribers life of approximately 70 months.

BM Telecom acquisition

In May 2002, MTS completed its acquisition of 100% of the outstanding common stock of Ufa-based BM Telecom, a closed joint-stock company, for $41.0 million in cash. At the date of acquisition, BM Telecom had approximately 100,000 subscribers and it holds a GSM-900/1800 license to operate in Bashkortostan Republic of Russia. This acquisition was accounted for by the purchase method. The purchase price was allocated as follows:

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

Current assets	$ 3,312
Non-current assets	14,736
License costs	48,932
Current liabilities	(3,603)
Non-current liabilities	(10,227)
Deferred taxes	(12,150)
Purchase price	$ 41,000

License costs associated with the acquisition of BM Telecom are amortized over the remaining term of the license of approximately 5 years.

Dontelecom acquisition

On September 26, 2002, MTS completed its acquisition of 66.66% of the outstanding common stock of Dontelecom, a closed joint-stock company, for cash consideration of $15.0 million (including 33.33% acquired from Sistema for $7.5 million). At the date of acquisition, Dontelecom had approximately 39,000 subscribers. Dontelecom holds a GSM-900/1800 license to operate in the Rostov region. This acquisition was accounted for using the purchase method. The purchase price was allocated as follows:

Current assets	$ 3,422
Non-current assets	8,401
License costs	14,739
Current liabilities	(5,849)
Non-current liabilities	(357)
Deferred taxes	(3,675)
Minority interest	(1,681)
Purchase price	$15,000

In October 2002, the Group completed the acquisition of the remaining 33.33% of the outstanding common stock of Dontelecom for $7.5 million. The acquisition was accounted for using the purchase method of accounting. The purchase increased the recorded license costs by $7.3 million.

License costs are amortized over the remaining contractual term of the license of approximately 3 years at the date of the acquisition.

UMC acquisition

On March 4, 2003, MTS acquired 57.7% of the outstanding voting interest of UMC, a provider of mobile services in Ukraine, for cash consideration of $199.0 million, including the acquisition of 16.3% of the outstanding voting interest from Deutsche Telekom AG, a related party, for $55.0 million. Acquisition costs relating to the transaction of $1.4 million were capitalized. In connection with the acquisition, MTS also assumed debt of UMC with face value of approximately $65.0 million, with the fair value of approximately $62.0 million. At the date of acquisition, UMC had approximately 1.8 million subscribers.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

The acquisition was accounted for using the purchase method. For convenience, MTS consolidated UMC from March 1, 2003. Purchase price allocation is as follows:

Current assets	$ 82,293
Non-current assets	272,721
License costs	82,200
Acquired customer base	30,927
Current liabilities	(63,551)
Non-current liabilities	(78,580)
Deferred taxes	(27,425)
Minority interest	(99,581)
Purchase price	$199,004

MTS paid $171.5 million of the purchase price in cash and agreed to pay the balance of the purchase price of $27.5 million to Cetel B.V., a wholly owned subsidiary of Deutsche Telekom AG, within one year. The amount payable accrues interest of 9% per annum.

MTS also had an option agreement with Ukrtelecom to purchase its remaining 26.0% stake in UMC, exercisable from February 5, 2003 to November 5, 2005, with an exercise price of $87.6 million. On June 4, 2003, MTS exercised its call option. As a result of the transaction, MTS' ownership in UMC increased from 57.7% to 83.7%. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by $10.2 million, increased acquired customer base cost by $13.9 million, and decreased minority interest by $66.4 million.

In addition, MTS entered into a put and call option agreement with TDC Mobile International A/S ("TDC") for the purchase of its 16.3% stake in UMC. The exercise period of the call option was from May 5, 2003 to November 5, 2004, and the put option was exercisable from August 5, 2003 to November 5, 2004. The call option price was $85.0 million plus interest accrued from November 5, 2002 to the date of the exercise at 11% per annum; the price of the put option was calculated based on reported earnings of UMC prior to the exercise and was subject to a minimum amount of $55.0 million. On June 25, 2003, MTS notified TDC of its intent to exercise its rights under the put and call option agreement. The purchase was completed during July 2003. MTS paid cash consideration of approximately $91.7 million to purchase the remaining 16.3% stake in UMC. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by $52.7 million, increased customer base cost by $8.7 million, and decreased minority interest by $43.8 million.

The UMC license costs are amortized over the remaining contractual terms of the licenses of approximately 9 to 13 years at the date of the acquisition, acquired customer base is amortized over the average remaining subscriber's life of approximately 47 months. Other acquired intangible assets, represented mostly by software, are amortized over their respective useful lives of 3 to 10 years.

In accordance with SFAS No. 141 "Business Combinations," the Group recognized $8.0 million of goodwill relating to workforce-in-place.

(Amounts in thousands of U.S. dollars,
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UMC is one of the two leading mobile operators in Ukraine, operating under nationwide GSM 900/1800 and NMT 450 licenses. As at the date of purchase of the controlling stake, it was providing services to approximately 1.8 million subscribers.

TAIF Telcom acquisition

In April 2003, MTS acquired 51.0% of the common shares of TAIF Telcom, a Russian open joint-stock company, for cash consideration of $51.0 million and 50.0% of the preferred shares of TAIF Telcom for cash consideration of $10.0 million. In May 2003, MTS acquired an additional 1.7% of the common shares of TAIF Telcom for cash consideration of $2.3 million. In connection with the acquisitions, MTS also assumed indebtedness of approximately $16.6 million that is collateralized by telecom equipment.

MTS also entered into call and put option agreements with the existing shareholders of TAIF Telcom to acquire the remaining 49.0% of common shares and 50.0% of preferred shares of TAIF Telcom. The exercise period for the call option on common shares is 48 months from the acquisition date and for the put option on common shares is 36 months following an 18 month period after the acquisition date. The call and put option agreements for the common shares stipulate a minimum purchase price of $49.0 million plus 8% per annum commencing from the acquisition date. The exercise period for the call option on preferred shares is 48 months following a 24 month period after the acquisition date and for the put option on preferred shares it is a 24 month period after the acquisition date. The call and put option agreements for the preferred shares stipulate a minimum purchase price of $10.0 million plus 8% per annum commencing from the acquisition date.

If all of the options are exercised, MTS' share in TAIF Telcom will increase to 100.0%.

The purchase price allocation was as follows:

Current assets	$ 3,870
Non-current assets	48,391
License costs	68,407
Current liabilities	(26,099)
Non-current liabilities	(5,550)
Deferred taxes	(16,814)
Minority interest	(8,965)
Purchase price	$ 63,240

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 4 years.

TAIF Telcom provides mobile services in the GSM-900/1800 standard in the Republic of Tatarstan and in the Volga region of Russia. At the date of acquisition, TAIF Telcom had approximately 240,000 subscribers.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

Sibchallenge acquisition

On August 22, 2003, MTS completed the purchase of 100.0% of Sibchallenge, a cellular operator in the Krasnoyarsk region, for cash consideration of $45.5 million, paid a finder's fee of $2.0 million and assumed net debt of approximately $6.6 million. Sibchallenge holds licenses to provide GSM 900/1800 and DAMPS mobile services in the Krasnoyarsk region of Siberia, the Republic of Khakasiya, and in the Taimyr Autonomous region, all of which are located in the Siberian part of Russia. At the date of acquisition, Sibchallenge had approximately 132,000 subscribers.

The purchase price allocation was as follows:

Current assets	$ 4,078
Non-current assets	16,678
License costs	52,625
Current liabilities	(6,405)
Non-current liabilities	(6,628)
Deferred taxes	(12,894)
Purchase price	$ 47,454

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 8 years.

Tomsk Cellular Communications acquisition

In September 2003, MTS purchased 100.0% of Siberian operator Tomsk Cellular Communications ("TSS") for cash consideration of $47.0 million. TSS holds licenses to provide GSM 900/1800 mobile cellular communications in the Tomsk region. At the date of acquisition, TSS had approximately 183,000 subscribers.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

Current assets	$ 3,299
Non-current assets	11,412
License costs	49,282
Current liabilities	(4,543)
Non-current liabilities	(105)
Deferred taxes	(12,345)
Purchase price	$ 47,000

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 8 years.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

Acquisitions of various regional companies

On October 22, 2001 MTS acquired 51% of the outstanding common stock of Novitel, Russian closed joint-stock company for the total amount of $1.4 million. Novitel acquisition was accounted for using the purchase method of accounting.

In August 2003, the Group reached an agreement to acquire, in a series of related transactions, equity interests in five Russian regional mobile phone operators from MCT Corporation for a total of $71.0 million. The Group agreed to purchase a 43.7% stake in Uraltel (described above) and 100.0% of Vostok Mobile BV, which holds a 50.0% stake in Primtelefon. The Group also agreed to purchase Vostok Mobile South, which holds 50.0% stakes in Astrakhan Mobile and Volgograd Mobile, as well as an 80.0% stake in Mar Mobile GSM. The Group also entered into agreements to acquire the remaining 20.0% of Mar Mobile GSM and another 2.95% stake in Uraltel from existing shareholders unrelated to MCT Corporation for approximately $1.0 million.

On August 26, 2003, the Group completed the acquisition of Vostok Mobile BV and recorded a 50.0% stake investment in Primtelefon using equity method of accounting.

On October 14, 2003, the Group completed the purchase of Vostok Mobile South and thus acquired a 50.0% stake in Volgograd Mobile and Astrakhan Mobile and an 80.0% stake in Mar Mobile GSM. Also, in a separate transaction the Group completed the acquisition of the remaining 20.0% stake in Mar Mobile GSM from existing shareholders unrelated to MCT corporation, thus consolidating a 100.0% ownership in the company.

Pro forma results of operations (unaudited)

The following unaudited pro forma financial data for the years ended December 31, 2003 and 2002, give effect to the acquisitions of UMC, TAIF Telcom, Sibchallenge, TSS, Kuban-GSM and other various regional companies as if they had occurred at the beginning of the respective years.

	December 31,	
	2003	2002
Pro forma:		
Net revenues	$2,640,856	$1,714,532
Net operating income	925,149	544,917
Net income	583,222	342,595
Earnings per share, basic and diluted	$ 0.294	$ 0.173

The pro forma information is based on various assumptions and estimates. The pro forma information is not necessarily indicative of the operating results that would have occurred if the Group acquisitions had been consummated as of January 1, 2002, nor is it necessarily indicative of future operating results. The pro forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions. The actual results of operations of these companies are included in the consolidated financial statements of the Group only from the respective dates of acquisition.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

5. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2003, 2002 and 2001 comprised of the following:

	December 31,		
	2003	2002	2001
Ruble current accounts	$40,597	$19,860	$ 15,282
Ruble deposits	20,201	—	—
U.S. dollar deposits	886	7,999	195,000
U.S. dollar current accounts	20,130	6,404	7,578
Other	8,562	398	1,769
Total cash and cash equivalents	$90,376	$34,661	$219,629

6. SHORT-TERM INVESTMENTS

Short-term investments, denominated in U.S. dollars, as of December 31, 2003 comprised of the following:

	Annual interest rate	Maturity date	December 31, 2003
OJSC Moscow Bank of Reconstruction and Development	4.8%	February 2, 2004	$200,000
OJSC Moscow Bank of Reconstruction and Development	8.0%	October 4, 2004	10,000
OJSC Moscow Bank of Reconstruction and Development	8.4%	October 21, 2004	19,100
OJSC Moscow Bank of Reconstruction and Development	8.4%	November 23, 2004	5,000
OJSC Moscow Bank of Reconstruction and Development	8.4%	December 5, 2004	5,900
OJSC Moscow Bank of Reconstruction and Development	8.4%	December 20, 2004	5,000
Total short-term investments			$245,000

Short-term investments, denominated in U.S. dollars, as of December 31, 2002 comprised of the following:

	Annual interest rate	Maturity date	December 31, 2002
OJSC Moscow Bank of Reconstruction and Development	9.0%	October 22, 2003	$19,100
OJSC Moscow Bank of Reconstruction and Development	9.0%	November 21, 2003	5,000
OJSC Moscow Bank of Reconstruction and Development	9.0%	December 5, 2003	5,900
Total short-term investments			$30,000

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

Short-term investments, denominated in U.S. dollars, as of December 31, 2001 comprised of the following:

	Annual interest rate	Maturity date	December 31, 2001
OJSC Moscow Bank of Reconstruction and Development	6.1%	September 30, 2002	$30,000
OJSC Moscow Bank of Reconstruction and Development	6.1%	September 30, 2002	25,000
Sberbank	8.3%	June 28, 2002	10,000
Sberbank	8.3%	June 28, 2002	10,000
Sberbank	8.3%	June 28, 2002	10,000
Other			304
Total short-term investments			$85,304

OJSC Moscow Bank of Reconstruction and Development is a related party (see also Note 18 Related Parties).

7. TRADE RECEIVABLES

Trade receivables as of December 31, 2003, 2002 and 2001 were as follows:

	December 31,		
	2003	2002	2001
Accounts receivable, subscribers	$87,149	$29,505	$19,091
Accounts receivable, roaming	26,500	17,266	10,345
Allowance for doubtful accounts	(13,698)	(6,270)	(5,178)
Trade receivables, net	$99,951	$40,501	$24,258

The following table summarizes the changes in the allowance for doubtful accounts for the years ended December 31, 2003, 2002 and 2001:

	December 31,		
	2003	2002	2001
Balance, beginning of year	$ 6,270	$5,178	$1,959
Provision for doubtful accounts	32,633	7,047	3,219
Accounts receivable written off	(25,205)	(5,955)	—
Balance, end of year	$13,698	$6,270	$5,178

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

8. INVENTORY

Inventory as of December 31, 2003, 2002 and 2001 comprised of the following:

	December 31, 2003	December 31, 2002	December 31, 2001
Spare parts for base stations	$26,635	$15,519	$10,795
Handsets and accessories	23,499	18,056	6,232
Other inventory	17,157	7,811	9,157
Inventory	$67,291	$41,386	$26,184

Obsolescence expense for the years ended December 31, 2003, 2002 and 2001 amounted to $3,307, $5,614 and $2,543, respectively, and was included in operating expenses in the accompanying consolidated statements of operations.

9. PROPERTY, PLANT AND EQUIPMENT

The net book value of property, plant and equipment as of December 31, 2003, 2002 and 2001 was as follows:

	December 31, 2003	December 31, 2002	December 31, 2001
Network and base station equipment (including leased network and base station equipment of $66,311, $55,383 and $32,248, respectively)	$1,775,180	$ 959,465	$616,699
Leasehold improvements	6,582	4,299	7,233
Office equipment, computers, software and other (including leased office equipment, computers and software of $1,923, $1,739 and $1,824, respectively)	147,395	68,271	42,340
Buildings	144,680	96,420	37,412
Vehicles	11,611	7,607	4,931
Property, plant and equipment, at cost	2,085,448	1,136,062	708,615
Accumulated depreciation (including accumulated depreciation on leased equipment of $23,343, $13,420 and $9,995, respectively)	(532,268)	(299,216)	(168,989)
Equipment for installation	334,264	313,222	263,483
Construction in-progress	368,632	194,565	52,947
Property, plant and equipment, net	$2,256,076	$1,344,633	$856,056

Depreciation expenses during the years ended December 31, 2003, 2002 and 2001 amounted to $233.1 million, $116.0 million and $73.7 million, respectively, including depreciation expenses for leased property, plant and equipment in the amount of $7.6 million, $3.4 million and $1.6 million, respectively.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

10. OTHER INTANGIBLE ASSETS

Intangible assets at December 31, 2003, 2002 and 2001 comprised of the following:

		December 31, 2003			December 31, 2002			December 31, 2001		
	Useful lives	Gross Carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
Amortized intangible assets:										
Acquired customer base	30 to 70 months	$ 81,289	$ (18,307)	$ 62,982	$ 7,410	$ (955)	$ 6,455	$ 768	$ (79)	$ 689
Rights to use premises	10 years	19,638	(10,476)	9,162	11,752	(8,352)	3,400	11,752	(7,177)	4,575
Numbering capacity with finite contractual life, software and other	3 to 10 years	338,222	(119,269)	218,953	184,237	(69,582)	114,655	111,631	(45,697)	65,934
		439,149	(148,052)	291,097	203,399	(78,889)	124,510	124,151	(52,953)	71,198
Unamortized intangible assets:										
Numbering capacity with indefinite contractual life		13,047	—	13,047	13,047	—	13,047	13,047	—	13,047
Goodwill		8,533	—	8,533	533	—	533	533	—	533
Total other intangible assets		$460,729	$(148,052)	$312,677	$216,979	$(78,889)	$138,090	$137,831	$(52,953)	$84,778

As a result of a limited availability of local telephone numbering capacity in Moscow and the Moscow region, MTS has been required to enter into agreements for the use of telephone numbering capacity with several telecommunication operators in Moscow. Costs of acquiring numbering capacity with finite contractual life are amortized over period of five to ten years in accordance with the terms of the contract entered into to acquire such capacity. Numbering capacity with indefinite contractual life is not amortized.

The principal component of MTS' right to use premises was obtained in the form of contributions to its charter capital in 1993. These premises included MTS' administrative offices and facilities utilized for mobile switching centers.

Amortization expense for the years ended December 31, 2003, 2002 and 2001 amounted to $69.2 million, $30.0 million and $17.5 million, respectively. Based on the amortizable intangible assets existing at December 31, 2003, the estimated amortization expense is $122.7 million during 2004, $90.0 million during 2005, $51.3 million during 2006, $15.9 million during 2007, $3.1 million during 2008 and $8.1 million thereafter. 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.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

11. DEFERRED CONNECTION FEES

Deferred connection fees for the years ended December 31, 2003, 2002 and 2001 were as follows:

	December 31,		
	2003	2002	2001
Balance at beginning of the year	$ 41,904	$ 47,412	$ 31,553
Payments received and deferred during the year	34,112	19,346	35,886
Amounts amortized and recognized as revenue during the year	(29,372)	(24,854)	(20,027)
Balance at end of the year	46,644	41,904	47,412
Less current portion	21,467	22,210	21,419
Non-current portion	$ 25,177	$ 19,694	$ 25,993

MTS defers initial connection fees from the moment of initial signing of the contract with subscribers and recognizes the revenue over the estimated average subscriber life (see Note 2 Summary of Significant Accounting Policies and New Accounting Pronouncements).

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

12. DEBT

At December 31, 2003, 2002 and 2001, debt comprised of the following:

	Currency	Annual interest rate (Actual rate at December 31, 2003)	December 31, 2003	December 31, 2002	December 31, 2001	Available credit facilities as of December 31, 2003
9.75% Notes due 2008	USD	9.75%	$ 400,000	$ —	$ —	$ —
8.38% Notes due 2010	USD	8.375%	400,000	—	—	—
10.95% Notes due 2004	USD	10.95%	299,640	298,943	248,976	—
Floating Rate Notes due 2004	USD	LIBOR+4% (5.15%)	298,196	—	—	—
Total notes			**$1,397,836**	**$298,943**	**$248,976**	$ —
Less current portion			**597,836**	**—**	**—**	n. a.
Total long-term notes			**$ 800,000**	**$298,943**	**$248,976**	n. a.
ING Bank (Eurasia)	USD	LIBOR+4.15% (5.30%)	$ 60,000	$ —	$ —	$ —
Dresdner Bank	USD	LIBOR+3.20%–3.35% (4.35%–4.50%)	15,400	39,280	3,000	600
Ericsson	USD	LIBOR+4% (5.15%)	23,400	30,150	34,650	—
Deutsche Telekom AG	USD	LIBOR+5%–7% (6.22%–8.22%)	7,981	—	—	—
TDC Mobile International A/S	USD	LIBOR+5%–7% (6.22%–8.22%)	6,838	—	—	—
Citibank	USD	LIBOR+3.5% (4.65%)	10,000	9,000	—	—
West LB	EUR	EURIBOR+2% (4.17%)	5,092	4,000	—	—
KFW	EUR	LIBOR+0.95%–4% (2.41%–5.46%)	4,313	—	—	—
HSBC	USD	LIBOR+2.75% (3.88%)	25,000	—	—	—
Hermes Credit Facility	EUR	EURIBOR+0.65% (2.82%)	55,550	—	—	3,700
AVAL bank	UAH	10–16%	10,890	—	—	9,110
Motorola	USD	LIBOR+1.5% (2.72%)	1,361	6,181	6,372	—
Guta Bank	USD	7%–15%	1,511	—	—	
International Moscow Bank	RUR	13.4%	10,864	—	—	1,019
International Moscow Bank	USD	LIBOR+3.1%–3.45% (4.25%–4.60%)	—	5,000	10,000	—
MBRD	RUR	18.5%	1,220	—	—	448
Ruble denominated debt	RUR	13.4%–20%	5,860	30,334	—	7,500
Other debt	USD	7%–15%	450	3,124	745	—
Total debt			**$ 245,730**	**$127,069**	**$ 54,767**	**$ 22,377**
Less current portion			**103,312**	**67,098**	**18,825**	n. a.
Total long-term debt			**$ 142,418**	**$ 59,971**	**$ 35,942**	n. a.

The Notes

On December 21, 2001, MTS Finance S.A. ("MTS Finance"), a 100% beneficially owned subsidiary of MTS, registered under the laws of Luxembourg, issued $250.0 million 10.95% (effective interest rate of 11.25%) notes at the price of 99.254%. Proceeds received from the notes, net of underwriting discount, were $248.1 million. Related debt issuance costs in the amount of $3.9 million were capitalized. On March 20, 2002, MTS Finance issued additional $50.0 million 10.95% (effective interest rate of 10.25%) notes at a price of 101.616%. Proceeds received from these notes, including the offering premium, were $50.8 million. Related debt issuance costs in the amount of $0.6 million were capitalized. All the notes are fully and unconditionally guaranteed by MTS OJSC and mature on December 21, 2004. MTS Finance makes interest payments on the notes semi-annually in arrears on June 21 and December 21 of each year, commencing on June 21, 2002. The notes are listed on the Luxemburg Stock Exchange. In May 2002, these notes were registered with the SEC under the Securities Act of 1933.

On January 30, 2003, MTS Finance issued $400.0 million 9.75% notes at par. These notes are fully and unconditionally guaranteed by MTS OJSC and mature on January 30, 2008. MTS Finance is required to make interest payments on the notes semi-annually in arrears on January 30 and July 30, commencing on July 30, 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes were $400.0 million and related debt issuance costs of $3.9 million were capitalized.

On August 5, 2003, MTS Finance issued $300.0 million notes bearing interest at floating rate 3 months LIBOR+4% (5.15% at December 31, 2003) at the price of 99% (effective interest rate of 6.19% at December 31, 2003). These notes are fully and unconditionally guaranteed by MTS OJSC and mature on August 7, 2004. MTS Finance is required to make interest payments on the notes quarterly, commencing on November 5, 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes, net of underwriting discount, were $297.0 million and related debt issuance costs of $1.8 million were capitalized.

On October 14, 2003, MTS Finance issued $400.0 million notes bearing interest at 8.375% at par. The cash proceeds, net of issuance costs of approximately $4.6 million, amounted to $395.4 million. These notes are fully and unconditionally guaranteed by MTS OJSC and will mature on October 14, 2010. MTS Finance is required to make interest payments on the notes semi-annually in arrears on April 14 and October 14 of each year, commencing on April 14, 2004. The notes are listed on the Luxembourg Stock Exchange.

These notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, limitations on the Group's ability to enter into sales leaseback transactions, restriction on any merger, consolidation or disposition of assets, restrictions on the sales of any licenses. In addition, these notes provide the holders a right to require MTS Finance to redeem all of the notes outstanding at 101% of the principal amount of the notes plus accrued interest upon any change in control, as defined.

Ericsson debt restructuring

In December 1996, Rosico entered into a credit agreement with Ericsson Project Finance AB ("Ericsson") that provided for a credit facility with an aggregate principal amount of $60,000 and had a maximum term of five years (the "Ericsson Loan"). The loan was repayable in ten equal consecutive quarterly payments of $6.0 million commencing in 1999. On July 24, 2001 MTS, Rosico and Ericsson signed an amendment to the credit agreement rescheduling Rosico principal payments in nineteen consecutive quarterly installments. The amounts advanced under the agreement bear interest of LIBOR+4% (5.15% at December 31, 2003). If Rosico fails to pay any amount under this facility, the overdue interest would bear interest at a rate of additional 6% per annum. The credit agreement contains covenants restricting Rosico's ability to encumber its present and future assets and revenues without lender's express consent.

Concurrent with the Group's acquisition of Rosico, Sistema agreed to fund the full and timely repayment of the Ericsson Loan and to indemnify Rosico and MTS for any costs incurred by either Rosico or MTS in connection with the repayment of the Ericsson Loan. During 2000, Sistema and MTS agreed on a method that would allow Sistema to fund its obligation in a manner that minimizes the total costs of meeting this obligation (including related tax costs). Under this method, MTS enters into a long-term, ruble-denominated promissory notes with nil % interest and maturities from 2049 to 2052 to repay a portion of the funding from Sistema. The carrying value of these notes is insignificant at December 31, 2003 and 2002. The Group records interest expense on these notes over the term such that the full amount of the obligation will be reflected as a liability at the date of repayment. Through December 31, 2003, Sistema has made payments under this obligation in the amount of $55.6 million, $36.5 million of which are repayable in the form of long-term, ruble denominated promissory notes with nil % interest. Amounts receivable from Sistema under this indemnification are recorded as shareholder receivable in the accompanying consolidated balance sheets.

At December 31, 2003, 2002 and 2001, $23.4 million, $30.2 million and $34.7 million were outstanding, respectively, under the Ericsson Loan.

On February 25, 2003, Ericsson assigned all of its rights and obligations under the Ericsson Loan to Salomon Brothers Holding Company, Inc.

Dresdner Bank credit facilities

In November 2001, Telecom XXI entered into a credit facility with Dresdner Bank CJSC ("Dresdner Bank") to borrow up to $20.0 million. Amounts borrowed by Telecom XXI under this credit facility are repayable within one to six months from the disbursement date and the credit facility has a final repayment date of November 2003. The borrowings bear interest of LIBOR+3.2% (4.35% at December 31, 2003) per annum. Default interest is 12% per annum. The loan was fully repaid in November 2003.

In December 2001 and April 2002, UDN-900 entered into credit agreements with Dresdner Bank, expiring on April 2004. As of December 31, 2003, 2002 and 2001, the amounts outstanding under these agreements were $5.4 million, $4.3 million and $nil million, respectively. These borrowings bear interest at LIBOR+3.2% (4.35%, at December 31, 2003) per annum and are guaranteed by MTS OJSC.

In July 2002, MTS OJSC entered into a credit facility with Dresdner Bank. The credit facility allows borrowings up to $12.0 million with the final repayment date no later than June 1, 2004. The amount advanced under the facility bears interest of LIBOR+1.95% (3.10% at December 31, 2003) per annum. Default interest is 12% per annum. As of December 31, 2003 and 2002, nil and $5.0 million was outstanding under this credit facility, respectively.

In October 2002, MSS entered into a credit agreement with Dresdner Bank to borrow up to $10.0 million. As of December 31, 2003 and 2002, $10.0 million was outstanding under this agreement. Borrowings under this agreement bear interest of LIBOR+3.35% (4.50% at December 31, 2003) per annum and mature in October 2004. The loan is guaranteed by MTS OJSC.

ING Bank (Eurasia)

In September 2003, UMC entered into a $60.0 million syndicated credit facility with ING Bank (Eurasia) ZAO, ZAO Standard Bank and Commerzbank Aktiengesellschaft with an interest rate of LIBOR+4.15% (5.30% at December 31, 2003). The loan is guaranteed by MTS OJSC. The proceeds were used by UMC to refinance its existing indebtedness. The loan is payable in 8 equal quarterly installments starting from September 2004. As of December 31, 2003, the principal outstanding under this credit facility is $60.0 million.

Deutsche Telekom AG and TDC Mobile International A/C

The credit facilities with Deutsche Telekom AG and TDC bear interest at LIBOR+5% (6.22% at December 31, 2003) and LIBOR+7% (8.22% at December 31, 2003) and are redeemable in five equal quarterly installments commencing April 2003. During the year, UMC paid $2.1 million of interest on Deutsche Telekom loan. At December 31, 2003, the unpaid balance on these loans was $14.8 million. The amounts outstanding under these facilities were guaranteed by MTS OJSC. The debt was fully repaid in April 2004.

KFW

On December 21, 1998, UMC entered into two loan agreements with KWF, a German bank, for EUR 1.9 million (approximately $2.4 million as of December 31, 2003) and EUR 10.9 million (approximately $13.6 million as of December 31, 2003). These loans bear interest at LIBOR + 4% (5.46% at December 31, 2003) and LIBOR+0.95% (2.41% at December 31, 2003) per annum, respectively, and mature on March 31, 2004 and February 28, 2005, respectively. At December 31, 2003, the unpaid balance on these loans was $4.3 million.

HSBC Bank LLC

In October 2003, TAIF Telcom entered into a $25.0 million credit facility with HSBC Bank LLC which is guaranteed by MTS OJSC. The facility bears interest at LIBOR+2.75% (3.88% at December 31, 2003) and is redeemable in ten equal quarterly installments commencing on June 2004. The loan is subject to certain restrictive covenants including, but not limited to, restriction on the amount of dividends paid by TAIF Telcom until MTS owns 100% of TAIF Telcom's outstanding common stock. At December 31, 2003, the outstanding balance is $25.0 million.

Hermes Credit Facility (HECF)

On December 30, 2003, UMC entered into Hermes Credit Facility with ING BHF Bank and Commerzbank to finance the acquisition of GSM equipment from Siemens Aktiengesellschaft. The aggregate amount available under this credit facility is EUR 47.4 million ($59.3 million at December 31, 2003). The loan is guaranteed by MTS OJSC and bears interest at EURIBOR+0.65% (2.82% at December 31, 2003). The amount outstanding will be redeemable in 10 equal semi-annual installments, starting on July 31, 2004 or earlier, depending on the fulfillment on the credit agreement terms by the borrower. The balance outstanding at December 31, 2003 is EUR 44.5 million ($55.6 million).

AVAL Bank

On December 31, 2003, UMC had the balance of $10.9 million of overdraft with AVAL bank. The short-term overdraft facility is limited to 110.0 million hryvnas ($20.0 million at December 31, 2003), bears interest at 10–16% per annum and matures on June 30, 2004.

Citibank credit facility

In November 2002, Telecom XXI entered into a credit facility with Citibank. Amounts borrowed under the credit facility and outstanding at December 31, 2003 must be repaid in June 2004 and bear interest of LIBOR+3.5% (4.65% at December 31, 2003) per annum. Overdue amounts bear an additional 3% per annum. At December 31, 2003, $10.0 million is outstanding under this facility. The amount is guaranteed by MTS OJSC.

Guta Bank

In January 2003, TAIF Telcom entered into a credit facility agreement with Guta Bank to finance the purchase of telecommunications equipment. The maximum amount allowed to be borrowed under the facility is approximately $2.2 million. The loan bears interest at 7% to 15% per annum and matures in February 2007. The amount outstanding under this facility was $1.5 million as of December 31, 2003. The loan is collateralized by equipment with a net book value of $2.9 million as of December 31, 2003.

International Moscow Bank

In November 2001, Telecom XXI entered into a credit facility with the International Moscow Bank to borrow up to $15.0 million. Amounts borrowed under the credit facility must be repaid within two months of the first disbursement under the credit facility and will bear interest of LIBOR+ 3.1% (4.25% at December 31, 2003) per annum. Any overdue amount bears interest at a rate of 7.9% per annum. At December 31, 2003, 2002 and 2001, $nil million, $nil million and $10 million, respectively were outstanding under this agreement.

In February 2002, SSS-900 entered into a credit facility agreement with the International Moscow Bank to borrow up to $5.0 million for the purpose of current operations and financing of investment outlay, including payments for contract with Ericsson Radio Systems AB. The amount bears interest at LIBOR+3.45% (4.60% at December 31, 2003). The default interest rate is 7.5% per annum. The debt was redeemed in May 2003.

On June 9, 2003, Kuban GSM entered into a 350.0 million ruble (approximately $11.9 million at December 31, 2003) credit facility with International Moscow Bank. Amounts borrowed under this facility mature in June 2005 and have an interest rate of 13.4% until June 2004.

As of December 31, 2003, approximately $10.9 million was outstanding under this facility. The loan is collateralized by equipment with book value of approximately $15.5 million at December 31, 2003.

Moscow Bank of Reconstruction and Development (MBRD)

In 2003, Dontelecom entered into a ruble denominated loan agreement with MBRD, a related party. The amounts borrowed under this loan bear interest at rate of 18.5% and payable in June 2004. During the year 2003 Dontelecom paid interest of $0.1 million. As of December 31, 2003, the total amount payable under this loan agreement amounted to $1.2 million.

During the year 2003, MTS OJSC signed several short-term loan agreements with MBRD. Amounts borrowed were payable during the period of one to two months. During the year interest expense on these loans was approximately $0.3 million.

Rosbank loan

In February and March 2003, Kuban-GSM entered into ruble-denominated credit facilities with Rosbank permitting borrowings of up to approximately 245.0 million rubles (approximately $8.3 million at December 31, 2003). Borrowings under this agreement bear interest at rates varying from 18% to 20% per annum and are secured by a pledge of equipment. The facilities mature in February 2005 and March 2005. As of December 31, 2003, the amount outstanding under this agreement was $0.8 million.

WestLB International loan

In July 2002, MTS-P, a wholly-owned subsidiary of the Company, entered into a credit facility agreement with WestLB International S.A. As of December 31, 2003 and 2002, the amount of borrowings under this agreement was $5.0 and $4.0 million, respectively. Amounts outstanding under this agreement bear interest of EURIBOR+2% (4.17% at December 31, 2003) per annum for the first two years for each advance and 4% per annum for the remaining interest periods for each advance until maturity. Final maturity of this agreement is December 28, 2006. The loan is guaranteed by MTS OJSC.

Motorola loan

In October 1997, MSS issued promissory notes to Motorola Inc. for delivery and installation of GSM 900 cellular equipment in the Omsk region in the amount of $5.4 million. There promissory notes were due to be repaid on various dates through September 2001. On November 27, 2001, MSS entered into an agreement to restructure this liability. This restructuring established a new repayment schedule under which the notes and the accrued interest as of November 27, 2001 are being repaid in regular installments from February 2002 to May 2004, imputing an interest rate of approximately 2.7%. MSS' total payments under this agreement have not changed by greater than 10% due to this restructuring. As of December 31, 2003, 2002 and 2001, the amounts payable under these promissory notes were $1.4 million, $6.2 million and $6.4 million, respectively.

Dontelecom has a loan agreement with Motorola for GSM cellular equipment, principal and interest on which are payable semiannually. The amounts outstanding bear interest of 8.23% per annum. The loan was fully repaid in January 2003.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

The following table presents aggregate scheduled maturities of debt principal outstanding as of December 31, 2003:

Payments due in the year ended December 31,	
2004	$ 701,148
2005	69,974
2006	48,014
2007	16,128
2008	408,302
Thereafter	400,000
	$1,643,566

13. CAPITAL LEASE OBLIGATIONS

The following table presents future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2003:

Payments due in the year ended December 31,	
2004	$12,741
2005	7,217
2006	1,779
2007	32
2008	33
Thereafter	277
Total minimum lease payments (undiscounted)	22,079
Less amount representing interest	(5,311)
Present value of net minimum lease payments	16,768
Less current portion of lease payable	(9,122)
Non-current portion of lease payable	$ 7,646

For a schedule by years of future minimum lease payments under capital leases to Invest-Svyaz-Holding, a shareholder of the Group and a wholly-owned subsidiary of Sistema, together with the present value of the net minimum lease payments as of December 31, 2003, see Note 18 Related Parties.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

14. ACCRUED LIABILITIES

Accrued liabilities at December 31, 2003, 2002 and 2001 were comprised of the following:

	December 31,		
	2003	2002	2001
VAT	$ 33,545	$29,393	$31,213
Interest payable	32,911	1,500	13,781
Taxes other than income	31,139	31,810	1,636
Other accruals	46,194	11,216	4,996
Total accrued liabilities	$143,789	$73,919	$51,626

15. INCOME TAX

MTS' provision for income taxes was as follows for the respective periods ended:

	December 31,		
	2003	2002	2001
Current provision for income taxes	$285,481	$129,406	$138,092
Deferred income tax benefit	(43,001)	(18,989)	(39,964)
Total provision for income taxes	$242,480	$110,417	$ 98,128

From January 1, 2001, MTS' statutory income tax rate was 35%. In August 2001, a new law regarding taxation of income became effective. Under that law, effective from January 1, 2002, the statutory income tax rate was reduced to 24%. This reduction in the statutory income tax rate resulted in the recognition of a net deferred tax benefit of approximately $22.0 million in 2001.

From January 1, 2004, UMC statutory income tax rate changes from 30% to 25% as a result of changes in Ukranian legislation.

The statutory income tax rate reconciled to MTS' effective income tax rate is as follows for the respective periods ended:

	December 31,		
	2003	2002	2001
Statutory income tax rate for year	24.0%	24.0%	35.0%
Adjustments:			
Expenses not deductible for tax purposes	2.3	2.1	13.6
Tax allowance generated from investment in infrastructure	—	—	(8.3)
Effect of decrease in income tax rate	—	—	(6.6)
Effect of higher tax rate of subsidiary	0.9	—	—
Currency exchange and translation	1.6	—	—
Other	0.4	(0.3)	(3.9)
Effective income tax rate	29.2%	25.8%	29.8%

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities at December 31, 2003, 2002 and 2001:

	December 31,		
	2003	2002	2001
Assets (liabilities) arising from tax effect of:			
Deferred tax assets			
Depreciation of property, plant and equipment	$ 19,171	$ 13,606	$ 8,269
Deferred connection fees	8,805	10,057	10,910
Allowance for doubtful accounts	14,157	1,505	1,130
Loss carryforward (Rosico and MSS)	7,113	10,033	14,709
Other	25,158	8,050	2,914
	74,404	43,251	37,932
Valuation allowance	(7,113)	(12,695)	(25,892)
Total deferred tax assets	67,291	30,556	12,040
Deferred tax liabilities			
Licenses acquired	(170,162)	$ (91,606)	$(66,745)
Other	(33,334)	(14,212)	(760)
Total deferred tax liabilities	(203,496)	(105,818)	(67,505)
Net deferred tax liability	$(136,205)	$ (75,262)	$(55,465)
Net deferred tax assets, current	$ 44,423	$ 12,223	$ 5,802
Net deferred tax asset, long term	—	—	6,238
Net deferred tax liability, long term	$(180,628)	$ (87,485)	$(67,505)

Net change in valuation allowance for the years ended December 31, 2003, 2002 and 2001 were $5.6 million, $13.2 million and negative $8.2 million, respectively.

As of December 31, 2003, 2002 and 2001, Rosico and MSS were entitled to loss carryforwards in the amounts of $29,638, $41,803 and $61,286, respectively. These loss carryforwards resulted in deferred tax assets at December 31, 2003, 2002 and 2001 in the amounts of $7,113, $10,033 and $14,709, respectively. As Russian companies are required to file tax declarations on a standalone basis, MTS is not able to utilize these losses to offset its taxable income. While Rosico was merged into MTS OJSC in June 2003, the Group has still recorded a valuation allowance for the entire amount of the available tax loss carryforward related to Rosico as MTS has not yet performed all procedures necessary to determine what amounts will be available for deductions in the future. In addition in 2002 the Group recorded a valuation allowance for the lower of cost or market provision in the amount of $2,662 since it was more likely than not that the tax asset will not be realized.

The Group does not record a deferred tax liability related to undistributed earnings of UMC, as we intend to permanently reinvest these earnings. The undistributed earnings of UMC as of December 31, 2003 were $327.8 million.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

16. SHAREHOLDERS' EQUITY

In accordance with Russian laws, earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations, denominated in rubles, after certain deductions. Net income of MTS OJSC for the year ended December 31, 2003, 2002 and 2001 which is distributable under Russian legislation totaled 13,423.0 million rubles ($437.4 million), 10,759.0 million rubles ($343.3 million) and 8,587.0 million rubles ($294.4 million), respectively.

17. STOCK BONUS AND STOCK OPTION PLANS

On April 27, 2000, MTS established a stock bonus plan and stock option plan for selected officers, key employees and key advisors. Under this plan, directors, key employees and key advisors received the right to participate in a stock option plan under which they may receive options to purchase up to 9,966,631 of MTS common shares.

During 2003, 2002 and 2001, MTS made several grants pursuant to its stock option plan to employees and directors of the Group. These options are generally vested over a two year period from the date of the grant, contingent on continued employment with the Company. A summary of the status of the Group's stock option plan is presented below:

	Shares	Weighted average exercise price, U.S. dollar
Outstanding at January 1, 2001	—	—
Granted during 2001	1,829,221	1.31
Outstanding at December 31, 2001	1,829,221	1.31
Granted	2,846,681	1.49
Forfeited	(27,481)	1.31
Outstanding at December 31, 2002	4,648,421	1.42
Granted	1,952,632	2.43
Exercised	(37,557)	1.31
Exchanged for cash award	(1,746,310)	1.31
Forfeited	(19,776)	1.31
Outstanding at December 31, 2003	4,797,410	1.87

None of the options outstanding at December 31, 2003 and 2002 were exercisable. Options outstanding at December 31, 2003, have exercise price ranging from $1.49 to $2.43 per share and their weighted average remaining contractual life was approximately one year at December 31, 2003.

During 2003, 19,776 stock options were forfeited, and 1,746,310 options were exchanged for cash consideration of $2.9 million that was included in operating expenses in the consolidated statements of operations. Since the date of the grant total options amounting to 1,913, nil and 45,344 related to 2003, 2002 and 2001 grants, respectively, have been forfeited.

Fair values of options granted in 2003, 2002 and 2001 were $1.02, $0.50 and $0.36 per share, respectively, and were estimated using the Black-Scholes option pricing model. The risk free rates applied for 2003, 2002 and 2001 were 5.2%, 6.1% and, 15.5%, respectively. The following assumptions were applied to options granted in 2003, 2002 and 2001, respectively: (i) expected dividend yields of approximately 3.0%; (ii) expected volatility rates of 40.0%, 50.0% and 45.0%, and (iii) expected lives of 2 years.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

In accordance with the Russian legislation, MTS Board members and key employees may be considered insiders with respect to the Group and thus may be restricted from selling their shares.

18. RELATED PARTIES

Related party balances as of December 31, 2003, 2002 and 2001 comprised of the following:

	December 31,		
	2003	2002	2001
Accounts receivable:			
T-Mobile for roaming	$ 853	$1,374	$ 677
Strom Telecom for software	1,074	—	—
Receivables from investee companies	1,429	2,195	1,700
Total accounts receivable, related parties	$ 3,356	$3,569	$2,377
Accounts payable:			
Cetel B.V. for UMC shares	$27,500	$ —	$ —
T-Mobile for consulting services	—	—	1,970
T-Mobile other payables	—	—	1,266
MGTS for interconnection	704	630	106
Telmos for interconnection	—	184	207
MTU-Inform for interconnection	2,398	4,154	2,593
Sundry payables	1,302	—	—
Total accounts payable, related parties	$31,904	$4,968	$6,142

Transactions with major related parties are described below.

OJSC Moscow Bank of Reconstruction and Development (MBRD)

Starting August 2000, MTS has been keeping certain bank and deposit accounts with MBRD, whose major shareholder is Sistema. As of December 31, 2003, MTS' cash position at MBRD amounted to $279.7 million including $265.2 million in time deposits and $14.5 million in current accounts. As of December 31, 2002, MTS' cash position at MBRD amounted to $38.7 million including $34.0 million in time deposits and $4.7 million in current accounts. As of December 31, 2001, MTS' cash position at MBRD amounted to $112.4 million including $105.0 million in the time deposits and $7.4 million in a current account. The related interest accrued and collected on deposits for the years ended December 31, 2003, 2002 and 2001 amounted to $9.9 million, $5.1 million and $3.0 million, respectively, and was included as a component of interest income in the accompanying consolidated statements of operations.

Loans transactions with MBRD are described in Note 12 Debt.

Rosno OJSC

MTS arranged medical insurance for its employees and insured its property in the amounts of approximately $874.0 million, $781.0 million and $612.0 million in 2003, 2002 and 2001, respectively, with Rosno OJSC, whose significant shareholder is Sistema. Insurance premiums paid to Rosno OJSC for the years ended December 31, 2003, 2002 and 2001, amounted to $16.9 million, $4.9 million and $8.0 million, respectively, including premiums paid for medical insurance amounting to $5.0 million, $3.6 million and $2.5 million, respectively. Management believes that all of the insurance contracts with Rosno OJSC have been entered at market terms.

Maxima Advertising Agency (Maxima)

In 2001, 2002 and 2003, MTS had agreements for advertising services with Maxima. Advertising fees paid to Maxima for the years ended December 31, 2003, 2002 and 2001, were $24.7 million, $13.1 million and $8.7 million, respectively. Maxima is related to MTS through MTS' directors who are also members of Maxima's board of directors.

Telmos

In 2003, 2002 and 2001, MTS had interconnection arrangements with, and received domestic and international long-distance services from Telmos, a subsidiary of Sistema. Interconnection and line rental fees paid to Telmos for the years ended December 31, 2003, 2002 and 2001, were approximately $1.6 million, $1.3 million and $4.0 million, respectively. Management believes that these arrangements are at market terms.

Moscow City Telephone Network (MGTS)

In 2003, 2002 and 2001, MTS had line rental agreements with MGTS and rented cable plant from MGTS for installation of fiber-optic cable. MTS also rented buildings for administrative office, sales and marketing offices as well as premises for switching and base station equipment. Amounts paid under these agreements for the years ended December 31, 2003, 2002 and 2001, were approximately $5.0 million, $4.4 million and $1.5 million, respectively. In 2002 and 2001, MTS also purchased buildings from MGTS and paid $2.0 million and $2.6 million, respectively. Management believes that all these transactions were made at market terms. Sistema is the majority shareholder of MGTS.

MTU-Inform

In 2003, 2002 and 2001, MTS had interconnection and line rental agreements with MTU-Inform, a subsidiary at Sistema. Amounts paid under these agreements for the years ended December 31, 2003, 2002, and 2001, amounted to approximately $26.6 million, $24.1 million and $29.0 million, respectively. In 2003, 2002 and 2001 MTS also purchased telephone numbering capacity from MTU-Inform. Payments under these agreements for the years ended December 31, 2003, 2002 and 2001, amounted to $0.5 million, $1.6 million and $4.7 million, respectively. Management believes that these agreements are at market terms.

(Amounts in thousands of U.S. dollars,
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Comstar

In 2003 and 2002, MTS had interconnection and line rental agreements with Comstar, a subsidiary of Sistema. Amounts paid under these agreements for the years ended December 31, 2003, and 2002, amounted to approximately $4.0 million, and $3.2 million, respectively. Management believes that these agreements are at market terms.

T-Mobile

In 2003, 2002 and 2001, the Group had non-exclusive roaming agreements with T-Mobile, a shareholder of the Group. Payments made by MTS under these roaming agreements were approximately $1.1 million, $1.0 million and $0.7 million for the years ended December 31, 2003, 2002 and 2001, respectively.

As discussed in Note 12, UMC had $8.0 million payable to Deutsche Telecom AG, parent company of T-Mobile. As discussed in Note 4, at December 31, 2003 MTS had a payable related to the purchase of UMC for $27.5 million to Cetel B.V., a wholly owned subsidiary of Deutsche Telecom AG.

Invest-Svyaz-Holding

In 2003, 2002 and 2001, MTS entered into agreements with Invest-Svyaz-Holding, a shareholder of MTS and a wholly-owned subsidiary of Sistema, for leasing of network equipment and billing system. These leases were recorded as capital leases based on the requirements of SFAS No. 13, "Accounting for Leases." The present value of future lease payments is reflected as a liability in the balance sheet. Amounts due within one year are classified as current liabilities, and the remaining balance as long-term liabilities. The interest rate implicit in these leases varies from 11% to 44%, which management believes are market terms.

The following table summarizes the future minimum lease payments under capital leases to Invest-Svyaz-Holding together with the present value of the net minimum lease payments as of December 31, 2003:

Payments due in the year ended December 31,	
2004	$ 9,518
2005	6,786
2006	1,732
Total minimum lease payments (undiscounted)	18,036
Less amount representing interest	(4,892)
Present value of net minimum lease payments	13,144
Less current portion of lease obligations	(6,223)
Non-current portion of lease obligations	$ 6,921

In addition to the above lease transactions, the Group guarantees debt of Invest-Svyaz-Holding in the amount of $21.6 million to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to the Group. For the year ended December 31, 2003, leases to the Group amounted to approximately 99% of revenues of Invest-Svyaz-Holding.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

For the year ended December 31, 2003, principal and interest paid to Invest-Svyaz-Holding were $5.4 million and $3.3 million, respectively. Principal and interest paid to Invest-Svyaz-Holding for the year ended December 31, 2002 were $2.9 million and $1.4 million. Principal and interest paid to Invest-Svyaz-Holding for the period from the date of acquisition of Telecom-900 on August 10, 2001 through December 31, 2001, were $0.5 million and $0.1 million, respectively. Management believes that these agreements are at market terms.

Strom Telecom

During 2003 the Group entered into three agreements, for a total amount up to $32.3 million with Strom Telecom, an associate of Sistema. Pursuant to these contracts, the Group purchased a billing system and a communication software support system for approximately $23.7 million.

See Note 4 Businesses Acquired for other related parties transactions.

19. OPERATING EXPENSES

Operating expenses for 2003, 2002 and 2001, consisted of the following:

	December 31,		
	2003	2002	2001
Salaries and social contributions	$156,808	$ 84,706	$ 44,425
General and administrative	42,530	26,549	21,569
Taxes other than income taxes	40,432	39,119	25,312
Repair and maintenance	39,406	20,361	10,578
Provision for doubtful accounts	32,633	7,047	3,219
Rent	31,968	15,578	9,479
Billing and data processing	22,067	9,549	2,981
Consulting expenses	11,361	7,692	2,093
Insurance	7,351	6,774	5,258
Other operating expenses	22,166	11,681	9,684
Total operating expenses	$406,722	$229,056	$134,598

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

20. INVESTMENTS IN AND ADVANCES TO ASSOCIATES

At December 31, 2003, 2002 and 2001, the Group's investments in and advances to associates included, respectively, the following:

	December 31,		
	2003	2002	2001
MTS Belarus—loans receivable	$ 51,481	$30,089	$ —
MTS Belarus—equity investment	5,884	2,455	—
Primtelefon—equity investment	31,174	—	—
Astrakhan Mobile and Volgograd Mobile—equity investment	5,806	—	—
Astrakhan Mobile and Volgograd Mobile—loans receivable	6,850	—	—
Volgograd Mobile—loans receivable	204	—	—
MSS—note receivable	827	—	—
Receivables from other investee companies	1,359	1,490	740
Total investments in and advances to associates	$103,585	$34,034	$740

MTS Belarus

In September 2001, MTS won a tender initiated by the Telecommunications Ministry of the Republic of Belarus to form a joint venture, which will have a GSM-900/1800 license to operate in Belarus. In accordance with the tender, in November 2001 the Group made an initial $10.0 million payment to the government of Belarus.

From December 2001, soon after the date the Group was awarded the tender, it became increasingly apparent based upon various communications and correspondence that the Group would not be able to commence operations in Belarus as expected. The Company halted additional payments under the original agreement and expensed its initial $10.0 million investment, as it appeared probable that the investment would not be recoverable. This charge is reflected as an impairment of investment in the accompanying consolidated statements of operations for the year ended December 31, 2001.

As a result of additional negotiations, and a change in the Belarus government's position, effective June 26, 2002, the joint venture received all of the governmental approvals and licenses required to commence operations in Belarus. Subsequently, the Group continued investing in MTS Belarus.

As of December 31, 2003 and 2002 the Group provided MTS Belarus with a total of $51.5 million and $30.1 million in loans, respectively. These loans bear interest at 3% to 11% per annum. All loans outstanding as of December 31, 2002 have been repaid according to the original terms.

Based on projected future cash flows as well as other factors, management believes that no impairment of the Group's investments in Belarus is required as of December 31, 2003.

Primtelefon, Astrakhan Mobile and Volgograd Mobile

As described in Note 4 Businesses Acquired, in August 2003 the Group purchased equity interests in various Russian regional mobile operators, including stakes in Primtelefon, Astrakhan Mobile and Volgograd Mobile, as a part of its strategic business plans.

(Amounts in thousands of U.S. dollars,
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21. OPERATING LICENSES

In connection with providing telecommunication services, the Group has been issued various operating licenses by the Ministry of Communications. In addition to the licenses received directly from the Ministry of Communications, the Group was granted access to various telecommunication licenses through acquisitions. At December 31, 2003, 2002 and 2001, recorded values of the Group's telecommunication licenses were as follows:

	December 31, 2003	December 31, 2002	December 31, 2001
Moscow license area (MTS OJSC)	$ 255,812	$ 255,812	$248,903
North-Western region (Telecom XXI)	74,639	74,639	74,639
Krasnodar and Adigeya regions (Kuban-GSM)	124,396	66,919	—
Bashkortostan Republic (BM Telecom)	48,932	48,932	—
Five regions of Asian Russia (Telecom-900)	84,395	34,237	31,542
Rostov region (Dontelecom)	22,067	22,067	—
Krasnoyarsk region, Taimyr region and Khakassia Republic (Sibchallenge)	52,625	—	—
Tomsk region (TSS)	49,282	—	—
Tatarstand Republic (TAIF Telcom)	68,407	—	—
Ukraine (UMC)	151,857	—	—
Seven regions of European Russia	19,503	19,503	19,503
Other	8,212	8,212	3,808
Licenses, at cost	960,127	530,321	378,395
Accumulated amortization	(257,024)	(143,402)	(79,568)
Licenses, net	$ 703,103	$ 386,919	$298,827

Amortization expense for the years ended December 31, 2003, 2002 and 2001 amounted to $113.6 million, $63.7 million and $42.1 million, respectively.

Based on the licenses existing at December 31, 2003, the estimated amortization expense is $149.5 million during 2004, $145.3 million during 2005, $140.7 million during 2006, $106.6 million during 2007, $63.4 million during 2008 and $97.6 million thereafter. 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.

The following table summarizes GSM-900/1800 telecommunication licenses held by the Group at December 31, 2003:

	GSM-900		GSM-1800	
License region	Licensee	Expiry date	Licensee	Expiry date
Moscow License Area				
Moscow	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Moscow Region	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
St. Petersburg License Area				
St. Petersburg	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Leningrad Region	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008

(Amounts in thousands of U.S. dollars,
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	GSM-900		GSM-1800	
License region	Licensee	Expiry date	Licensee	Expiry date
Regional License Areas				
European Russia				
Adygeya Republic	Kuban-GSM	April 28, 2008	Kuban-GSM	April 28, 2008
Arkhangelsk	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Bashkortostan Republic	BM Telecom	August 22, 2007	BM Telecom	August 22, 2007
Belgorod	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Belgorod	ReCom	May 15, 2008		
Bryansk	ReCom	May 15, 2008	MTS OJSC	April 28, 2008
Chuvashia Republic(1)	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Dagestan Republic(1)	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Ivanovo	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Ingushetia Republic(1)	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Kabardino-Balkar Republic(1)	—	—	MTS OJSC	December 30, 2013
Kaliningrad	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Kalmykia Republic(1)	BIT	January 25, 2011	MTS OJSC	December 30, 2013
Kaluga	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Karachaevo-Cherkesia Republic(1)	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Karelia	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Kirov	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Komi Republic	MTS OJSC	August 22, 2007	MTS OJSC	April 28, 2008
Komi-Permyatsk(1)	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Kostroma	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Krasnodar Region	Kuban-GSM	May 30, 2007	Kuban-GSM	May 30, 2007
Kursk	ReCom	May 15, 2008	MTS OJSC	April 28, 2008
Lipetsk	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Lipetsk	ReCom	May 15, 2008	—	—
Mari-El Republic(1)	Mar Mobile GSM	January 15, 2012	Mar Mobile GSM	January 15, 2012
Mordovia Republic(1)	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Murmansk	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Nenetsk region	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Nizhny Novgorod	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Novgorod	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Orel	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Orel	ReCom	May 15, 2008	—	—
Orenburg	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Perm	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Rostov	Dontelecom	July 1, 2005	Dontelecom	July 1, 2005
Pskov	MTS OJSC	October 1, 2006	—	—
Pskov	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Ryazan	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Samara(1)	MTS OJSC	December 30, 2012	MTS OJSC	December 30, 2012
Saratov	MTS OJSC	July 11, 2012	MTS OJSC	July 11, 2012
Severnaya Osetia-Alania Republic(1)	—	—	MTS OJSC	December 30, 2013
Smolensk	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Stavropol region(1)	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Tambov	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008

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except share and per share amounts or if otherwise stated)

	GSM-900		GSM-1800	
License region	Licensee	Expiry date	Licensee	Expiry date
Tatarstan Republic	TAIF Telcom	June 26, 2007	TAIF Telcom	June 26, 2007
Tula	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Tver	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Udmurt Republic	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Udmurt Republic	UDN-900	February 21, 2007	—	—
Ulyanovsk[(1)]	—	—	MTS OJSC	December 30, 2013
Vladimir	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Vologda	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Voronezh	ReCom	May 15, 2008	MTS OJSC	April 28, 2008
Yaroslavl	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Asian Russia				
Altai Region	MTS-Barnaul	September 8, 2010	MTS-Barnaul	September 8, 2010
Altai Republic	SCS-900	July 19, 2011	MTS OJSC	December 30, 2013
Amur region	ACC	January 10, 2007	ACC	January 10, 2007
Chelyabinsk	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Chukotka[(1)]	BIT	July 19, 2011	—	—
Evenkia autonomous region[(1)]	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Kemerovo[(1)]	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Khabarovsk	FECS-900	January 10, 2007	FECS-900	January 10, 2007
Khakassia Republic	Sibchallenge	September 13, 2011	Sibchallenge	September 13, 2011
Khanty Mansiysk region	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Krasnoyarsk region	Sibchallenge	December 21, 2010	Sibchallenge	September 13, 2011
Kurgan	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Novosibirsk	SCS-900	February 21, 2007	SCS-900	February 21, 2007
Omsk	MSS	December 20, 2006	MSS	December 20, 2006
Sakhalin[(1)]	BIT	July 19, 2011	—	—
Sverdlovsk Region	Uraltel	March 1, 2006	Uraltel	March 1, 2006
Sverdlovsk Region	—	—	MTS OJSC	April 28, 2008
Taimyr autonomous region	Sibchallenge	December 21, 2010	Sibchallenge	September 13, 2011
Tomsk	TSS	June 5, 2008	TSS	June 5, 2008
Tyumen	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Tyva Republic[(1)]	BIT	July 19, 2011	MTS OJSC	December 30, 2013
Yamalo-Nenetsk region[(1)]	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Ukraine				
Ukraine	UMC	December 3, 2013	UMC	December 3, 2013

(1) The Group's regional license areas in which the licensee has not commenced commercial operations as at December 31, 2003.

Each of the Group's licenses, except the licenses covering the Moscow license area, contains a requirement for service to be commenced and for subscriber number and territorial coverage targets to be achieved by a specified date. The Group has met these targets or received extensions to these dates in those regional license areas in which the Group has not commenced operations. The management believes that the Group is in compliance with all material terms of our licenses.

The Group's operating licenses do not provide for automatic renewal. The Group has limited experience with the renewal of its existing licenses. However, management believes that licenses required for the Group's operations will be renewed upon expiration.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

22. COMMITMENTS AND CONTINGENCIES

Capital commitments—As of December 31, 2003, MTS had executed non-binding purchase agreements in the amount of approximately $266.1 million to subsequently acquire property, plant and equipment.

Operating lease—The Group has entered into lease agreements of space for telecommunication equipment and offices, which expire in various years up to 2052. Rental expenses under these operating leases of $32.0 million, $15.6 million and $9.5 million for the years ended December 31, 2003, 2002 and 2001, respectively, are included in operating expenses in the accompanying statements of operations. Future minimum lease payments due under non-cancelable leases at December 31, 2003 were:

Payments due in the 12 months ended December 31,	
2004	$10,248
2005	4,497
2006	2,924
2007	1,932
2008	1,376
Thereafter	12,389
Total	$33,366

Operating licenses—When MTS commenced its operations in 1994, licenses generally contained certain provisions for unspecified fees to be paid for utilization of frequencies. Most of MTS current licenses now provide for payments to be made for finance telecommunication infrastructure improvements, which in the aggregate could total approximately $110.2 million, as at December 31, 2003. However, a decision on the terms and conditions of such payments has not been finalized. Accordingly, MTS has not made any payments to date pursuant to any of current operating licenses. Further, management believes that MTS will not be required to make any such payments. If such payments would be required in the future, management believes that it would be limited to purchasing certain equipment for its own use in the related license area. In relation to these uncertainties, MTS has not recorded a contingent liability in the accompanying financial statements.

Provision for doubtful accounts—The increase in the provision for doubtful accounts to $32.6 million at December 31, 2003 from $7.0 million at December 31, 2002 was primarily attributable to a $16.7 million provision related to dealer and subscriber fraud. Certain dealers and subscribers together fraudulently exploited billing time lags by placing a sizeable amount of domestic and international long-distance calls using subscriber accounts registered under false names. MTS discovered the fraud in March 2003 and has taken measures to prevent further fraud of this nature.

Issued guarantees—As of December 31, 2003 the Group has issued guarantees to third party banks for the loans taken by Invest-Svyaz-Holding, a shareholder of the Group and a wholly-owned subsidiary of Sistema for a total amount of $21.6 millions (see also Note 18 Related Parties). The Group issued additional guarantees on behalf of MTS-Belarus, an equity investee, for the total amount of $14.5 million. Under these guarantees the Group could be potentially liable for a maximum amount of $36.1 in case of the borrower's default under the obligations. The guarantees expire by August 2005.

As of December 31, 2003 no event of default has occurred under any of the guarantees issued by the Group.

Contingencies—The Russian economy continues to display certain traits consistent with that of an emerging market. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be subject to the government's continued actions with regard to supervisory, legal, and economic reforms.

On January 1, 2004, a new Law on telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. The Group cannot predict with any certainty how the new law will affect MTS. The new law creates a new interconnect pricing regime in 2004 that should be more transparent and unified and it creates a universal service charge calculated as a percentage of revenue which will be introduced from 2005. The new law may increase the regulation of the MTS's operations and until the time when appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax (''VAT''), corporate income tax (profits tax), a number of turnover-based taxes, and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that is more significant than typically found in countries with more developed tax systems.

In recent years, the Russian government has initiated revisions of the Russian tax system. Effective January 1, 1999, the first part of the Tax Code was enacted. Effective January 1, 2001, the second part of the Tax Code was enacted and effective January 1, 2002 new regulations, relating to federal income tax were enacted. The new tax system is generally intended to reduce the number of taxes, the overall tax burden on businesses, and to simplify the tax laws.

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2003, substantially all of the tax declarations of the Group for the preceding three years were open to further review.

In the ordinary course of business, MTS may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which MTS operates. In the opinion of management, the MTS's liability, if any, in all pending litigation, other legal proceeding or other matters, will not have a material effect upon the financial condition, results of operations or liquidity of MTS.

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

23. SEGMENT INFORMATION

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance. The Group's business is organized based on geographical operations. Management of the Group regularly reviews certain operational and statistical information by license area, however currently no discrete financial information is available on this basis, therefore the performance is measured and decisions about resource allocation are made by management based on operating income by legal entities as an aggregate of the license area information.

Intercompany eliminations presented below consist primarily of the following items: intercompany sales transactions, elimination of gross margin in inventory and other intercompany transactions conducted under the normal course of operations.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

At December 31, 2003, the Group has several operating segments, of which three are reportable segments—MTS OJSC (merged with Rosico), UMC and Telecom XXI. UMC is located in Ukraine whereas all other operating segments are located in RF.

	Year ended December 31,		
	2003	2002	2001
Revenue:			
MTS OJSC	$1,471,198	$1,044,877	$ 831,857
UMC[1]	394,038	—	—
Telecom XXI	210,460	79,166	733
Other	601,171	291,143	64,047
Intercompany eliminations	(130,669)	(53,430)	(3,390)
Total revenue	$2,546,198	$1,361,756	$ 893,247
Depreciation and amortization:			
MTS OJSC	$ 199,946	$ 144,004	$ 114,923
UMC[1]	66,392	—	—
Telecom XXI	36,782	17,343	7,597
Other	114,484	48,333	10,798
Intercompany eliminations	(1,688)	—	—
Total depreciation and amortization	$ 415,916	$ 209,680	$ 133,318
Operating income:			
MTS OJSC	$ 527,837	$ 365,698	$ 316,894
UMC[1]	131,704	—	—
Telecom XXI	80,632	2,331	(11,468)
Other	198,176	100,531	19,507
Intercompany eliminations	(15,751)	(4,189)	(824)
Total operating income	$ 922,598	$ 464,371	$ 324,109
Total operating income	$ 922,598	$ 464,371	$ 324,109
Currency exchange and translation losses (gains)	(693)	3,474	2,264
Interest income	(18,076)	(8,289)	(11,829)
Interest expense	106,551	44,389	6,944
Other (income)/expenses	3,420	(2,454)	(2,672)
Income before provision for income taxes and minority interest	831,396	427,251	329,402
Additions to long-lived assets:			
MTS OJSC	$ 389,446	$ 360,598	$ 415,336
UMC[1]	900,465	—	—
Telecom XXI	174,128	175,361	7,539
Other	566,475	169,378	168,672
Total additions to long-lived assets	$2,030,514	$ 705,337	$ 591,547

(1) Acquired in March 2003.

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

	As of December 31,		
	2003	2002	2001
Long-lived assets:			
MTS OJSC	$1,454,570	$1,288,062	$1,045,034
UMC[(1)]	648,812	—	—
Telecom XXI	288,256	150,533	83,500
Other	899,920	435,236	111,951
Intercompany eliminations	(19,702)	(4,189)	(824)
Total long-lived assets	$3,271,856	$1,869,642	$1,239,661
Total assets:			
MTS OJSC	$3,245,545	$1,908,018	$1,625,053
UMC[(1)]	394,470	—	—
Telecom XXI	296,042	130,011	42,707
Other	558,091	557,801	190,139
Intercompany eliminations	(268,797)	(330,867)	(130,407)
Total assets	$4,225,351	$2,264,963	$1,727,492

(1) Acquired in March 2003.

24. SUBSEQUENT EVENTS

Acquisition of additional interests—In March 2004, MTS acquired an additional 11% shares in SCS-900. The value of consideration equals $8.5 million. SCS provides GSM mobile services in the Novosibirsk region and Altay Republic.

On April 16, 2004, MTS acquired an additional 40% stake in FECS-900 from Far East Telecommunications Company OJSC, increasing its ownership in the company to 100%. The value of consideration equals $8.3 million. FECS-900 provides GSM 900/1800 services under the MTS brand in the Khabarovsk region.

On April 13, 2004 MTS acquired an additional 7.5% stake in MSS from Sibirtelecom OJSC, increasing its ownership in the company to 91.0%. The value of consideration paid equals $2.2 million. MSS provides GSM 900/1800 services under MTS brand in the Omsk region.

The purchase price allocation for these acquisitions has not been finalized at the date of these statements.

Payment to Cetel B.V.—On March 17, 2004, MTS settled a balance of $27.5 million due to Cetel B.V., a wholly owned subsidiary of Deutsche Telecom AG, due for UMC acquisition (see Note 4 Businesses Acquired).

License expansions—In December 2003, at the open tender organized by the State Committee for Radio Frequencies and the Ministry of Defense MTS acquired additional GSM 900/1800 frequency licenses to operate in 11 new regions of Russia. MTS has also received 900 MHz license extensions to existing licenses in several regions. The term of the 900/1800 MHz GSM license for the Moscow Region has been extended until December 2008.

Total purchase consideration paid for the licenses and extensions identified above was less than $0.1 million.

Additional loan facility—In April 2004, the Group entered into a short-term loan facility with Credit Suisse First Boston International in the amount of $200.0 million. The proceeds were used to repay the floating rate notes. Amounts outstanding under the loan facility agreement bear interest at LIBOR + 2.25% per annum. Management intends to fully repay this bridge loan with the proceeds from the Notes to be issued in May 2004.

Redemption of the floating rate notes—On May 5, 2004 the Group redeemed all of the outstanding $300.0 million floating rate notes, issued on August 5, 2003 in the principal amount plus accrued interest thereon to the date of redemption.

UMC—During 2003, MTS acquired 100% of the outstanding voting interest of UMC (see also Note 4 Businesses Acquired) from various parties. On June 7, 2004, the General Prosecutor of Ukraine filed a claim against UMC and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to MTS. The complaint also seeks an order that would prohibit MTS from alienating 51% of its stake in UMC until the claim is resolved. As of the date of these statements MTS has started the process of evaluating the claim. The Company believes that it acquired UMC in full compliance with Ukrainian law and intends to vigorously defend its acquisition of UMC.

APPENDIX A—REAL ESTATE VALUATION REPORT

Report and Regulated Valuation for

Sistema Group
Leontievsky per.10
Moscow
Russia
125009

of various properties, together known as:

the Project Scarlet properties

AS AT 30 DECEMBER 2004

PREPARED BY:

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The Directors
Sistema Group
Leontievsky per.10
Moscow
Russia
125009

For the attention of Alexei Kaurov—Head of Funding Department

Our Ref: SRL/PS6V

9 February 2005

Dear Sirs

PROPERTY VALUATION AS AT 30 DECEMBER 2004
VARIOUS PROPERTIES TOGETHER KNOWN AS "THE PROJECT SCARLET PROPERTIES" ("THE PROPERTIES")
SISTEMA GROUP ("THE COMPANY")

In accordance with your instructions dated 7 November 2004, we have pleasure in reporting to you as follows:

1. SCOPE OF INSTRUCTIONS

We, Cushman & Wakefield Healey & Baker ("*C&WH&B*"), have considered each property as set out in the Appendix.

We are instructed to prepare this Valuation Report for inclusion in a prospectus ("Sistema Offering Memorandum") concerning the proposed placing and offer ("Sistema Offering") of Ordinary Shares in the Company, as required by the Listing Rules of the UK Listing Authority.

The effective date of each valuation is 30 December 2004.

Each valuation has been prepared in accordance with the Practice Statements contained in the RICS Appraisal and Valuation Standards published by The Royal Institution of Chartered Surveyors in May 2003 ("*the Red Book*"), and prepared by an appropriate valuer who conforms to the requirements as set out in the Red Book, acting in the capacity of External Valuer.

We confirm that this Valuation Report is a Regulated Purpose Valuation as defined in the Red Book.

2. BASIS OF VALUATION

Each property is either: held as an investment; for development; or is in the course of development and has, as instructed and in accordance with the requirements of the Red Book, been valued on the basis of Market Value, as defined in the Red Book as:

"*The estimated amount for which a property should exchange on the date of valuation between a willing buyer and a willing seller in an arm's-length transaction after proper marketing wherein the parties had each acted knowledgeably, prudently and without compulsion*."

3. TENURE AND TENANCIES

We have not had access to the Title Deeds or Leases and each valuation has been based entirely on the information which the Company has supplied to us as to tenure, tenancies and statutory notices.

We understand each property is either held by the Company, its subsidiaries, or jointly with third parties. We have valued a 100% share of the tenure stated in each property as if each property was held entirely by the Company as at the valuation date. We have not made any adjustment to value, which may be appropriate when considering fractural ownership.

A number of properties are held leasehold on ground leases from Moscow City Government. The standard terms of these leases are that rents are reviewed annually (upwards, or downwards) in accordance with a City-wide formula that is set by the Moscow City Government. Each ground lease is subject to Term Extension Right Clause as standard, allowing for the extension of the duration of the lease upon expiry, on the same terms and conditions. However you should be aware that the effectiveness of the Term Extension Right Clause remains untested in the market because few leases have reached expiry. Our valuation assumes that the ground lease at each property can be extended in accordance with the Term Extension Right Clause.

Where a property is either "*currently in the course of development*" or "*held for future development*" and is held leasehold, the land leases generally confer the landlord's permission to develop. Where the considered development scheme differs from that anticipated by the land lease, our valuation assumes that the required variation to the landlord's permission will be forthcoming without material cost or delay. Where a property is to be held leasehold but the terms of the land lease are not finalised, our valuation takes in to account any additional, reasonable, risks of delay and cost in receiving landlord's permissions. We have assumed that there are no unforeseeable circumstances that would cause additional cost or delay in excess of that generally experienced.

The development of each property identified in this report as an "*MGTS*" property (Moskovsky Gorodsky Telephony Sistem, (or Moscow City Telephone System) is to incorporate a floor area suitable for the installation of the tenant's digital telephone exchange. Each valuation includes the cost to the Company to provide such areas (structural and associated works), completed to a "shell" condition. Upon completion, each valuation assumes that these areas will be leased to the telephone operator company for use as a digital telephone exchange, on normal market terms, save as to rent, which is nil.

Unless disclosed to us to the contrary and recorded in the Appendix, each valuation is on the basis that:

(a) the property possesses a good and marketable title, free from any unusually onerous restrictions, covenants or other encumbrances;

(b) where the interest held in the property is leasehold, there are no unreasonable or unusual clauses which would affect value and no unusual restrictions or conditions governing the assignment or disposal of the interest;

(c) leases to which the property may be subject are on standard market terms, and contain no unusual or onerous provisions or covenants which would affect value;

(d) all notices have been served validly and within appropriate time limits;

(e) the property excludes any mineral rights; and

(f) vacant possession can be given of all accommodation which is unlet, or occupied either by the Company or by its employees on service occupancies.

In relation to asset 24, 3, Krestovki River Emb., Saint Pertersberg, we are informed by the Company that land lease rights are "*in the process of being formulated*". Our valuation takes into account the additional uncertainty surrounding the land lease rights to this property and the additional uncertainty as regards the time required to finalise the formulation of these rights.

In relation to asset 26, Pekin Hotel, Moscow, legal documentation is incomplete. Our valuation is on the basis that full title is available for the property in the form of an ownership certificate for the existing buildings and either a lease for the land or perpetual rights for the use of the land.

4. NET ANNUAL RENT

The net annual rent for each property is referred to in the Schedules appended. Net annual rent is defined in the Listing Rules as:

"the current income or income estimated by the valuer:

(i) ignoring special receipts or deductions arising from the property;

(ii) excluding Value Added Tax and before taxation (including tax on profits and any allowances for interest on capital or loans); and

(iii) after making deductions for superior rents (but not for amortisation), and any disbursements including, if appropriate, expenses of managing the property and allowances to maintain it in a condition to command its rent".

5. TOWN PLANNING

We have not made formal searches, but have generally relied on verbal enquiries and any informal information received from the Local Planning Authority, or from the Company.

Each valuation is on the basis that the property has been erected either prior to planning control or in accordance with a valid planning permission and is being occupied and used without any breach of planning or building regulations. Except where stated otherwise, each valuation is on the basis that each property is not affected by proposals for road widening, Compulsory Purchase, planning inquiry, or archaeological investigation.

We are informed by the Company that for a number of "properties held for development", the relevant planning permission approvals are either; "*in the process of being applied for*", or "*in the process of being updated*". Each valuation assumes that all required planning permission consents will be received within a normally acceptable timescale and that there are no such issues which would materially delay the issuance of the required consent, or have a material effect on value or marketability.

Although, where appropriate, we have considered the Company's business plan to develop each property, each valuation reflects our opinion of an appropriate development that could reasonably be expected to form the basis of a bid for a property by a third party. Therefore our valuations do not necessarily reflect the Company's intended investment/development program.

6. STRUCTURE

We have neither carried out a structural survey of each property, nor tested any services or other plant or machinery. We are therefore unable to give any opinion on the condition of the structure or services at any property. Each valuation takes into account any information supplied to us and any defects noted during our inspection, but otherwise are on the basis that there are no latent defects, wants of repair or other matters which would materially affect each valuation.

We have not inspected those parts of each property which are covered, unexposed or inaccessible and each valuation is on the basis that they are in good repair and condition.

We have not investigated the presence or absence of High Alumina Cement, Calcium Chloride, Asbestos and other deleterious materials. In the absence of information to the contrary, each valuation is on the basis that no hazardous or suspect materials or techniques have been used in the construction of any property. You may wish to arrange for investigations to be carried out to verify this.

7. SITE AND CONTAMINATION

We have not investigated ground conditions/stability and each valuation is on the basis that any buildings have been constructed, having appropriate regard to existing ground conditions. Where the property has development potential, our valuation is on the basis that there are no adverse ground conditions which would affect building costs. However, where you have supplied us with a building cost estimate, we have relied on it being based on full information regarding existing ground conditions. We have considered the Company's construction estimates in the light of typical market norms.

We have not carried out any investigations or tests, nor been supplied with any information from you or from any relevant expert that determines the presence or otherwise of contamination (including any ground water). Accordingly, our valuation has been prepared on the basis that there are no such matters that would materially affect our valuation. Should this basis be unacceptable to you or should you wish to verify that this basis is correct, you should have appropriate investigations made and refer the results to us so that we can review our valuation.

8. PLANT AND MACHINERY

Where the interest held in the property is freehold, usual landlord's fixtures such as lifts, escalators and central heating have been treated as an integral part of the building and are included within the asset valued. Where the interest held in the property is short leasehold (<50 years), these items have been treated as belonging to the landlord upon reversion of the lease.

Process-related plant/machinery and tenants' fixtures/trade fittings have been excluded from each valuation.

9. INSPECTIONS, AREAS AND DIMENSIONS

We have inspected each property internally, and externally from ground level on dates between 12 and 19 October 2004, except for asset 19 (5/1, Teatralny proezd, Moscow ("Detsky Mir")), which was inspected on 23 October 2003 and assets 26 (Pekin Hotel, Moscow), 27 (Former Sport Hotel, Moscow) and 28 (Serebryanny Bor (residential) Moscow) which were inspected externally from ground level only on dates between 1 and 8 December 2004. No measured surveys have been carried out by C&WH&B, we have relied entirely on the site and floor areas and dimensions provided to us by the Company. We have assumed that these are correct and calculated on the appropriate basis, as normally adopted by the local property market. Any reference to the age of buildings are approximate.

10. SOURCES OF INFORMATION

All formal information relating to a property has been provided to us by the Company. Each valuation is based on the information which has been supplied to us by the Company or which we have obtained in response to our enquiries. We have relied on this information as being correct and complete and on there being no undisclosed matters which would affect each valuation.

11. GENERAL PRINCIPLES

In respect of tenants' covenants, whilst we have taken into account information of which we are aware, we have not received a formal report on the financial status of the tenants. We have not been supplied with any information to indicate that there are material arrears or that the tenants are unable to meet their commitments under the leases. Each valuation is on the basis that this is correct. You may wish to obtain further information to verify this.

Where we have reflected development potential in a valuation, we have assumed that all structures at the property will be completed using good quality materials and first class workmanship and that the development scheme will let to tenants who satisfy the tenant mix policy and are of reasonable covenant status and on typical market lease terms.

No allowances have been made for any expenses of realisation arising from a sale or development of each property. Each valuation does not make allowance either for the cost of transferring sale proceeds internationally or elsewhere within the Company, or for any restrictions on doing so.

No account has been taken of any leases granted between subsidiaries of the Company, and no allowance has been made for the existence of a mortgage, or similar financial encumbrance on or over each property. Where a grant has been received, no allowance has been made in our valuations for any requirement to repay the grant.

A purchaser of a property is likely to obtain further advice or verification relating to certain matters referred to above before proceeding with a purchase. You should therefore note the conditions on which this Valuation Report has been prepared.

The valuation of each property has been undertaken by Mr. R. N. H. Dodson, FRICS, Mr. S. R. Logan MRICS and Mr. T. Millard MRICS.

We strongly recommend that no disposal of any property should be undertaken without proper exposure to the market. Each valuation assumes that there is an active letting and funding market.

12. SPECIAL ASSUMPTIONS, RESERVATIONS AND DEPARTURES

We can confirm that each valuation is not made on the basis of any Special Assumptions or any Departures from the Practice Statements contained in the Red Book. Subject to the general limitations of our inspections and sources of information set out above, each valuation is not subject to any specific Reservations in relation to restricted information or property inspection.

13. DISCLOSURE

The members of The Royal Institution of Chartered Surveyors who are named in Section 9 above have not previously been the signatories to the valuations provided to the Company for the same purposes as this Valuation Report. C&WH&B have not previously carried out these valuations for the same purpose as this Valuation Report on behalf of the Company.

C&WH&B, or its associate, Styles and Riabokobylko Ltd, have from time to time provided other professional or agency services to the client and have done so for a period of less than 5 years. In relation to the preceding financial year the proportion of the total fees payable by the Company to the total fee income of either C&WH&B, or Styles and Riabokobylko Ltd is less than 5%.

14. AGGREGATE VALUATION

Subject to the foregoing, and based on values current as at 30 December 2004, we are of the opinion that the aggregation of the Market Value of each 100% share of each freehold and leasehold interest held by the Company in each property, as set out in the appendix, is the total sum of:

US$316,335,000
(Three hundred and sixteen million three hundred and thirty five thousand US Dollars).

This sum may be apportioned as follows:

	Freehold	Leasehold (Less than 50 years)
(i) Properties held as investments	US$ 0	US$ 37,860,000
(ii) Properties in the course of development	US$45,870,000	US$ 40,580,000
(iii) Properties held for development	US$16,775,000	US$175,250,000
Total	**US$62,645,000**	**US$253,690,000**

The valuation stated above represents the aggregate of the current values attributable to the individual properties and should not be regarded as a valuation of the portfolio as a whole in the context of a sale as a single lot. We set out the value ascribed to each property in the appendix.

We have considered an appropriate development commencement date and development period for each property in isolation, based on each property's particular circumstance. Each valuation does not consider any effect of multiple properties being developed concurrently (e.g. any resource, expense or savings issues if undertaken by a single developer), or released to the market (occupation or investment) together.

The Summary Valuation Schedule shows our opinion of Equity IRR (i.e. discount rate) on an un-leveraged basis as used in the Market Valuation for each property. This discount rate is calculated on the assumption that each property would be held upon development completion and that no debt is used (see "Global Assumptions—Debt Assumptions" below).

For those *Properties held for Development* and *Properties in the Course of Development*, the Summary Valuation Schedule and individual property schedules present our opinion of *Market Value assuming built and fully let* and our opinion of *Net Market Rental Value per annum upon completion.* In respect of asset 23 (Avrora, Moscow) and asset 7 (11, Rogozhsky Val street, Moscow), these entries are shown as "n/a" as these properties are intended to be sold with vacant possession upon development completion.

15. CONFIDENTIALITY

The contents of this Valuation Report are intended to be confidential to the addressees and for the specific purpose stated. Before the Valuation Report or any part of its contents are reproduced or referred to in any document, circular or statement or disclosed orally to a third party, our written approval as to the form and context of such publication or disclosure must first be obtained. For the avoidance of doubt, such approval is required whether or not this firm is referred to by name and whether or not our Valuation Report is combined with others.

Notwithstanding the preceding paragraph, our prior written approval shall not be required for the reproduction and inclusion of this report, in its entirety, in the Sistema Offering Memorandum or for the reproduction and dissemination of this report in its entirety in connection with the Sistema Offering. Where part only of this report is reproduced, included or disseminated, the preceding paragraph will apply.

Yours faithfully
For and on behalf of Cushman & Wakefield Healey & Baker

R N H DODSON FRICS
Partner

S R LOGAN MRICS
Partner

GENERAL PRINCIPLES ADOPTED IN THE PREPARATION OF VALUATIONS AND REPORTS

We list below the general principles upon which valuations and reports are normally prepared and they shall apply unless specifically mentioned otherwise in the foregoing.

RICS Appraisal and Valuation Standards

All valuations are carried out in accordance with the Red Book and are undertaken by appropriately qualified valuers as defined therein.

Valuation Basis

All valuations are made on the appropriate basis as agreed with the company in accordance with the provisions and definitions of the Red Book unless otherwise specifically agreed and stated. The specific basis of valuation adopted in relation to a particular instruction and the definition thereof is detailed in this Report.

No allowances are made in our valuations for any expenses of realisation, or to reflect the balance of any outstanding mortgages, either in respect of capital or interest accrued thereon.

It should be noted that our valuations are based upon the facts and evidence available at the date of valuation. It is therefore recommended that valuations be periodically reviewed.

Information Supplied

We accept as being complete and correct the information provided to us by the sources detailed in our Report, relating to items such as tenure, tenancies, tenants' improvements and other relevant matters. We have relied on this information and on there being no undisclosed matters, which would affect our valuation.

Documentation and Title

We do not normally read documents of title. Where title documentation or leases are provided to us, we recommend that reliance should not be placed on our interpretation thereof without verification by your legal advisors.

Unless notified to the contrary, we assume that each property has a good and marketable title, free from any unusually onerous restrictions, covenants or other encumbrances and is free from any pending litigation. We further assume that all documentation is satisfactorily drawn and that there are no unusual or onerous clauses, restrictions, easements, covenants or other outgoings, which would adversely affect the value of the relevant interest(s).

Tenant's Covenant Strength

We do not make detailed enquiries into the covenant strength of occupational tenants but rely on our judgement of the market's perception of them. Any comments on covenant strength should therefore read in this context. Furthermore, we assume, unless otherwise advised, that all tenants are capable of meeting their financial obligations under the lease and that there are no material arrears or undisclosed breaches of covenant.

Inspections

We undertake such inspections and conduct investigations as are, in our opinion, correct in our professional judgement, appropriate and possible in the particular circumstances. External inspections are carried out from ground level only.

Structural surveys

Unless expressly instructed, we do not undertake structural surveys, nor do we inspect those parts that are covered, unexposed or inaccessible, or test any of the electrical, heating, or other services. Any readily apparent defects or items of disrepair noted during our inspection will be reflected in our valuations, but no assurance is given that any property is free from defect. We assume that those parts which have not been inspected would not reveal material defects which would cause us to alter our report and valuations.

Where we have been supplied with information on the condition of the structure and services our valuation reflects this. Otherwise, our valuation is on the basis that there are no latent defects, wants of repair or other matters which would materially effect our valuation.

Hazardous & deleterious materials

Unless expressly instructed, we do not carry out investigations to ascertain whether any building has been constructed or altered using deleterious materials or methods. Unless specifically notified, our valuations assume that no such materials or methods have been used. Common examples include high alumina cement concrete, calcium chloride, asbestos and wood wool used as permanent shuttering.

Site Conditions

Unless specifically requested, we do not carry out investigations on site in order to determine the suitability of ground conditions and services, nor do we undertake environmental, archaeological, or geo-technical surveys. Unless notified to the contrary, our valuations are on the basis that these aspects are satisfactory and also that the site is clear of underground mineral or other workings, methane gas, or other noxious substances.

In the case of properties which have redevelopment potential, we assume that the site has the load bearing capacity suitable for the anticipated form of redevelopment without the need for additional and expensive foundations or drainage systems. Furthermore we assume in such circumstances that no unusual costs will be incurred in the demolition and removal of any existing structure on the property.

Contamination

In preparing our valuations we have assumed that no contaminative or potentially contaminative use is, or has been, carried out at the property.

Unless specifically instructed, we do not undertake any investigation into the past or present uses of either the property or any adjoining or nearby land, to establish whether there is any potential for contamination from these uses and assume that none exist. However, should it subsequently be established that such contamination exists at any of the properties or on any adjoining land or that any premises have been or are being put to contaminative use, this may be found to have a detrimental effect on the value reported.

In preparing our valuations we have assumed that all necessary consents and authorisations for the use of the property and the processes carried out at the property are in existence, will continue to subsist and are not subject to any onerous conditions.

High voltage electricity supply apparatus

Where there is high voltage electrical supply equipment close to the property, it should be noted that the possible effects of electromagnetic fields have been the subject of media coverage. The National Radiological Protection Board (NRPB), an independent body with responsibility for advising on electromagnetic fields, has advised that, following studies in 2000 and 2001, there may be a risk, in specified circumstances, to the health of certain categories of people. Public perception may, therefore, affect marketability and future value of the property.

Plant & machinery

Our valuations include items usually regarded as forming part of the building and comprising landlord's fixtures, such as boilers, heating, lighting, sprinklers and ventilation systems but generally exclude operational plant and machinery and those fixtures and fittings normally considered to be the property of the tenant.

Mortgages

No allowance is made for the existence of any mortgage, or similar financial encumbrance on or over the property and no account taken of any leases between subsidiaries.

Government Grants

All valuations are given without any adjustment for capital based Government grants received or potentially receivable at the date of valuation.

Special Purchaser Value

Unless otherwise stated, our valuations do not reflect any element of marriage value or special purchaser value which could possibly be realised by a merger of interests or by a sale to an owner occupier of an adjoining property, other than in so far as would be reflected in offers made in the open market by prospective purchasers apart from the purchaser with a special interest.

Aggregation

In the valuation of portfolios, each property is valued separately and not as part of the portfolio. Accordingly, no allowance, either positive or negative, is made in the aggregate value reported to reflect the possibility of the whole or part of the portfolio being put on the market at any one time.

Overseas Properties

Our valuations of overseas properties will be reported in the appropriate local currency and represent our opinion of the realisable value in the country of origin, computed in accordance with local practices, with no allowance made for the transfer of funds to the UK.

VALUATION METHODOLOGY

There are three generally adopted approaches used to value property: *The Sales Comparison Approach; The Income Approach*; and *The Cost Approach*. We have valued the properties using the income approach, taking account of sales comparables where they are available. The cost approach has not been used as this produces a "Non-Market Value" suitable for financial statements relating only to "specialised properties". An overview of The Sales Comparison Approach and The Income Approach and how these relate to the Russian Market, follows.

The Sales Comparison Approach

This method involves analysing all available information on sales of comparable properties that have taken place and making adjustments in the prices achieved to reflect the differences in the properties sold and the property to be valued.

This approach hinges on the availability of reliable market evidence of comparable sales. Distinction must be drawn between information that is known to be accurate and reported information that is second hand or at best hearsay. Only information that is known to be accurate can be relied upon with any degree of comfort to provide an accurate valuation.

There are severe difficulties of applying this valuation approach in emerging real estate markets, including Russia, as due to their comparative immaturity the availability of reliable market information is very limited. To reflect this, the International Valuation Standards Committee ("IVSC") (the leading international body for setting valuation standards) devoted a recent White Paper to the study. It identifies specific problems for valuers in emerging markets, which apply very well to Moscow and to Russia—and these problems also tend to inhibit the operation of the market as a whole, in particular as regards investment.

The principal problem is a lack of transparency and a relatively low volume of recorded deals. In mature property markets there is a wealth of information available on completed sales transactions, in the form of yields and total sales prices, and this makes it relatively straight-forward to assess the market value of any property. In Moscow this sort of information is often not available, and where the details of transactions are publicized their accuracy can not always be guaranteed. In addition, a large number of sales transactions in Moscow take place "off-market" and therefore details of them are seldom known beyond those who were party to the deal.

The volume of completed deals is very low in all sectors of the Moscow real estate market. In addition—as outlined above, deal information is rarely reported accurately and is often manipulated for other reasons benefiting the separate parties to any sale deal. Therefore it is often necessary to use offered prices as a basis for assessing the opinion as to value using the sales comparison approach.

The Income Approach

The most commonly used technique for assessing market value within the Income Approach is Discounted Cashflow. This is a financial modelling technique based on explicit assumptions regarding the prospective cashflow to a property or business and the costs associated with being able to generate the income. To this assessed cashflow is applied a market-derived discount rate to establish a present value of the income stream. This Net Present Value ("NPV") is an indication of Market Value[(1)]. This approach is considered to be the most sophisticated valuation technique, over and above even the Sales Comparison Approach, because it allows differences between comparable sales and the subject property to be explicitly considered and analysed. It is therefore less based on subjective judgements but objectively on market available information.[(2)] For the basis of the current valuations where for the majority of properties consents exist for a specific type of development, the income approach is the most relevant.

The residual for properties under development or properties held for future development is the NPV of all future income streams less the NPV of all future costs. The costs include all of the development costs still outstanding in respect of each property and future incomes are assessed based on current returns for completed properties of a similar nature in the market adjusted to reflect the expected completion date for the particular project and anticipated future trends in rents and / or sales prices.

(1) International Valuation Standards, Sixth Edition—Guidance Note 9.

(2) International Valuation Standards Committee Newsletter—Global Valuation Issues (Sept. 2003).

The difficulty in applying this method in the Russian market is assessing the correct market derived discount rate, due to the very small number of transactions, the lack of transparency in the reporting of information and in the wide variations in returns required on projects from different investors.

The costs and incomes associated with the project have been assessed on the basis of standard construction costs in the market together with property or project specific information provided by the developer and current market returns adjusted to reflect anticipated future trends. The assumptions are intended to be conservative so as to calculate the minimum return that the project can be expected to generate. This will also provide a conservative Market Valuation.

In order to assess the residual valuation of the land a discount rate has to be applied to the projected cashflows. The discount rate is market derived and reflects the minimum returns a typical investor would require to undertake a project of this type. This approach then provides the maximum value that an investor would be willing to pay for the land in its current condition, being the Net Present Value of all identified future costs and incomes at the necessary rate of return.

In the Moscow market this approach specifically excludes the use of debt and the effect of leverage. The availability of debt, and on what terms, varies widely from investor to investor, and there is no market standard—especially in a comparatively immature debt market such as Moscow. Pre-debt discount and capitalization rates are therefore used to represent the risk-return requirement of investors.

The Cost Approach

Under IVS this approach is relevant to specialised properties (i.e. properties that are rarely if ever sold on the open market ... due to their uniqueness which arises from their specialised nature and design of the buildings, their configuration, size, location or otherwise) and Limited Market Property (i.e. properties that because of market conditions, unique features, or other factors attract relatively few buyers).

GLOBAL ASSUMPTIONS

For those properties "held for development" or "in the course of development", some general assumptions have been made in developing the residual valuations, in addition to the assumptions and conditions above. These are summarised below:

Acquisition Cost

The properties are currently owned and the aim of the report is to establish the Market Value of each property in its current condition. Therefore no acquisition cost is included in the calculation;

Development Proposals

It has been assumed where project documentation exists that any development would conform to the overall sizes as provided to us unless it is reasonable to assume that development could take place in some other form. For each MGTS property it has been assumed that it is only possible to convert the existing buildings (with the exception of two specific properties) and that the building sizes will therefore remain the same. It has been assumed that the ongoing space requirements for housing the digital phone exchanges as supplied to us are accurate;

Utilities & Road Improvement

In Russia the cost of providing utilities and executing necessary road improvements can vary widely. Where utilities need to be provided or road works executed it has been assumed that the cost estimates supplied to us are accurate;

Construction Phasing

All projects, with the exception of asset 18 ("NIIDAR"), have been assumed to be constructed in one phase. Due to the size of the NIIDAR project it has been assumed that it would be phased and that the phasing would be designed to maximise the returns from the site;

Construction Costs

Construction costs have been assessed in accordance with standard rates in the market that a third party developer/purchaser would expect to have to pay in the course of the development of each project. In some cases these costs differ in their general level than the anticipated construction costs as provided by the Company;

Construction Contract

An advance payment is included in the cost calculations, which is charged to the first quarter of the construction contract. A hold-back against defects requiring remedy is also included and is charged to the quarter after completion of construction of the relevant phase;

Permit & Design Costs

Where there are outstanding permitting costs these have been assessed in line with the anticipated numbers as supplied by the client as, once again, there can be a wide variation in the permitting costs. Design costs—where appropriate have been assessed in line with market standards;

Assumed Sale

In order to assess the capital value of a completed development, we have assumed that a property is to be held upon completion for a period until the net income stabilizes, and thereafter is sold. This is a valuation technique and does not necessarily represent the intention of the owner;

Returns

Rental rates for commercial office spaces have been projected together with capitalization rates, for the period of the cashflow. Sales prices for residential developments have been assessed for the reasonably expected completion dates;

These figures are based on research carried out by *Stiles & Riabokobylko in association with Cushman & Wakefield Healey & Baker* and market information. In respect of commercial rents they are exclusive of operating expenses and VAT and have been assessed on a conservative basis (see *market analysis* above). They therefore provide realistic minimum figures that it is anticipated can be achieved;

Market Capitalization rates have been projected based on the assessment that the property investment market for the Moscow and Moscow region will become more sophisticated over the period and that the number of active investors will increase. It is therefore anticipated that the changes in market yields will reflect the experiences in other Eastern European countries where the property investment environment is already more mature such as Poland and the Czech Republic and that there will be a yield compression over time;

Review/Renewal Period

This is the length of the initial leases. The rents for the initial leases remain fixed for their entire term and the rent during this period will depend upon the prevailing market rental rate in the year of completion. The assumed length of initial leases varies depending upon the property class—office leases are typically 5 years and retail leases are typically 3 to 5 years;

Vacancy Rate

Vacancy has been assumed for the duration of each project and depends upon the property class and the relative merits of each anticipated project;

Operating Expenses

For commercial properties these are assumed to be paid by the tenant at cost, and they are therefore cashflow and VAT neutral and they are not included in the cashflow analysis. For residential properties it is also assumed that operating expenses will be passed through to residents in the form of a service charge or similar;

Security Deposit

It is common for tenants to pay security deposits in the Russian market which are held interest free by the Landlord and offset against the last relevant period of the lease. Standard levels of Security Deposit have been assumed for different property classes. These deposits are treated as financing cashflow and will be off-settable against the final relevant period of each lease;

Debt Assumptions

In assessing the Market Value of property it has been assumed that no debt is used. There are wide variations as to the financing terms available in the as yet immature Russian property finance market and it is not therefore possible to apply standard terms. Therefore unleveraged yields are used to provide a consistent approach;

VAT Rate

The VAT rate has been taken at the current rate of 18% introduced at the beginning of 2004. The VAT rate is of importance because although in theory VAT in Russia is immediately recoverable from the government the practice is slightly different. The VAT paid on construction and other development costs is considered a VAT credit account in favour of the landowner. VAT on future rents can be retained and offset against the VAT account until it is zeroed out. This has a significant effect on cashflow;

It has been assumed that all of the costs in association with the development of the project will be subject to VAT and also that all of the tenants (where appropriate) will be VAT paying. Where applicable the current VAT credit account ahs been taken into account—depending upon the tenure of the property. I.e. freehold property sales are subject to VAT, but sales of shares in a company are not. Therefore where a property is held in a Special Purpose Vehicle or similar structure no VAT would be payable on a sale of shares;

VAT Inflation Loss

The VAT credit account is ruble denominated whereas rents are receivable in dollars. A factor is used to take account of annual losses to the VAT credit account balance, which is non-interest bearing, due to inflation and exchange rate movements;

Cash Reserve

A contingency account against future capital expenditures is a prudent measure. Contributions to this cash reserve have been set depending on the different criteria of each proposed development;

Agent's & Brokers Fees

Standard market practice is to use brokers to lease commercial space. This has been taken into account;

Depreciation

Assessed over 30 years on a straight line basis, in line with local regulations. The type of tenure affects the annual depreciation and will therefore affect the level of costs which are deductible for profit tax purposes. A sale of a freehold property results in the property being held on the balance sheet at the transaction value and usually results in a higher level of depreciation and therefore a higher level of tax deductible costs, potentially increasing income. Where a property is held in a Special Purpose Vehicle (SPV) any sale of the shares will not affect the value of the property on the balance sheet (usually the existing depreciated construction cost) and this will ordinarily result in a lower level of depreciation;

Taxes

Similarly property tax is payable on the book value of any property, currently at 2.2% and the nature of the tenure will affect the overall level of property tax payable. There may also be affects on the level of other taxes payable due to the type of tenure. All of these factors have been taken into account.

Project Scarlet—Property Valuation as at 30 December 2004. All currency in US Dollars.

Property Ref.	City	Property Address	Tenure	Net annual rent US$ per annum	Net Market Rental Value US$ per annum (upon completion)	Market Value as at 30 December 2004	Gross Development Value upon completion (note 1)	Market Value assuming built and fully let (note 2)	Total outstanding development costs	Equity IRR (note 3)
Property held as an investement										
17	Moscow	5, 1st Tverskaya—Yamskaya street ("Hals Tower")	Leasehold	$4,912,477	$ 4,800,000	$ 26,160,000				Mixed
28	Moscow	Serebryanny Bor (residential)	Leasehold	$1,298,403	$ 2,095,300	$ 11,700,000				16.00%
Properties currently in the course of development										
1	Moscow	40/3, Pokrovka street	Leasehold	$ 0	$ 4,600,000	$ 12,530,000	$39,000,000	$ 49,400,000	$ 19,900,000	Office 20.5% Hotel 15%
2	Moscow	13, Mokhovaya street	Leasehold	$ 0	$ 6,290,000	$ 13,350,000	$47,400,000	$ 47,400,000	$ 14,000,000	18.00%
14	Moscow	vl. 7, Nastasyinsky lane	Leasehold	$ 0	$ 2,620,000	$ 14,700,000	$23,000,000	$ 23,000,000	$ 4,250,000	16.00%
22	Moscow	Trudovaya	Freehold	$ 0	$ 5,100,000	$ 14,880,000	$15,400,000	$ 30,900,000	$ 6,600,000	19.00%
23	Moscow	Avrora	Freehold	$ 0	n/a	$ 30,990,000	$58,400,000	n/a (note 4)	$ 19,700,000	22.50%
Properties held for future development										
3	Moscow	2, Novy Arbat street	Leasehold (MGTS)	$ 0	$ 4,535,000	$ 5,125,000		$ 26,400,000	$ 6,000,000	25.00%
4	Moscow	1-3,5, Bakuninskaya street	Leasehold (MGTS)	$ 0	$ 3,900,000	$ 1,600,000		$ 20,500,000	$ 9,000,000	25.00%
5	Moscow	30A/1, Bolshaya Gruzinskaya street	Leasehold (MGTS)	$ 0	$ 1,150,000	$ 985,000		$ 6,050,000	$ 2,000,000	25.00%
6	Moscow	1, 1st Dubrovskaya street	Leasehold (MGTS)	$ 0	$12,000,000	$ 4,450,000		$ 75,000,000	$ 29,000,000	25.00%
7	Moscow	11, Rogozhsky Val street	Leasehold (MGTS)	$ 0	n/a	$ 2,200,000	$47,500,000	n/a (note 4)	$ 33,000,000	27.50%
8	Moscow	20/1, Bol. Balkansky lane	Leasehold (MGTS)	$ 0	$ 1,080,000	$ 860,000		$ 5,000,000	$ 2,300,000	22.50%
9	Moscow	6/1, Broshevsky lane	Leasehold (MGTS)	$ 0	$ 765,000	$ 445,000		$ 3,800,000	$ 2,000,000	22.00%
10	Moscow	5, Vsevolozhsky lane	Leasehold (MGTS)	$ 0	$ 2,250,000	$ 2,325,000		$ 12,850,000	$ 3,000,000	25.00%
11	Moscow	19, Daev lane	Leasehold (MGTS)	$ 0	$ 2,265,000	$ 2,300,000		$ 12,250,000	$ 3,200,000	25.00%
12	Moscow	5/2, Milyutinsky lane	Leasehold (MGTS)	$ 0	$ 2,440,000	$ 2,440,000		$ 13,500,000	$ 3,400,000	25.00%
13	Moscow	7/1, Nastasyinsky lane	Leasehold (MGTS)	$ 0	$ 1,350,000	$ 1,960,000		$ 7,700,000	$ 1,700,000	25.00%
15	Moscow	5/2, Pokrovsky boulevard	Leasehold (MGTS)	$ 0	$ 1,200,000	$ 1,430,000		$ 6,500,000	$ 1,500,000	25.00%
16	Moscow	5/1, Stolyarny lane	Leasehold (MGTS)	$ 0	$ 1,720,000	$ 1,250,000		$ 8,800,000	$ 3,100,000	25.00%
18	Moscow	1st Bukhvostova street 12/11, 1st Bukhvostova street 3.("NIIDAR")	Leasehold	$ 0	$69,950,000	$ 31,650,000		$586,500,000	$410,000,000	27.50%
19	Moscow	5/1, Teatralny proezd ("Detsky Mir")	Leasehold	$6,921,434	$24,983,000	$ 28,900,000		$161,200,000	$ 97,000,000	15.75%
20	Moscow	Sebebryany Bor	Leasehold	$ 0	$ 2,250,000	$ 4,150,000		$ 15,000,000	$ 4,400,000	19.50%
21	Moscow Region . .	Zdravnitsa	Freehold	$ 0	$ 4,855,000	$ 2,075,000		$ 28,600,000	$ 17,500,000	20.00%
24	Saint Petersburg . .	3, Krestovki river emb.	Leasehold	$ 300,000	$ 580,000	$ 1,980,000		$ 32,000,000	$ 23,000,000	30.00%
25	Saint Petersburg . .	7, Pulkovskoye shosse	Freehold	$ 0	$11,000,000	$ 14,700,000		$ 68,750,000	$ 32,000,000	17.50%
26	Moscow	Pekin Hotel, B. Sadovaya 5/1 and 5/2, Gasheka street 12/6 and 2nd Brestskaya Street 1/1	Leasehold	$ 0	$31,300,000	$ 49,200,000		$219,000,000	$113,000,000	Office 20% Hotel 15%
27	Moscow	Former Sport Hotel	Leasehold	$ 0	$82,600,000	$ 32,000,000		$472,000,000	$290,000,000	20.00%
				$8,219,837		$316,335,000				

Notes:

1. "Gross Development Value upon Completion" means the Market Value of the property assuming it is fully completed, available with Vacant Possession, based on market prices as at 30 December 2004.

2. "Market Value assuming built and fully let" means the Market Value of the property assuming it is fully completed and fully leased on market terms, based on market prices as at 30 December 2004.

3. "Equity IRR" means unleveraged IRR, no leverage has been assumed.

4. "n/a" as these properties are intended to be sold with vacant possession upon development completion.

Market Value as at 30 December 2004
PROPERTIES HELD AS INVESTMENTS

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 17 **5, 1st Tverskaya— Yamskaya street** (“Hals Tower”) Moscow Russia	The property comprises a “Class B” office building completed in July 2001, arranged over 13 above ground floors and 1 basement, comprising a gross area of 12,235.9 sq.m., a net leasable area of 8,724 sq.m., 30 underground parking spaces and 60 further parking spaces in a vertical parking facility. The land area comprises 1,439 sq.m. and is held on a land lease from the Moscow City Government expiring 17 October 2012 subject to standard Statutory annual rent reviews. Extension rights are subject to notice from either party prior to the expiry of the tenancy. The building is held freehold.	The property is fully leased, being subject to 22 commercial tenancies with average terms of between 3 and 5 years. Termination dates range from end of 2004 to beginning of 2008. Tenants are responsible for fit-out and internal repair plus operating expenses. 1,720.7 sq.m. is occupied by *“Sistema Telecommunications, Information and Services”* on an inter-company lease, drafted on a similar standard form as for the other leases in the building and has a termination date of 30 November 2005.	US$4,912,477	US$4,800,000	US$26,160,000
No. 28 **Serebryany Bor** (existing residential complex in one of Moscow’s most prestigious residential areas adjacent to the Moscow river within a natural area on the west side of the city) Moscow, Russia	The property comprises a complex of 36 residential units, constructed from 1950 to 1970s. The properties at addresses Khoroshevsky Serebryanny Bor 4th Line, 126, buildings 7 and 8 are apartments (24 units), the remainder are all detached houses (12 units). The apartments range in size from 60 sq.m. to 120 sq.m. with an average size of 87 sq.m., and the houses from 135 sq.m. to 306 sq.m. with an average size of 188 sq.m. The total area of the buildings is 4,369.1 sq.m. of which 2,574.8 sq.m. is currently leased and 1,794.3. sq.m. is vacant. The land is held on 49 year leases from the Moscow City Government dated 1997 subject to standard Statutory annual rent review and renewal rights, except for the land under one building recently acquired for which the land lease rights are being formulated. The buildings are freehold.	There are 18 residential tenancies all of less than 12 months duration.	US$1,298,403	US$2,095,300	US$11,700,000

Market Value as at 30 December 2004
PROPERTIES HELD IN COURSE OF DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 1 **40/3 Pokrovka street.** Moscow Russia	The property comprises a land plot of 6,026 sq.m. Its existing use is a cleared development site. The property is held leasehold on a 25 year lease from the Moscow City Government dated 5 November 1995 subject to standard Statutory annual rent review and extension rights. Permission for construction is included in lease. The property is in the course of development and is to be developed in accordance with: Resolution of the MCG dated 13.08.2002 # 639—PP *"For construction office-hotel complex on 40/3 Pokrovka street"*. The development is anticipated to complete in a single phase in Q1 2006 to provide 14,772 sq.m. (gross) of Class A office space and 9,515 sq.m. (168 rooms) three star hotel (total GLA 24,287 sq.m.). Total outstanding development costs are estimated as US$19,900,000.	The property is not subject to any sub-tenancies. The property is subject to a General Construction Contract for development.	US$0	US$4,600,000 upon completion office element only	US$12,530,000 (Gross Development Value upon Completion is US$39,000,000) (Assuming built and fully let on market terms US$49,400,000)

Market Value as at 30 December 2004
PROPERTIES HELD IN COURSE OF DEVELOPMENT

Property ID: Property Address:	**Description, Age and Tenure:**	**Terms of Existing Tenancies:**	**Net Annual Rent:**	**Estimated Net Annual Rent:**	**Market Value:**
No. 2 **13, Mokhovaya Street** (directly across Manezh Square from the Kremlin) Moscow, Russia	The property comprises a former mansion building, constructed in 1935 arranged over 7 above ground floors and basement, comprising a gross area of 5042.5 sq.m., standing on a land plot of 2,660 sq.m. Its existing use is vacant and disused. The land is held leasehold on a lease from the Moscow City Government dated 20 January 2003 valid until 2049, subject to standard Statutory annual rent review and extension rights. Permission for construction is included in lease. The building is Freehold. The property is in the course of development which is anticipated to complete in a single phase in Q4 2005, a reconstruction of the existing building together with new construction to provide 15,915 sq.m. gross of Class A office space arranged over 7 floors and including underground parking, retail areas and conference space. The property is to be developed in accordance with an Investment Contract dated December 2002 for the renovation of the existing building. Total outstanding development costs are estimated as US$14,000,000.	The property is not subject to any sub-tenancies. It is intended that the Company will occupy the completed property. The property is subject to a General Construction Contract for development.	US$0	US$6,290,000 upon completion	US$13,350,000 (Gross Development Value upon Completion is US$47,400,000) (Assuming built and fully let on market terms US$47,400,000)

Market Value as at 30 December 2004
PROPERTIES HELD IN COURSE OF DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 14 **vl. 7, Nastasyinsky lane** Moscow Russia	The property comprises a development site comprising an office building under construction on a land plot of 2,880 sq.m. It is understood that all utilities are connected to the site. The land is held leasehold on a short term, annually renewable construction lease. An ownership certificate for the building will be issued upon completion. The property is to be developed in accordance with a Resolution of the MCG dated 14.10.2003 # 1831—RP *"For construction exchange complex on 7, Nastasyinsky lane"*. The property is in the course of development which is anticipated to complete in a single phase in Q2 2005, to provide a newly constructed "Class A" office building comprising 5,253 sq.m. above ground and 2,995 sq.m. below ground. There will be 26 surface and 42 underground car parking spaces. Total outstanding development costs are estimated as US$4,250,000.	The property is not subject to any sub-tenancies. There is a Letter of Intent for purchasing the completed building in Summer 2005 for US$24,600,000.	US$0	US$2,620,000 upon completion, excluding parking.	US$14,700,000 (Gross Development Value upon Completion is US$23,000,000) (Assuming built and fully let on market terms US$23,000,000)

Market Value as at 30 December 2004
PROPERTIES HELD IN COURSE OF DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 22 **Trudovaya** Moscow region, Russia	The property comprises a 15.5 ha. land site in a woodland setting. It is understood that all mains utilities are connected to the site. The property is held Freehold. The property is in the course of development which is anticipated to complete in a single phase in Q1 2005 to provide 89 residential units (totaling 17,061 sq.m.) in a secure compound, for lease. An administrative block of 792 sq.m. will provide supporting uses (e.g. convenience store, restaurant, leisure club etc.) Total outstanding development costs are estimated as US$6,600,000.	The property is not subject to any tenancies. The property does not have the benefit of the appropriate planning consents.	US$0	US$5,100,000 upon completion	US$14,880,000 Development Value upon Completion is US$15,400,000) (Assuming built and fully let on market terms US$30,900,000)

Market Value as at 30 December 2004
PROPERTIES HELD IN COURSE OF DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 23 **Avrora** (adjoining Moscow canal) Moscow Region, Russia	The property comprises a 93 ha. land site. Its existing use is vacant land providing up to 73 ha. of individual land plots for residential development. The property is held Freehold. The property is in the course of development and is to be developed in accordance with 2 existing planning permission consents obtained in 2004 for construction of individual residential units on 78.5 ha. The completion of utilities and access works is anticipated to complete in Q1 2005. The development of the residential plots allows for 2 options—either provision of utilities only and sale of undeveloped individual land plots, or the development of residential units for sale and/or lease. Total outstanding development costs are estimated as US$19,700,000.	The property is not subject to any tenancies. There are no other contractual arrangements disclosed that effect the property.	US$0	n/a as is anticipated to be sold with vacant possession upon completion.	US$30,990,000 attributable entirely to the freehold element. Development Value upon Completion is estimated at US$58,400,000) (Assuming built and fully let on market terms is n/a)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 3 **2, Novy Arbat street** Moscow, Russia	The property comprises a standard MGTS exchange building constructed in the 1970s, arranged over 7 floors above ground, with high ceilings (4.6m) and 1 basement level under part only, providing a gross area of 11,113.8 sq.m. The existing use is as a telecommunications central exchange or vacant. The land area comprises 1,509 sq.m. and is held on a 25 year land lease from Moscow City Government from 22 December 1994, subject to standard Statutory annual rent review and extension rights. The building is held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 15 months, to include a renovation of the existing structure to provide approx. 8,500 sq.m. of "class B" office accommodation, 615 sq.m. of street front retail and 2,000 sq.m. dedicated to the renovated telephone exchange. There is no car parking. Total outstanding development costs are estimated as US$6,000,000.	Five tenants occupy a total of 1,469.6 sq.m. for a total rent of US$394,554 per annum. The tenants are responsible for operating expenses, utilities and internal repairs (excluding capital improvements). The tenants include one third party on a short term annually renewable lease, one third party on an indefinite lease that can be terminated at any time by the Landlord on three months' notice and three inter-company leases: MBRD and Intourist on short term-annually renewable leases and MTS on a lease expiring on 30 June 2006. The form of these leases is the same as the third party leases. The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area in addition to the 2,000 sq.m. required for the telephone exchange. There are no other contractual arrangements disclosed that affect the property.	US$0	US$4,535,000 upon completion	US$5,125,000 (Assuming built and fully let on market terms US$26,400,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 4 **1-3,5, Bakuninskaya street** Moscow, Russia	The property comprises 2 principal buildings. One constructed in the 1970s, is arranged over 12 floors above ground and 1 basement level, to provide a gross area of 7,103.8 sq.m. above ground. The other was constructed in the 1930s, is arranged over 4 levels, to provide a gross area of 4,046.3 sq.m. The existing use is as a telecommunications central exchange or vacant. There are some ancillary maintenance buildings. The land comprises 3,495 sq.m. and is held on a 25 year land lease from Moscow City Government from 19 December 1994 subject to standard Statutory annual rent review and extension rights. The building is held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 18 months to include a renovation of the existing tower structure to provide 5,800 sq.m. of "class B" office accommodation, and the construction of a new building to provide 5,800 sq.m. of "class B" office accommodation, with 2,000 sq.m. dedicated to the renovated telephone exchange, together with car parking. Total outstanding development costs are estimated as US$9,000,000.	The property is not subject to any tenancies. The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area in addition to the 2,000 sq.m. required for the telephone exchange. There are no other contractual arrangements disclosed that effect the property.	US$0	US$3,900,000 upon completion	US$1,600,000 (Assuming built and fully let on market terms US$20,500,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 5 **30A/1, Bolshaya Gruzinskaya street** Moscow, Russia	The property comprises a standard MGTS exchange building constructed in the 1980s, arranged over 6 floors (with high ceilings) above ground and 1 basement level, providing a gross area of 4,593.8 sq.m. The existing use is as a telecommunications central exchange, with 1 floor used as offices. The land area comprises 2,304 sq.m. and is held on a 15 year land lease from Moscow City Government from 12 April 1995 subject to standard Statutory annual rent review and extension rights. The building is held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 12-15 months, to include a renovation of the existing structure to provide 3,400 sq.m. of "class B" office accommodation and 2,000 sq.m. dedicated to the renovated telephone exchange. Total outstanding development costs are estimated as US$2,000,000.	The property is not subject to any tenancies. The property is partially occupied by the Company for the purposes of its business. It is assumed that the company will not occupy any area after development in addition to the 2,000 sq.m. required for the telephone exchange. There are no other contractual arrangements disclosed that effect the property.	US$0	US$1,150,000 upon completion	US$985,000 (Assuming built and fully let on market terms US$6,050,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 6 **1, 1st Dubrovskaya street** Moscow, Russia	The property comprises 3 buildings, a standard MGTS exchange building extending to 3,242 sq.m., an office building extending to 4,168.2 sq.m. and a small single storey building used as a health/fitness centre and extending to 202.6 sq.m. All were constructed in the 1970s, together providing a gross area of 7,612.8 sq.m. The land area comprises 5,900 sq.m. and is held on a 25 year land lease from Moscow City Government from 20 February 1995, subject to standard Statutory annual rent review and extension rights. The buildings are held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 2 years to include demolition of the existing structures, and new construction to provide 28,800 sq.m. of "class A" office accommodation and 1,200 sq.m. dedicated to the telephone exchange. Total outstanding development costs are estimated as US$29,000,000.	The property is subject to one tenant occupying 15 sq.m. on a short term annually renewable inter-company lease for a total rent of US$1,907 per annum. The tenant is responsible for operating expenses, utilities and internal repairs (excluding capital improvements). The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area after development in addition to the 1,200 sq.m. required for the telephone exchange as outlined. There are no other contractual arrangements disclosed that effect the property.	US$0	US$12,000,000 upon completion	US$4,450,000 (Assuming built and fully let on market terms US$75,000,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 7 **11, Rogozhsky Val street** Moscow, Russia	The property comprises 4 buildings of 3,093.7 sq.m., 1,139.3 sq.m., 206.80 sq.m. and 318.20 sq.m. respectively. The largest building was constructed in the 1950s and is currently used as a central exchange, the second building is administrative and the two small buildings are used for warehouse purposes. It is understood that the remaining three buildings were constructed in the 1950s. The land area comprises 5,937 sq.m. and is held on a 25 year land lease from Moscow City Government from 21 March 1996 subject to standard Statutory annual rent review and extension rights. The buildings are held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 2 years to include demolition of the existing structures, and new construction to provide 38,000 sq.m. of residential accommodation and 3,000 sq.m. dedicated to the renovated telephone exchange. Total outstanding development costs are estimated as US$33,000,000.	The property is not subject to any tenancies. The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area after development in addition to the 3,000 sq.m. required for the telephone exchange. There are no other contractual arrangements disclosed that effect the property.	US$0	n/a as is anticipated to be sold with vacant possession upon completion.	US$2,200,000 (Assuming built and fully let on market terms is n/a.) Gross Development Value upon Completion is US$47,500,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 8 **20/1, Bol. Balkansky lane** Moscow, Russia	The property comprises a standard MGTS exchange building constructed in the 1970s, rranged over 6 floors above ground and 1 basement level, providing a gross area of 4,400 sq.m. The existing use is as a telecommunications central exchange or vacant. The land area comprises 2,435 sq.m. and is held on a 25 year land lease from Moscow City Government from 12 April 1995 subject to standard Statutory annual rent review and extension rights. The building is held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 15 months to include a renovation of the existing structure to provide 3,200 sq.m. of "class B" office accommodation, 1,200 sq.m. dedicated to the renovated telephone exchange, together with surface car parking. Total outstanding development costs are estimated as US$2,300,000.	Two tenants occupy 781 sq.m. on four lease agreements for a total rent of US$52,019 per annum. The tenants are responsible for operating expenses, utilities, insurance and repairs (excluding capital improvements). The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area after development in addition to the 1,200 sq.m. required for the telephone exchange as outlined. There are no other contractual arrangements disclosed that effect the property.	US$0	US$1,080,000 upon completion	US$860,000 (Assuming built and fully let on market terms US$5,000,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 9 **6/1, Broshevsky lane** Moscow, Russia	The property comprises a standard MGTS exchange building constructed in the 1970s, arranged over 4 floors above ground and 1 basement level, providing a gross area of 4,591 sq.m. The existing use is as a telecommunications central exchange and offices. The land area comprises 1,883 sq.m. and is held on a 25 year land lease from Moscow City Government from 6 March 1995 subject to standard Statutory annual rent review and extension rights. The building is held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 9 months to include a renovation of the existing structure to provide 3,400 sq.m. of budget office accommodation, 1,200 sq.m. dedicated to the renovated telephone exchange, together with surface car parking. Total outstanding development costs are estimated as US$2,000,000.	The property is not subject to any tenancies. The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area after development in addition to the 1,200 sq.m. required for the telephone exchange. There are no other contractual arrangements disclosed that effect the property.	US$0	US$765,000 upon completion	US$445,000 (Assuming built and fully let on market terms US$3,800,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 10 **5, Vsevolozhsky lane** Moscow, Russia	The property comprises a standard MGTS exchange building constructed in the 1970s, arranged over 4 floors above ground and 1 basement level, providing a gross area of 5,185 sq.m. above ground. The existing use is as a telecommunications central exchange, with the ground floor used as offices. The land area comprises 2,327 sq.m. and is held on a 25 year land lease from Moscow City Government from 20 December 1994 subject to standard Statutory annual rent review and extension rights. The building is held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 15 months to include a renovation of the existing structure to provide 5,000 sq.m. of "class B" office accommodation and 1,200 sq.m. dedicated to the renovated telephone exchange. There is no car parking provision. Total outstanding development costs are estimated as US$3,000,000.	The property is not subject to any tenancies. The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area after development in addition to the 1,200 sq.m. required for the telephone exchange as outlined. There are no other contractual arrangements disclosed that effect the property.	US$0	US$2,250,000 upon completion	US$2,325,000 (Assuming built and fully let on market terms US$12,850,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 11 **19, Daev lane** Moscow, Russia	The property comprises a standard MGTS exchange building constructed in the 1980s, arranged over 6 floors above ground and 1 basement level, providing a gross area of 6,468.7 sq.m. The existing use is as a telecommunications central exchange with the ground floor used as offices. The land area comprises 2,943 sq.m. and is held on a 25 year land lease from Moscow City Government from 20 December 1994 subject to standard Statutory annual rent review and extension rights. The building is held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 15 months to include a renovation of the existing structure to provide 5,300 sq.m. of "class B" office accommodation and 1,200 sq.m. dedicated to the renovated telephone exchange, together with surface car parking. Total outstanding development costs are estimated as US$3,200,000.	Four tenants occupy a total of 432 sq.m. on short term annually renewable leases for a total rent of US$91,525. The tenants are responsible for operating expenses, utilities and internal repair. Two of these are inter-company leases and are in the same form as the third party leases. The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area after development in addition to the 1,200 sq.m. required for the telephone exchange. There are no other contractual arrangements disclosed that effect the property.	US$0	US$2,265,000 upon completion	US$2,300,000 (Assuming built and fully let on market terms US$12,250,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 12 **5/2, Milyutinsky lane** Moscow, Russia	The property comprises a standard MGTS exchange building constructed in the 1980s, arranged over 9 floors above ground and 1 basement level, providing a gross area of 6,861 sq.m. The existing use is as a telecommunications central exchange or vacant. No information has been provided on tenure. We note that title documents on perpetual land lease rights of 3,800 sq.m. are subject to Moscow Land Committee (MLC) approval. We assume that the MLC will execute a lease agreement with MGTS within a reasonable time period and this will be granted subject to standard Statutory annual rent review and extension rights. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 15 months to include a renovation of the existing structure to provide 5,700 sq.m. of "class B" office accommodation. There is no car parking provision. There is no provision for a telephone exchange. Total outstanding development costs are estimated as US$3,400,000.	The property is not subject to any tenancies. The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area after development. There are no other contractual arrangements disclosed that effect the property.	US$0	US$2,440,000	US$2,440,000 (Assuming built and fully let on market terms US$13,500,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 13 **7/1, Nastasyinsky lane** Moscow, Russia	The property comprises a standard MGTS exchange building constructed in the 1960s, arranged over 4 floors above ground, providing a gross area of 2,907 sq.m. The existing use is as a telecommunications central exchange or vacant. The building is held freehold. The total land area comprises 4,215 sq.m. and is held on a 25 year land lease from Moscow City Government from 5 May 1995 subject to standard Statutory annual rent review and extension rights. This area is also occupied by an adjoining building which we have been specifically instructed to exclude from the valuation. Therefore the total land area associated with the exchange building is currently unknown. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 12 months to include a renovation of the existing structure to provide 3,000 sq.m. of "class B" office accommodation, together with limited surface car parking (less than 10 spaces). There is no provision for a telephone exchange. Total outstanding development costs are estimated as US$1,700,000.	The property is not subject to any tenancies. The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area after development. Sistema International occupies 242.9 sq.m. of the ground floor under the terms of an inter-company lease. Sistema International is responsible for all operating expenses, utilities, insurance and repairs (excluding capital improvements) under the terms of the lease. The rent currently being paid is approximately equivalent to the nominal sum of US$15,600 per annum. There are no other contractual arrangements disclosed that effect the property.	US$0	US$1,350,000 upon completion	US$1,960,000 (Assuming built and fully let on market terms US$7,700,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 15 **5/2, Pokrovsky boulevard** Moscow, Russia	The property comprises 2 buildings, both constructed in the 1930s. One is arranged 4 floors above ground and 1 basement level, providing a gross area of 3,275.1 sq.m. The second is arranged over 2 floors above ground and 1 basement level, providing a gross area of 656.2 sq.m. The existing use is as a telecommunications central exchange and office. The land area comprises 1,816 sq.m and is held on a 25 year land lease from Moscow City Government from 22 August 1995 subject to standard Statutory annual rent review and extension rights. The building is held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 12 months to include a renovation of the existing structures to provide 2,700 sq.m of "class B" office accommodation 1,200 sq.m dedicated to the renovated telephone exchange, together with a limited number of surface car parking (approx. 15). Total outstanding development costs are estimated as US$1,500,000.	The property is not subject to any tenancies. The property is partially occupied by the Company for the purposes of the business. It is assumed that the company will not occupy any area after development in addition to the 1,200 sq.m required for the telephone exchange as outlined. There are no other contractual arrangements disclosed that effect the property.	US$0	US$1,200,000 upon completion	US$1,430,000 (Assuming built and fully let on market terms US$6,500,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 16 **5/1, Stolyarny lane** Moscow, Russia	The property comprises a standard MGTS exchange building constructed in the 1960s, arranged over 6 floors above ground and 1 the basement level, providing a gross area of 6,415.8 sq.m. The existing use is as a telecommunications central exchange, with the ground, third and fifth floors in office and call centre use. The land area comprises 4,182 sq.m and is held on a 25 year land lease from Moscow City Government from 22 December 1994 subject to standard Statutory annual rent review and extension rights. The building is held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 18 months to include a renovation of the existing structure to provide 4,500 sq.m of "class B" office accommodation, 2,000 sq.m dedicated to the renovated telephone exchange, together with limited surface car parking (approx. 15 places). Total outstanding development costs are estimated as US$3,100,000.	The property is partially occupied by the Company for the purposes of business. It is assumed that the company will not occupy any area after development in addition to the 2,000 sq.m required for the exchange as outlined. There are no other contractual arrangements disclosed that effect the property.	US$0	US$1,720,000 upon completion	US$1,250,000 (Assuming built and fully let on market terms US$8,800,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 18 **1st Bukhvostova street 12/11, 1st Bukhvostova street 3 (NIIDAR)** Moscow, Russia	The property comprises a land plot of 11.4 ha. with 30 industrial, light industrial and administrative buildings, plus 5 parts of other buildings, constructed variously from 1940s to 1980s, together providing a gross area totaling 144,149 sq.m. The existing use is a research institute and production and office facilities. The land is held on 2 lease agreements with Moscow City Government. The first, dated 1 November 2002, relates to 9.3 ha. and expires 30 July 2012. The second, dated 27 June 1996, relates to 2.1 ha. and expires 30 September 2019. Both are subject to standard Statutory annual rent reviews and extension rights. The buildings are held freehold. The property is held for development. Planning permission approvals are in the process of being applied for. The development is anticipated to commence in Q4 2005 for a duration of 6 years in 3 phases to include demolition of the existing structures, and new construction to provide a mixed use scheme—institute, residential for sale and offices and retail for lease. The current proposals are for 200,000 sq.m of offices, 60,000 sq.m of retail, 130,000 sq.m of residential for sale and 85,000 sq.m for the use of the institute. Total outstanding development costs are estimated as US$410,000,000.	A part of the property is subject to a number of tenancies on short lease terms (<12 month). Further details have not been provided although we understand that all can be terminated at short notice by the Landlord. The property is partially occupied by the Company for the purposes of the business. It is assumed that the research institute will continue in occupation of part of the property (up to 85,000 sq.m) and this area has been included in the valuation at a discounted rent. No further details of the proposed occupation have been made available. There are no other contractual arrangements disclosed that effect the property.	US$0	US$69,950,000 upon completion	US$31,650,000 (Total Gross Development Value is US$586,500,000. apportioned between; residential sales of US$162,500,000; and, US$424,000,000 for the commercial element assuming built and fully let on market terms.)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 19 **5/1, Teatralny proezd (Detsky Mir)** Moscow, Russia	The property comprises a purpose built department store constructed in 1957 and arranged over seven above ground floors, mezzanine and basement providing a gross area of 57,568.3 sq.m of which 33,328.5 sq.m is sales area. Existing use is retail. The land area comprises 9,868 sq.m and is held on a 49 year land lease from Moscow City Government from 11 August 1995, subject to standard Statutory annual rent review and extension rights. The building is held freehold. The property is held for development. Existing planning permission approvals for redevelopment for retail/ entertainment purposes are in the process of being updated. The development will provide a gross construction area of 79,795 sq.m (plus additional basement parking) and approximately 38,700 sq.m of rentable area. Total outstanding development costs are estimated as US$97,000,000.	Currently the premises are occupied by a total of 178 tenants on 183 lease agreements and is producing a total rent of US$10,688,469 per annum. This rent is inclusive of operating expenses, ground rent and utilities. It is understood that all of the tenancies are short term (less than one year) and that there is no security of tenure.	US$6,921,434	US$24,983,000	US$28,900,000 (Assuming built and fully let on market terms US$161,200,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No: 20 **Serebryany Bor** Moscow, Russia	The property comprises principally vacant land plots totaling approx. 3.2 ha. There are six residential buildings on part of the property extending to a total area of 612.3 sq.m, which are due for demolition. Two of the properties were constructed prior to 1917, two in 1956 and one in 1969. The construction date of the final building is unknown. It is understood that full utilities are available to the sites. The property is located in one of Moscow's most prestigious residential locations. The property is held leasehold from Moscow City Government. The property is held for development and its existing use is residential and vacant land. The development is anticipated to commence in 2005 for a duration of 1½ years in a single phase, to provide 25 residential units with an average size of approximately 200 sq.m each, totaling 5,000 sq.m. Total outstanding development costs are estimated as US$4,400,000.	The property has existing development consents for residential uses, dated 2000 as amended, within the leases. There are no other contractual arrangements disclosed that effect the property.	US$0	US$2,250,000 upon completion	US$4,150,000 (Assuming built and fully let on market terms US$15,000,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No: 21 **Zdravnitsa** Moscow Region, Russia	The property comprises a 16.9 ha. cleared land site. The property is held freehold. The property is held for development and is to be developed in accordance with a planning permission dated 1998 for the development of 84 cottages. The development is anticipated to commence in 2005 for a duration of 2 years, to provide 83 individual residential units with an average size of approximately 200 sq.m each, totaling 16,600 sq.m lettable area for lease in a secure, woodland setting. Total outstanding development costs are estimated as US$17,500,000. An alternative development of this property would be to install utilities only serving individual land plots and to sell these individually for residential development.	The property is not subject to any tenancies. There are no other contractual arrangements disclosed that effect the property.	US$0	US$4,855,000 upon completion	US$2,075,000 (Assuming built and fully let on market terms US$28,600,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 24 **3, Krestovki river emb.** St. Petersburg, Russia	The property comprises a mansion type building (arranged over 4 floors, to provide 3,372.3 sq.m.) and 7 ancillary buildings originally constructed in 1930s and 1950s as an institute. The ancillary buildings include a workshop (arranged over 3 floors, to provide 4,498.3 sq.m.), further workshop (1 floor, 319.3 sq.m.), former health club (1 floor, 124.7 sq.m.), old garage (2 floors, 344.4 sq.m.), new garage (2 floors, 167 sq.m.), warehouse (1 floor, 175.3 sq.m.) and electrical house (1 floor, 21.7 sq.m.). Existing uses are offices and light industrial. The site is located in one of the most prestigious residential zones of St. Petersburg. Land lease rights are in the process of being formulated and the size of the land will be assessed accurately at that time. The building is held freehold. The property is held for development. Existing planning permission approvals are in the process of being updated. Total outstanding development costs are estimated as US$23,000,000.	The property is subject to 70 short term (11 month) tenancies. The total area rented extends to 4,645 sq.m. with an estimated net monthly income in November 2004 of US$5,850. The tenants pay all-inclusive rents, including VAT and operating expenses which amounted to $29,660 in November 2004. Due to the large turnover of tenants this rental figure changes on a monthly basis. There are no other contractual arrangements disclosed that effect the property.	US$300,000	US$580,000	US$1,980,000 (Total Gross Development Value is US$32,000,000 apportioned between; residential sales of US$28,800,000; and, US$3,200,000 for the commercial element assuming built and fully let on market terms)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 25 **7, Pulkovskoye shosse** (main St. Petersburg to airport highway) St. Petersburg, Russia	The property comprises a cleared 12.6 ha. site held for development. The former use was as an agricultural nursery. The property is held Freehold. The property is held for development and existing planning permission approval, dated February 2004 for public-business zone development, is in the process of being updated. The property forms part of a larger master-planned retail park of anticipated 180-200,000 sq.m. (gross) retail space, with associated surface car parking. The development is anticipated to commence in Q2 2005 for a duration of 9-12 months, to provide approx. 55,000 sq.m. of retail warehousing together with associated surface car parking. Total outstanding development costs are estimated as US$32,000,000.	The property is not subject to any tenancies. There are no other contractual arrangements disclosed that effect the property.	US$0	US$11,000,000 upon completion	US$14,700,000 (Assuming built and fully let on market terms US$68,750,000)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 26 **Pekin Hotel** B. Sadovaya 5/1 and 5/2, Gasheka street 12/6 and 2nd Brestskaya street 1/1 (located on the “Garden Ring”, close to Tverskaya) Moscow, Russia	The property is an existing Soviet era hotel, constructed in the 1960s, and comprises three buildings, two of which (3,568.4 sq.m. and 1,058.7 sq.m. respectively) are currently freehold owned by the company “Beijing-Invest”, which is majority controlled by Sistema, and for the third (25,877.3 sq.m.) there is an agreement in principle for transfer of ownership to the company “Beijing-Invest”, as a result of reconstruction, on a land plot of 1.73 ha. The agreed price for the transfer of the third building has been taken into account in the valuation. The land lease rights are in the process of being formulated. The property is held for development. The development is anticipated to commence in Q4 2005 and to be completed in Q4 2007 to provide a total area of 109,072 sq.m., including reconstruction of the hotel (22,000 sq.m.), new office building (47,349 sq.m.), retail areas—both new build and reconstruction (13,907 sq.m.), public areas (2,280 sq.m.) and underground parking (23,536 sq.m.—648 places). Total outstanding development costs are estimated at US$113,000,000.	The property is not subject to any tenancies. There is a Resolution of Moscow City Government No. 1064-PP dated 24 December 2002 that provides for conclusion of an investment contract for the site development between Moscow City Government and the company “Beijing-Invest”, There are no other contractual arrangements disclosed that effect the property.	US$0	US$31,300,000 upon completion, excluding hotel and parking	US$49,200,000 (Assuming built and fully let on market terms US$219,000,000 —excluding hotel)

Market Value as at 30 December 2004
PROPERTIES HELD FOR DEVELOPMENT

Property ID: Property Address:	Description, Age and Tenure:	Terms of Existing Tenancies:	Net Annual Rent:	Estimated Net Annual Rent:	Market Value:
No. 27 **Former Sport Hotel** Moscow Russia	The property comprises a cleared development site extending to 2.10 ha. There is an investment contract with the Moscow City Government for the construction of 195,000 sq.m. of hotel, office, retail and leisure multi-functional centre. There is a further agreement from the Moscow City architect's office for the construction of 2 towers and a base building on the site providing a total of 420,000 sq.m. including 90,000 sq.m. underground parking. The property is held for development. Development details are at an initial stage, however we understand that the development is anticipated to commence in 1Q 2006 and completed in 3Q 2008 to provide 135,000 sq.m. in the base building (comprising 20,000 sq.m. offices, 40,000 sq.m. retail, 35,000 sq.m. restaurants & leisure uses and 40,000 sq.m. of public areas), a hotel tower of 73,000 sq.m. (350 rooms) and an office tower of 122,000 sq.m. Total outstanding development costs are estimated at US$290,000,000.	None Disclosed. There are no other contractual arrangements disclosed that effect the property.	US$0	US$82,600,000 Upon completion, excluding hotel and parking	US$32,000,000 (Assuming built and fully let on market terms US$472,000,000 —excluding hotel)

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JOINT-STOCK FINANCIAL CORPORATION
SISTEMA

1,592,663 Shares
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OFFERING MEMORANDUM
February 9, 2005

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