



Mobile TeleSystems Finance S.A.

\$400,000,000

8.375% notes due 2010

Guaranteed by Mobile TeleSystems OJSC

The Company—

- We are Mobile TeleSystems OJSC, a leading provider of mobile telecommunications services in the Russian Federation.

The Issuer—

- Our beneficially wholly-owned finance subsidiary, Mobile TeleSystems Finance S.A., a company organized under the laws of Luxembourg, will issue the notes.

The Guarantor—

- If the issuer fails to make payments on the notes when they are due, we have agreed unconditionally and irrevocably to make the payments.

The Notes—

- The notes being offered hereby will be issued under an indenture to be dated October 14, 2003.

Maturity—

- The notes will mature at par on October 14, 2010.

Interest—

- The issuer will pay interest on the notes at an annual rate equal to 8.375%. The issuer will make interest payments on the notes semi-annually in arrears on April 14 and October 14 of each year, commencing on April 14, 2004. Payments on the notes will be made free and clear of, and without withholding or deduction for, any taxes imposed by Luxembourg or the Russian Federation, to the extent described under "Description of the Notes—Taxation and Additional Amounts."

Ranking—

- The notes will be general unsecured obligations of the issuer, senior to all present and future subordinated obligations and equal to all present and future unsecured obligations.
- The guarantee will be our general unsecured obligation, senior to all our existing and future subordinated obligations, equal to all our existing and future unsecured obligations and effectively junior to all our existing and future secured obligations and all existing and future obligations of our subsidiaries.

Permission from the Central Bank of Russia—

- The permission of the Central Bank of Russia is required for us to make payments in U.S. dollars under the guarantee. We have applied for, but have not yet received, such permission. We will undertake in the indenture to use our best efforts to obtain such permission. See "Summary—Optional Redemption by the

Holders upon a Failure by MTS to Obtain Permission from the Central Bank of Russia."

Redemption at the Option of the Issuer—

- The notes are not redeemable except in limited circumstances, including for tax reasons.

Redemption at the Option of the Holders of the Notes—

- If we or the issuer experience certain types of mergers, consolidations or other changes of control, you will have the right to require the issuer to redeem all of your notes at 101% of their principal amount, plus accrued interest.
- We are required to obtain permission from the Central Bank of Russia prior to making payments in U.S. dollars under the guarantee. As of the date hereof, we have applied for, but have not yet received, such permission. If we fail to obtain such permission within 60 days after the closing date, you will have the right until we have obtained such permission to require the issuer to redeem all of your notes at 101% of their principal amount, plus accrued interest to the redemption date.

Notice to Investors—

- **Investing in the notes involves risks. You should carefully consider the risk factors beginning on page 10 before investing.**
- The notes will be offered and sold outside the United States in offshore transactions in reliance on Regulation S under the U.S. Securities Act and in the United States to "qualified institutional buyers" (as defined in Rule 144A under the U.S. Securities Act) in reliance on Rule 144A.

Settlement—

- The notes will be delivered on or about October 14, 2003 through Euroclear, Clearstream or DTC, as the case may be, against payment therefor in immediately available funds.
- The closing date of the offering is October 14, 2003. See "Plan of Distribution."

Listing—

- Application has been made to list the notes on the Luxembourg Stock Exchange. The notes represented by restricted global notes have been designated for trading in the Private Offerings, Resale and Trading through Automated Linkages, or PORTAL, Market of the National Association of Securities Dealers, Inc. There can be no assurance that a trading market for the notes will develop.

ISSUE PRICE: 100%

Joint Bookrunners

Credit Suisse First Boston

ING

Co-Managers

ABN AMRO

JPMorgan

RZB-Austria Raiffeisen Zentralbank Österreich AG

**Commerzbank Securities
Merrill Lynch International
Renaissance Capital**

Financial Advisor to the Guarantor

Moscow Bank of Reconstruction and Development

October 14, 2003



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IMPORTANT INFORMATION ABOUT THIS OFFERING MEMORANDUM

This offering memorandum is based on information provided by us and other sources believed to be reliable. The initial purchasers of the notes 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 summarizes certain documents and other information and we refer you to them for a more complete understanding of what we discuss in this offering memorandum.

We and the issuer accept responsibility for the information contained in this offering memorandum. To the best of our knowledge and that of the issuer, the information contained in this offering memorandum is in accordance with the facts and does not omit anything likely to materially affect the import of this offering memorandum.

In making an investment decision regarding the notes offered hereby, you must rely on your own examination of our company and the terms of this offering, including the merits and risks involved. You should rely only on the information contained in this offering memorandum. We have not, and the initial purchasers 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 notes. We are not, and the initial purchasers are not, making any representation to any offeree or purchaser of the notes regarding the legality of an investment in the notes by such offeree or purchaser under appropriate investment or similar laws.

We obtained the market data used in this offering memorandum, which may include approximations or be rounded for convenience, 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 website do not form any part of this offering memorandum.

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

The distribution of this offering memorandum and the offer and sale of the notes may be restricted by law in certain jurisdictions. You must inform yourself about, and observe, any such restrictions. See “Plan of Distribution” and “Transfer Restrictions” 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 notes or possess or distribute this offering memorandum and must obtain any consent, approval or permission required for your purchase, offer or sale of the notes 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 initial purchasers are not, making an offer to sell the notes or a solicitation of an offer to buy any of the notes to any person in any jurisdiction except where such an offer or solicitation is permitted.

Notwithstanding the foregoing or anything herein to the contrary, each recipient of this offering memorandum (and each employee, representative, or other agent of such recipient) may disclose to any and all other persons, without limitation of any kind, the tax treatment and tax structure of the transactions described herein and all materials of any kind (including opinions or other tax analyses) that are provided to such recipient relating to such tax treatment and tax structure. However, any such information relating to such tax treatment or tax structure is required to be kept confidential to the extent reasonably necessary to comply with any applicable federal or state securities laws. For this purpose, the tax treatment of a transaction is the purported or claimed U.S. federal income tax treatment of the transaction, and the tax structure of a transaction is any fact that may be relevant to understanding the purported or claimed U.S. federal income tax treatment of the transaction.

The notes have not been registered with, recommended by, disapproved by or approved by the U.S. Securities and Exchange Commission (the “Commission”) or any other domestic or foreign securities regulatory commission or authority. In addition, neither the Commission nor any state securities commission has approved or disapproved of these securities or determined if this offering memorandum is truthful or complete. Any representation to the contrary is a criminal offense.

The notes will be offered and sold outside the United States in offshore transactions in reliance on Regulation S under the U.S. Securities Act of 1933, as amended (the “U.S. Securities Act”) and in the United States to “qualified institutional buyers” (as defined in Rule 144A under the U.S. Securities Act) in reliance on Rule 144A.

STABILIZATION

In connection with this offer, 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 notes at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there may 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.

NOTICES TO NON-U.S. 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) falling within Article 49(2)(a) to (e) of the Order (all such persons together being referred to as “relevant persons”). The notes are only available to, and any invitation, offer or agreement to subscribe, purchase or otherwise acquire such notes will be engaged in only with, relevant persons. Any person who is not a relevant person should not act or rely on this document 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 412-B OF THE NEW HAMPSHIRE REVISED STATUTES 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 OF NEW HAMPSHIRE 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.

LIMITATION ON ENFORCEABILITY OF CIVIL LIABILITIES

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

- effect service of process within the United States upon substantially all of our directors and executive officers named in this offering memorandum; or
- enforce, in the U.S. courts, judgments obtained in U.S. courts against us or substantially all of our directors and executive officers named in this offering memorandum in any action, 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 located outside the United States, liabilities predicated upon the U.S. 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 the recognition and enforcement of judgments in civil cases exists between the Russian Federation and the country where the judgment is rendered. No such treaty exists between the United States and the Russian Federation, or between the United Kingdom and the Russian Federation, for the reciprocal enforcement of foreign court judgments.

The notes are governed by the laws of the State of New York, and we and the issuer have agreed that disputes arising thereunder are subject to the non-exclusive jurisdiction of federal and state courts in the Borough of Manhattan in the City of New York or, at the option of the noteholders, to arbitration in accordance with the Rules of the London Court of International Arbitration in London, United Kingdom. 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 the enforcement of awards against Russian companies in favor of foreign investors; and
- the inability of Russian courts to enforce such orders and corruption.

We and the issuer have appointed Puglisi & Associates, 850 Library Avenue, Suite 204, Newark, Delaware 19715, as our agent for service of process in any suit, action or proceeding with respect to the notes. However, such appointment may not be respected by a Russian court.

CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Matters discussed in this document may constitute forward-looking statements. The Private Securities Litigation Reform Act of 1995 provides safe harbor protections for forward-looking statements in order to encourage companies to provide prospective information about their businesses. Forward-looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, and underlying assumptions and other statements, which are other than statements of historical facts.

Mobile TeleSystems OJSC, or MTS, desires to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and is including this cautionary statement in connection with this safe harbor legislation. This document and any other written or oral statements made by us or on our behalf may include forward-looking statements, which reflect our current views with respect to future events and financial performance. The words “believe,” “expect,” “anticipate,” “intends,” “estimate,” “forecast,” “project,” “will,” “may,” “should” and similar expressions identify forward-looking statements. Forward-looking statements appear in a number of places including, without limitation, “Risk Factors,” “Business” and “Operating and Financial Review and Prospects,” and include statements regarding:

- strategies, outlook and growth prospects;
- future plans and potential for future growth;
- liquidity, capital resources and capital expenditures;
- growth in demand for our services;
- economic outlook and industry trends;
- developments of our markets;
- the impact of regulatory initiatives; and
- the strength of our competitors.

The forward-looking statements in this document are based upon various assumptions, many of which are based, in turn, upon further assumptions, including without limitation, management’s examination of historical operating trends, data contained in our records and other data available from third parties. Although we believe that these assumptions were reasonable when made, because these assumptions are inherently subject to significant uncertainties and contingencies which are difficult or impossible to predict and are beyond our control, we cannot assure you that we will achieve or accomplish these expectations, beliefs or projections. In addition to these important factors and matters discussed elsewhere herein and in the documents incorporated by reference herein, important factors that, in our view, could cause actual results to differ materially from those discussed in the forward-looking statements include the achievement of the anticipated levels of profitability, growth, cost and synergy of our recent acquisitions, the timely development and acceptance of new products, the impact of competitive pricing, the ability to obtain necessary regulatory approvals, the condition of the Russian economy, political stability in Russia, the impact of general business and global economic conditions and other important factors described herein and from time to time in the reports filed by us with the Securities and Exchange Commission.

Except to the extent required by law, neither we, nor any of our respective agents, employees or advisors intends or has any duty or obligation to supplement, amend, update or revise any of the forward-looking statements contained or incorporated by reference in this document.

CURRENCIES

In this document, references to “U.S. dollars,” “dollars” or “\$” are to the lawful currency of the United States, references to “rubles” are to the lawful currency of the Russian Federation, references to “hryvnas” are to the lawful currency of Ukraine and references to “€” or “euro” are to the lawful currency of the member states of the European Union that adopted a single currency in accordance with the Treaty of Rome establishing the European Economic Community, as amended by the treaty on the European Union, signed at Maastricht on February 7, 1992.

OFFERING MEMORANDUM SUMMARY

In addition to this summary, you are urged to read the entire offering memorandum carefully, especially the discussion of the risks of investing in the notes under "Risk Factors," before deciding to buy the notes.

The Company

Overview of Operations

We are a leading provider of mobile cellular communications services in the Russian Federation and employ technology based primarily on Global System for Mobile Communications, or GSM. We are the largest mobile operator in Russia in terms of net revenues, generating \$535.7 million during 2000, \$893.2 million during 2001, \$1.4 billion during 2002 and \$1.1 billion during the first six months of 2003. As of September 1, 2003, we had approximately 9.5 million subscribers in Russia, making us the largest mobile cellular operator in Russia in terms of subscribers, and 2.3 million subscribers in Ukraine. Our unconsolidated joint venture in Belarus, Mobile TeleSystems LLC, had 251,600 subscribers as of September 1, 2003.

As of June 30, 2003, we had licenses to operate in 58 regions of Russia with a population of approximately 110.2 million people, or approximately 76% of the country's total population. As of June 30, 2003, we had commenced commercial operations in 49 of these regions, with a combined population of approximately 100.4 million people, including approximately 17.0 million in the Moscow license area and approximately 14.0 million in the North-West license area, which includes St. Petersburg. Since June 30, 2003, we have acquired licenses for 18 additional regions, covering a population of approximately 17.5 million, and have commenced operations in nine additional regions.

The Moscow license area, which encompasses the City of Moscow and the Moscow region, remains our principal market in terms of revenues, although today more than one-half of our total subscriber base resides outside of the Moscow license area. According to AC&M-Consulting, approximately 36.4% of all mobile cellular subscribers in Russia reside in the Moscow license area, where penetration stood at approximately 53.3% as of June 30, 2003. In Russia generally, penetration was lower, at approximately 17.3% according to AC&M-Consulting. We had approximately 4.1 million subscribers in the Moscow license area as of June 30, 2003, representing approximately 45.6% of all mobile cellular subscribers in the area according to AC&M-Consulting. Our subscribers in Russia outside of the Moscow license area, in what we refer to as regional license areas, totaled approximately 5.2 million as of June 30, 2003. According to AC&M-Consulting, as of June 30, 2003, we had a 37.1% market share of total mobile cellular subscribers in Russia. Ukrainian Mobile Communications (UMC), our subsidiary in Ukraine, had approximately 2.0 million subscribers as of June 30, 2003 and, according to Ukrainian News, a 46% market share of total mobile cellular subscribers in Ukraine.

Both our subscriber base, which reflects only active subscribers, and our net revenues have increased significantly since 1996, as summarized below:

<u>Period</u>	<u>Subscribers⁽¹⁾⁽²⁾</u> <u>(in thousands)</u>	<u>Net revenues</u>
Twelve months ended December 31:		
1996	19	\$ 53,645
1997	60	\$ 208,408
1998	114	\$ 338,323
1999	306	\$ 358,327
2000	1,194	\$ 535,712
2001	2,650	\$ 893,247
2002	6,644	\$1,361,756
Six months ended June 30, 2002	4,370	\$ 563,902
Six months ended June 30, 2003	11,340	\$1,052,134

(1) For a description of our definition of "subscriber" see footnote 12 to "Summary Financial and Operating Data."

(2) Subscribers in Russia as of the end of each period and, as of June 30, 2003, subscribers in Russia and Ukraine. We do not include our subscribers in Belarus in our operating information, because our joint venture in Belarus is not consolidated in our financial statements.

To maintain and increase our market share, we use a combination of newspaper, magazine, radio, television, direct mail and outdoor advertising, focusing in particular on brand and image advertising and public relations, to position us as a leading cellular operator in Russia. Supporting these efforts, we had a sales and distribution network consisting of 27 integrated sales and customer service centers and over 4,500 independent dealer distribution outlets in the Moscow license area as of June 30, 2003. We had 200 sales and customer service centers in Russia as of June 30, 2003. In Ukraine and Belarus we had 32 and three sales and customer service centers, respectively, as of June 30, 2003.

We seek to minimize our exposure to the credit risk of our subscribers through our advance-payment billing system, which is used by over 97% of our subscribers in Russia and approximately 95% of our subscribers in Ukraine. Under this system, our subscribers prepay for their access, usage and value-added service fees.

In addition to standard voice services, we offer our subscribers enhanced services including voice mail, short message service (SMS), general packet radio service (GPRS) and data and fax transmission. We also offer our subscribers the ability to roam automatically throughout Europe, and in much of the rest of the world, and had bilateral roaming agreements with 266 GSM service providers in 116 countries and Russia.

Business Strategy

Our primary goal is to maintain our position as a leading national mobile operator in Russia by integrating our regional networks into a single unified network, adopting a coordinated marketing approach and deploying integrated nationwide customer service and billing systems. In addition, we intend to take advantage of selected opportunities to expand our network coverage in the Russian Federation and other countries of the CIS and offer our customers new products and services. To accomplish this, we intend to implement the following strategies:

- Maintain our leading position in the Moscow license area by growing our subscriber base and focusing on the quality of our subscriber mix, service quality, cost control and the development of services and incentives aimed at encouraging subscriber loyalty.

- Continue to develop our operations in the regions in which we currently operate and, in particular, in St. Petersburg, which we consider to be the second-most important mobile market in Russia after Moscow.
- Selectively expand our network to parts of Russia in which we do not already operate, focusing on high-density population areas with relatively high per capita incomes, such as regional capitals, and along transportation routes.
- Further develop our operations in Ukraine and Belarus and expand our operations into other countries of the CIS as attractive opportunities arise through the acquisition of existing operators or new licenses.
- Continue to provide new and varied tariff plans and value-added service options which appeal to the various groups of subscribers within our network.
- Continue to take advantage of the Moscow license area as a platform from which to test and launch new products and services.
- Implement a simplified and strengthened centrally-managed corporate function to enhance performance and efficiency at all levels of our operations and simultaneously integrate our operations in all territories where we are present.

Implementation of these strategies is subject to a number of risks, including our ability to manage our rapid growth and development, integrate new acquisitions successfully and compete effectively against existing and new competitors. See “Risk Factors” for a description of these and other risks we face.

The Offering

The following summary contains basic information about the notes. It may not contain all the information that is important to you. For a more complete understanding of the terms of the notes, please read the section in this offering memorandum entitled “Description of the Notes” and particularly those headings within such section that we refer you to below.

Issuer	Mobile TeleSystems Finance S.A., a company organized under the laws of Luxembourg.
Guarantor	Mobile TeleSystems OJSC, an open joint-stock company organized under the laws of the Russian Federation.
Notes Offered	\$400,000,000 aggregate principal amount of 8.375% notes due 2010.
Maturity Date	October 14, 2010.
Interest	The issuer will pay interest on the notes at an annual rate of 8.375% on April 14 and October 14 of each year. The first interest payment will be made on April 14, 2004.
Denominations	The notes will be issued in denominations of \$1,000 and integral multiples thereof.
Ranking	The notes will be general unsecured obligations of the issuer, senior to all present and future subordinated obligations and equal to all present and future unsecured obligations.
Central Bank of Russia Permission	We are required to obtain permission from the Central Bank of Russia prior to making payments in U.S. dollars under the guarantee. As of the date hereof, we have applied for, but have not yet received this permission. We will undertake in the indenture to use our best efforts to obtain such permission. See “Description of the Notes—The Guarantee” and “—Redemption at Option of Holders upon a Failure by MTS to Obtain a Permission from the Central Bank of Russia to make Payments in U.S. Dollars under the Guarantee” and “Risk Factors—Risks Relating to the Notes and the Trading Market—If we are unable to obtain permission from the Central Bank of Russia for purposes of making payments pursuant to the guarantee, we will not be able to make payments in U.S. dollars pursuant to the guarantee and the guarantee may not be enforceable.”
Guarantee	We are fully and unconditionally guaranteeing all payments of principal and interest on the notes. This guarantee will be our general unsecured obligation, senior to all our present and future subordinated obligations, equal to all our present and future unsecured obligations and effectively junior to all our present and future secured obligations and all present and future obligations of our subsidiaries.
Optional Redemption by the Holders upon a Change in Control	If we or the issuer experience certain types of mergers,

consolidations or other changes in control, you will have the right to require the issuer to redeem all of your notes at 101% of their principal amount, plus accrued interest.

Optional Redemption by the
Holders upon a Failure by MTS to
Obtain Permission from the Central
Bank of Russia

If we fail to obtain permission from the Central Bank of Russia to make payments in foreign currency under the guarantee within 60 days after the closing date, you will have the right until we have obtained such permission to require us to redeem all of your notes at 101% of their principal amount, plus accrued interest to the redemption date. If you exercise this right, you will not have full recourse to us under the guarantee, as a permission of the Central Bank of Russia would not then have been obtained, and you will have to rely for payment on the issuer of the notes, which could seek to enforce the agreement pursuant to which the issuer loaned the offering proceeds to us.

Tax Redemption by the Issuer

The issuer may redeem all (but not part) of the notes at any time, at a redemption price equal to 100% of the aggregate principal amount of the notes plus accrued interest if either we or the issuer has or will become obligated to pay Additional Amounts on the notes as a result of a change or amendment in the laws, treaties, rulings or regulations of any Taxing Jurisdiction (or any change or amendment in the application or interpretation of such laws, treaties, rulings or regulations) effective after the issue date of the notes, where we or the issuer cannot avoid such obligation by taking reasonable measures.

Certain Covenants

The indenture governing the notes contains covenants limiting:

- the ability of the issuer, us and our subsidiaries to incur debt;
- the ability of the issuer, us and our subsidiaries to create liens;
- the ability of the issuer, us and our subsidiaries to lease properties sold or transferred by us;
- the ability of the issuer, us and our subsidiaries to enter into loan transactions with affiliates;
- our ability to merge or consolidate with another person or convey our properties and assets to another person; and
- our ability to sell or transfer any of our or our subsidiaries' GSM licenses for the Moscow, St. Petersburg, Krasnodar and Ukraine license areas.

These covenants are subject to important exceptions and qualifications described under “Description of the Notes—Principal Covenants.”

Use of Proceeds	The issuer will lend the net proceeds of the offering to us. We intend to use \$200 million of the net proceeds from the offering to repay the loans we obtained from Credit Suisse First Boston International and from ING Bank (Eurasia) ZAO and ING (Ireland) Limited to finance certain capital expenditures and for general corporate purposes, including dividends. See “Operating and Financial Review and Prospects—Recent Developments—CSFBi Loan” and “—ING Loan.” Over time, we intend to use the remaining proceeds to repay certain of our existing indebtedness that was incurred for acquisitions of mobile operators in Russia and Ukraine. See “Use of Proceeds.”
Transfer Restrictions	We have not registered the notes under the U.S. Securities Act. You may only offer or sell the notes in transactions exempt from or not subject to the registration requirements of the U.S. Securities Act and in compliance with all applicable laws of any relevant jurisdiction. See “Transfer Restrictions.”
Listing	The notes have been designated for trading in the PORTAL Market. Application to list the notes on the Luxembourg Stock Exchange has been made but is not expected to be approved prior to closing. We have agreed in the purchase agreement with the initial purchasers to obtain the listing of the notes on the Luxembourg Stock Exchange within 28 days from the date of this offering memorandum.
Trustee, Registrar, Transfer Agent and Principal Paying Agent	JPMorgan Chase Bank.
Luxembourg Listing Agent, Luxembourg Paying Agent and Transfer Agent	J.P. Morgan Bank Luxembourg S.A.

SUMMARY FINANCIAL AND OPERATING DATA

The summary consolidated financial data below shows our historical financial information for the five-year period ended December 31, 2002, and for the six-month periods ended June 30, 2002 and 2003. The summary consolidated financial data as of and for the years ended December 31, 2000, 2001 and 2002 are derived from the audited consolidated historical financial statements, prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP), included elsewhere in this document. The summary consolidated financial data as of and for the six months ended June 30, 2002 and 2003 are derived from the unaudited consolidated financial statements prepared in accordance with U.S. GAAP included elsewhere in this document, and reflect normal and recurring adjustments that are necessary for a fair statement of the results for the interim periods presented. Results for interim periods are not necessarily indicative of results for the full year. In addition, the following table presents summary financial information as of and for the years ended December 31, 1998 and 1999 derived from our audited consolidated financial statements not included in this document. The summary financial data should be read in conjunction with our financial statements included elsewhere in this document, "Risk Factors" and "Operating and Financial Review and Prospects."

Key industry data and certain MTS operating data are also provided below.

	Years Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003 ⁽²⁾
(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)							
Statement of operations data:							
Net revenues:							
Service revenues ⁽¹⁾	\$ 313,282	\$ 314,568	\$ 484,469	\$ 830,308	\$ 1,274,287	\$ 522,386	\$ 992,673
Connection fees	8,697	12,755	14,885	21,066	24,854	12,228	16,166
Equipment sales	16,344	31,004	36,358	41,873	62,615	29,288	43,295
Total net revenues	338,323	358,327	535,712	893,247	1,361,756	563,902	1,052,134
Cost of services and products:							
Interconnection and line rental . .	43,617	38,958	41,915	75,278	113,052	55,081	78,908
Roaming expenses	13,223	21,725	41,178	68,387	83,393	28,713	45,269
Cost of equipment	14,658	29,932	39,217	39,828	90,227	38,119	73,639
Total cost of services and products	71,498	90,615	122,310	183,493	286,672	121,913	197,816
Operating expenses ⁽³⁾	67,470	74,612	110,242	134,598	229,056	91,672	168,944
Sales and marketing expenses . .	15,657	23,722	76,429	107,729	171,977	64,795	135,564
Depreciation and amortization . .	19,629	53,766	87,684	133,318	209,680	90,678	174,774
Impairment of investment	—	—	—	10,000	—	—	—
Net operating income	164,069	115,612	139,047	324,109	464,371	194,844	375,036
Currency exchange and translation loss (gain) ⁽⁴⁾	25,125	3,238	1,066	2,264	3,474	690	(1,408)

	Years Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003 ⁽²⁾
(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)							
Other expenses (income):							
Interest income	\$ (2,181)	\$ (801)	\$ (7,626)	\$ (11,829)	\$ (8,289)	\$ (5,497)	\$ (8,823)
Interest expenses, net of amounts capitalized ⁽⁵⁾	8,302	11,805	11,335	6,944	44,389	20,687	42,813
Other expenses (income), net . . .	4,838	(829)	(502)	(2,672)	(2,454)	2,721	855
Total other expenses (income), net	10,959	10,175	3,207	(7,557)	33,646	17,911	34,845
Income before provision for income taxes and minority interest	127,985	102,199	134,774	329,402	427,251	176,243	341,599
Provision for income taxes	62,984	18,829	51,154	98,128	110,417	53,954	96,412
Minority interest in net (loss) income	(1,027)	(2,291)	(6,428)	7,536	39,711	14,688	36,445
Net income before cumulative effect of a change in accounting principle	66,028	85,661	90,048	223,738	277,123	107,601	208,742
Cumulative effect of a change in accounting principle, net of income taxes of \$9,644 in 2001 .	—	—	—	(17,909)	—	—	—
Net income	\$ 66,028	\$ 85,661	\$ 90,048	\$ 205,829	\$ 277,123	\$ 107,601	\$ 208,742
Dividends declared	\$ 10,119	\$ 11,879	\$ 13,631	\$ 2,959	\$ — ⁽⁶⁾	\$ —	\$ 111,412
Pro forma net income giving effect to the change in accounting principle, had it been applied retroactively	\$ 59,439	\$ 78,258	\$ 93,108	\$ 223,738	\$ 277,123	\$ 107,601	\$ 208,742
Net income per share, basic and diluted	\$ 0.047	\$ 0.052	\$ 0.050	\$ 0.104	\$ 0.140	\$ 0.054	\$ 0.105
Dividends declared per share . . .	\$ 0.01	\$ 0.01	\$ 0.01	—	— ⁽⁶⁾	—	\$ 0.06
Weighted average common shares outstanding	1,397,945,938	1,634,527,040	1,806,968,096	1,983,359,507	1,983,359,507	1,983,359,507	1,983,359,507
Consolidated cash flow data:							
Cash provided by operating activities	\$ 103,486	\$ 116,801	\$ 190,914	\$ 338,201	\$ 412,772	\$ 107,315	\$ 395,341
Cash used in investing activities . .	(122,051)	(115,184)	(423,349)	(441,523)	(697,921)	(279,671)	(702,226)
(of which capital expenditures)	(103,132)	(118,338)	(224,898)	(441,200)	(574,272)	(242,016)	(383,239)
Cash (used in) provided by financing activities	(9,624)	(11,557)	298,543	247,592	100,817	65,297	385,338
Consolidated balance sheet data (end of period):							
Cash, cash equivalents and short-term investments	\$ 20,884	\$ 10,000	\$ 245,828	\$ 304,933	\$ 64,661	\$ 111,823	\$ 143,561
Property, plant and equipment, net	167,975	250,270	439,307	856,056	1,344,633	1,142,199	1,866,543
Total assets	614,165	682,047	1,101,332	1,727,492	2,283,296	2,015,679	3,299,942
Total debt (long-term and short-term) ⁽⁷⁾	110,155	112,123	52,773	325,840	454,485	418,211	977,270
Total shareholders' equity:	269,942	343,724	801,084	1,018,279	1,302,044	1,128,489	1,403,296
including capital stock	49,276	49,276	40,352	40,352	40,352	40,352	40,352

	Years Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003 ⁽²⁾
(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)							
Key financial ratios (end of period):							
Total debt/total capitalization ⁽⁸⁾ . . .	28.0%	24.6%	6.2%	24.2%	25.9%	27.0%	41.1%
Key industry data (end of period):							
Estimated population in Russia (millions) ⁽⁹⁾	146.7	145.9	144.8	143.9	145.2	143.5	144.5
Russian cellular subscribers (thousands) ⁽¹⁰⁾	718	1,360	3,400	8,040	18,001	11,370	25,130
Industry penetration ⁽¹⁰⁾	0.5%	0.9%	2.3%	5.5%	12.4%	8.1%	17.3%
MTS operating data: ⁽¹¹⁾							
MTS—total subscribers (end of period, thousands) ⁽¹²⁾	114	306	1,194	2,650	6,644	4,370	11,340
MTS share of total Russian subscribers (end of period) ⁽¹⁰⁾	16%	23%	35%	33%	38%	37%	37%
Average monthly usage per Russian subscriber (minutes) ⁽¹³⁾	384	224	151	157	159	167	162
Average monthly revenue per Russian subscriber (in U.S. dollars) ⁽¹⁴⁾ \$	302 \$	124 \$	54 \$	36 \$	23 \$	25 \$	19
Churn ⁽¹⁵⁾	31.2%	20.7%	21.6%	26.8%	33.9%	7.7%	11.0%
<p>⁽¹⁾ Service revenues represent subscription fees, usage charges and value-added service fees, as well as roaming fees charged to other operators for their subscribers, or guest roamers, utilizing our network. Guest roaming fees were \$56.5 million, \$44.0 million, \$43.2 million, \$52.6 million and \$83.4 million for the years ended December 31, 1998, 1999, 2000, 2001 and 2002, respectively, and \$34.1 million and \$62.8 million for the six months ended June 30, 2002 and 2003, respectively.</p> <p>⁽²⁾ Our results of operations for the six months ended June 30, 2003 include the results of operations for UMC for the months of March through June.</p> <p>⁽³⁾ Operating expenses include taxes (other than income taxes), primarily revenue and property-based taxes, of \$16.5 million, \$15.6 million, \$26.9 million, \$25.3 million and \$39.1 million for the years ended December 31, 1998, 1999, 2000, 2001 and 2002, respectively, and \$16.3 million and \$17.9 million for the six months ended June 30, 2002 and 2003, respectively.</p> <p>⁽⁴⁾ On a day-to-day basis, we are exposed to exchange losses on cash balances and other monetary assets and liabilities denominated in currencies other than the U.S. dollar, primarily rubles, hryvnas and euro. See Note 2 to our audited consolidated financial statements included elsewhere in this document.</p> <p>⁽⁵⁾ Capitalized interest expenses were \$1.2 million, \$1.3 million, \$0.9 million, \$nil and \$nil for the years ended December 31, 1998, 1999, 2000, 2001 and 2002, respectively, and \$nil and \$nil for the six months ended June 30, 2002 and 2003, respectively.</p> <p>⁽⁶⁾ On June 30, 2003, our shareholders approved cash dividends of \$0.056 per share (\$1.12 per ADS) for a total of \$111.4 million. This distribution is reflected in our financial statements for the six months ended June 30, 2003.</p> <p>⁽⁷⁾ Includes notes payable, bank loans, equipment financing, capital lease obligations and financing derivatives.</p> <p>⁽⁸⁾ Calculated as book value of total debt divided by the sum of the book values of total shareholders' equity and total debt at the end of the relevant period. See note 7 above for the definition of "total debt."</p> <p>⁽⁹⁾ Source: Goskomstat; the December 31, 2002 and June 30, 2003 population statistics provided by Goskomstat take into account the All-Russian Population Census undertaken by the Russian government in October 2002.</p> <p>⁽¹⁰⁾ Source: Sotovik, J'Son & Partners and AC&M-Consulting.</p> <p>⁽¹¹⁾ Source: Sotovik, J'Son & Partners, AC&M-Consulting and our data.</p> <p>⁽¹²⁾ We define a "subscriber" as an individual or organization whose account does not have a negative balance for more than 61 days. For the "Jeans" tariffs only, introduced in November 2002, we define "subscriber" as an individual or organization whose account does not have a negative balance for more than 183 days. For a description of our "Jeans" tariffs, see "Business—Business Overview—Sales and Marketing—Tariffs."</p> <p>⁽¹³⁾ Average monthly minutes of usage per subscriber is calculated by dividing the total number of minutes of usage during a given period by the average number of our subscribers during such period and dividing by the number of months in such period.</p> <p>⁽¹⁴⁾ We calculate our average monthly service revenue per subscriber by dividing our service revenues for a given period, including guest roaming fees, by the average number of our subscribers during that period and dividing by the number of months in that period.</p> <p>⁽¹⁵⁾ We define "churn" as the total number of subscribers who cease to be a "subscriber" as defined in note 12 during the period (whether involuntarily due to non-payment or voluntarily, at such subscriber's request), expressed as a percentage of the average number of our subscribers during that period.</p>							

RISK FACTORS

An investment in the notes involves a high degree of risk. You should carefully consider the following information about these risks, together with the information contained in this document, before you decide to buy the notes. If any of the following risks actually occur, our business, financial condition or results of operations could be adversely affected. In that case, the value of the notes could 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 do not know 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 notes.

Risks Relating to Business Operations in Emerging Markets

Emerging markets such as the Russian Federation, Belarus and Ukraine 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, Belarus and Ukraine 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 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 notes.

Risks Relating to Our Business

All or part of our subscriber database, containing private information relating to our subscribers, was illegally copied and stolen, and is currently available for sale in Russia on the black market. This security breach of our database could adversely impact our reputation and lead to subscriber lawsuits, a loss of subscribers and an inability to gain new subscribers which, in turn, could negatively impact our revenues and results of operations.

In January 2003, we discovered that our 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 our subscribers, and is currently being sold in Russia on the black market. 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 available and being sold on CD-ROM.

We are currently conducting an internal investigation relating to this theft. While we do not believe that this was an internal security breach, we do not yet know the identity of the perpetrator of the theft.

The breach of security of our database and illegal sale of our subscribers' personal information could adversely impact our reputation and may prompt lawsuits against us by individual and corporate subscribers. For example, in January 2003, lawsuits were filed by two of our subscribers seeking compensation for damages resulting from the leak of the subscribers' confidential information. While the subscribers subsequently withdrew their claims, if these or any similar lawsuits were successful, we could have to pay significant damages, including consequential damages. It may also lead to a loss in

subscribers and our inability to attract new subscribers. Each of these factors, individually or in the aggregate, could negatively impact our revenues and results of operations.

Increased competition and a more diverse subscriber base have resulted in declining average monthly service revenues per subscriber which may adversely affect our results of operations.

While our subscriber base and revenues are constantly growing as we continue to grow our operations in Moscow and to expand into regions outside of Moscow, our average monthly service revenues per subscriber are decreasing. We expect to see a continued decline 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 our overall subscriber mix. See “Operating and Financial Review and Prospects—Trend Information—Sales” and “—Operating Results.” This decline in our average monthly service revenues per subscriber may adversely affect our results of operations.

Our failure to implement the necessary infrastructure to manage our growth could have a material negative effect on our business and results of operations.

Our billing system registers and debits the account of a subscriber for calls made by such subscriber one to two hours after such calls were made. There is also an additional delay between the time that a subscriber’s balance reaches zero and the disconnection of such subscriber from our 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. We discovered this fraud in March 2003, and we estimate that we incurred approximately \$17.4 million in losses during the first half of 2003 as a result of this dealer fraud. We have taken measures to prevent further use of this scheme, such as requiring our subscribers to activate their long distance services in person at our service centers. This, in turn, may cause us to lose subscribers who view the new requirement as burdensome and negatively affect our market share. We have also canceled our contracts with certain dealers who had the highest numbers of fraudulent accounts.

Our ability to manage our business successfully is contingent upon our ability to implement sufficient operational resources and infrastructure. While we are in the process of implementing measures to prevent further dealer fraud of this kind, the failure or breakdown of key components of our infrastructure in the future, including our billing system, could have a material negative effect on our profits and results of operations.

If we cannot successfully develop our network, we will be unable to expand our subscriber base, and therefore, lose market share and revenues.

We plan to expand our network infrastructure in the following ways:

- extend coverage and increase the capacity of our existing network in the Moscow license area;
- further develop our operations in Ukraine and Belarus and further develop coverage in St. Petersburg, Krasnodar, Nizhny Novgorod, Perm, Rostov, Tartarstan and in the other regions in which we currently operate; and
- introduce service in the regions in which we have licenses and have not yet commenced operations.

Our ability to increase our subscriber base depends upon the success of our network expansion. We have expended considerable amounts of resources to enable this expansion. For a discussion of our regional expansion, see “Business—Regional Expansion.” Limited information regarding the potential

regional markets into which we are considering expanding, either through acquisitions or new licenses, complicates accurate forecasts of future revenues from those regions, increasing the risk that we may overestimate these revenues. In addition, we have expanded and are likely to continue to expand our network through acquisitions. Although we are currently in discussions with mobile cellular telecommunications providers in various regions of the Russian Federation and countries of the CIS regarding potential acquisitions, we cannot give assurances that any acquisitions will be completed on favorable terms or at all. Moreover, we may not be able to integrate previous or future acquisitions successfully or operate them profitably.

The integration of our businesses, including those 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 business may be difficult as our culture 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 our results of operations.

We also may face problems and complications that we are unaccustomed to dealing with during the course of our expansion into countries outside of the Russian Federation. For example, after we signed agreements for the acquisition of a majority stake in Ukrainian Mobile Communications (UMC) in November 2002, a lawsuit was filed in Ukraine seeking to prevent the sale by one of the selling shareholders, Ukrtelecom, of its shares in UMC. Though this lawsuit was dismissed and our acquisition of a majority stake in UMC was consummated in March 2003, we cannot give assurances that any future claims relating to this transaction will not challenge our purchase of Ukrtelecom's stake in UMC.

The buildout of our 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. The failure of any equipment we use to receive timely certification or re-certification could also hinder our expansion plans. We also, at times, put our equipment into operation prior to receiving certification, which could lead to administrative sanctions including fines and/or the seizure of such equipment. To the extent we fail to expand our network on a timely basis, we could experience difficulty in expanding our subscriber base.

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

We have experienced substantial growth and development in a relatively short period of time. Management of this growth has required significant managerial and operational resources and is likely to continue to do so. We have recently added two new vice president positions, subordinate only to our chief executive officer, in response to this growth. Our future operating results depend, in significant part, upon the continued contributions of a small number of our key senior management and technical personnel. Management of growth will require, among other things:

- stringent control of network buildout and other costs;
- 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;
- implementation of adequate internal controls and disclosure controls and procedures;
- increased marketing activities;

- the need to provide additional service centers;
- hiring and training of new personnel; and
- coordination among our logistical, technical, accounting, finance, marketing and sales personnel.

Our success will depend, in part, on our ability to continue to attract, retain and motivate qualified personnel. Competition in Russia for personnel with relevant expertise is intense, due to the small numbers of qualified individuals. Although we attempt to structure our compensation packages in a manner consistent with evolving standards of the Russian labor market, we are not insured against damage that may be incurred in case of the loss or dismissal of our key personnel. Our failure to successfully manage our growth and personnel needs could have a material adverse effect on our business, operating performance and financial condition.

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

Our ability to provide commercially viable services depends upon our ability to continue to interconnect cost-effectively with MGTS 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 and the nature of the call. We have entered into interconnection agreements with several local, domestic and international telecommunications operators, including MGTS and Rostelecom. Interconnection with these operators is required to complete calls originating on our network but terminating outside of it and to complete calls to our subscribers originating outside of our network.

Any difficulties or delays in interconnecting cost-effectively with other networks could hinder our ability to provide services, causing us to lose subscribers, increase our costs and decrease our revenues. Although Russian legislation requires that operators of public switched telephone networks may not refuse to provide interconnections or discriminate against one operator in comparison to another, we believe that, in practice, some public network operators attempt to impede mobile operators by delaying interconnection applications and charging varying interconnect rates to different mobile operators and, in particular, more favorable rates to local mobile operators, potentially enabling our competitors to offer lower prices.

Governmental regulation of our tariffs in Ukraine could negatively affect our revenues and results of operations.

A recently-passed amendment to the Law of Communications of Ukraine forbids Ukrainian mobile communications operators from charging subscribers for incoming calls in Ukraine. This amendment, which became effective as of September 19, 2003, prevents our Ukrainian subsidiary, UMC, from charging its subscribers for any incoming calls. UMC estimates that it received in excess of \$60 million in 2002 in revenue for incoming calls, representing over 20% of its total revenues in 2002. While this legislation will apply to all mobile communications operators in Ukraine and we have adjusted our tariffs in an effort to offset the loss of incoming call revenues, its impact may nonetheless have an overall negative impact on our revenues.

If frequencies currently assigned to us are reassigned to other users, or if we fail to obtain renewals of our frequency allocations, our network capacity will be restrained and our ability to expand limited, resulting in a loss of market share and lower revenues.

There is a limited amount of frequency available for mobile operators in each of the regions in which we operate or hold licenses to operate. We are dependent on access to adequate spectrum allocation in each market in which we operate in order to maintain and expand our subscriber base.

While we believe that our current spectrum allocations are sufficient, we cannot be certain that frequency will be allocated to us in the future in the quantities, with the geographic span and for time periods that would allow us to provide wireless services on a commercially feasible basis throughout all of our license areas. For example, the Ukrainian government is currently delaying the allocation of new frequencies to mobile communications operators in Ukraine which, in turn, may constrain our 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 impact on our network capacity. For example, on September 5, 2000, we received a letter from the State Service for Communication Control, a department of the Ministry of Communications. The letter cancelled the approval the State Service for Communication Control had given us in May 2000 for certain frequencies within the 900 MHz band in order to install base stations with restricted emanation, which we used primarily for the development of our network in the underground stations of the Moscow subway system. While the Department of Communications Control, also under the Ministry of Communications, halted the implementation of this letter on September 14, 2000, and the Ministry of Communications reinstated these frequency allocations to us on November 14, 2000, there can be no assurance that future attempts will not be made to remove frequency allocations from us. In addition, frequency allocations are often issued for periods that are shorter than the terms of the licenses, and we cannot assure you that such allocations will be renewed in a timely matter or at all. If our frequencies are revoked or we are unable to renew our frequency allocations, our network capacity would be restrained and our ability to expand limited, resulting in a loss of market share and lower revenues.

We may be required to contribute to the cost of the Russian government's 900 MHz frequency conversion which could negatively affect our financial results.

A program was approved by the Russian government in November 2001 providing for the transfer during 2002-2003 of the frequency used by air traffic control systems in order to allocate additional frequency for mobile communications. In the event that we and other mobile operators are required by the Russian government to finance the costs of such frequency transfer, our financial results could be negatively affected if we are unable to pass on all or some of this expense to our subscribers.

Because we lack full redundancy and insurance for our systems, a systems failure could prevent us from operating our business and lead to a loss of customers, damage to our reputation and violations of the terms of our licenses and contracts with customers.

We have back-up capacity for our network management, operations and maintenance systems, but automatic transfer to back-up capacity is limited. In the event that the primary network management center were unable to function, significant disruptions to our system would occur, including our inability to provide services. Disruptions in our services have occurred on August 3, 2000, December 15, 2000, January 23, 2001 and May 30, 2003, and there can be no assurance that these types of disruptions will not recur. These types of disruptions could lead to a loss of customers, damage to our reputation and violations of the terms of our licenses and contracts with customers. These failures could also lead to a decrease in value of the notes, significant negative publicity and litigation.

Our 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 and similar events. We do not carry business interruption insurance to protect us in the event of a catastrophe, even though such an event could have a significant negative impact on our business.

Failure to fulfill the terms of our licenses, including the payment of license contributions could result in their revocation.

Our 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. GSM operators are required to provide service to the federal government at regulated tariff rates. The amount and pricing of such services are subject to change and, if they were to materially and adversely change, so would our operating costs.

In addition, most of our current licenses provide for payments to be made to finance telecommunication infrastructure improvements, which in the aggregate could total approximately \$110.2 million, as of June 30, 2003. However, no decisions regulating the terms and conditions of such payments have been formulated. Accordingly, we have made no payments to date pursuant to any of the current licenses which could require such payments.

Each of our licenses also requires service to be started by a specific date. Each of our licenses, other than the licenses which cover the Moscow license area, also contains requirements as to the number of subscribers and required territorial coverage to be reached by specified dates. Our licenses for the Moscow license area contain requirements relating to network capacity. These requirements are subject to adjustment during the term of the license.

If the terms of a license are not fulfilled or the service provider violates legislation, the license may be suspended or terminated. Decisions of the Ministry of Communications on suspension or termination of licenses may be appealed in court. To date, there have been no legal actions seeking to suspend or terminate any of our licenses, nor have we received any notice of violation with respect to any of our licenses.

However, if we fail to comply with the requirements of applicable Russian legislation, or we fail to meet the terms of our licenses, our licenses and other authorizations necessary for our operation may be suspended or revoked. A suspension or revocation of our licenses or other necessary governmental authorizations could negatively impact our business and results of operations. The same adverse consequences may result from the suspension or revocation of our licenses for Ukraine. For example, these licenses have not been updated to reflect changes in our identification information, which may serve as a basis for Ukrainian authorities to take actions to terminate them. In order to have the licenses re-issued to reflect these changes, we would need to reapply to the Ministry of Communications of Ukraine and incur the risk that the Ministry would exercise its broad discretion and refuse to re-issue such licenses.

If we are unable to maintain our favorable brand image, we may be unable to attract new subscribers and retain existing subscribers, leading to loss of market share and revenues.

Our ability to attract new subscribers and retain existing subscribers depends in part on our ability to maintain what we believe to be our favorable brand image. Negative rumors regarding our services could negatively affect this brand image. In addition, consumer preferences change and our failure to anticipate, identify or react to these changes by providing attractive services at competitive prices could negatively affect our market share. The loss of market share could negatively affect our revenues.

We may be unable to obtain licenses for third-generation, or UMTS, mobile cellular services on commercially reasonable terms or at all, which would materially adversely affect our competitive position and limit our ability to expand our services, leading to a loss of customers and a decline in revenues.

The Ministry of Communications has previously stated that it expected to announce the procedures for the award of licenses for UMTS mobile cellular services during 2002, and then during 2003. To date, however, no procedures have been announced. Depending upon the procedures adopted, we 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 would materially adversely affect our ability to compete with operators who are able to operate these services and limit our ability to expand our services, leading to a loss of customers and a decline in revenues.

Regulatory uncertainties affecting the renewal of our licenses could result in an inability to renew our licenses or increases in our obligations and a reduction of our rights under the terms of a renewed license, increasing our costs and limiting our service area.

Our licenses expire in various years from 2004 to 2013 and may be renewed upon application to the Ministry of Communications. For example, our GSM license with frequency allocation in the 900 MHz band covering the Moscow license area expires in December 2004. Officials of the Ministry of Communications have broad discretion in deciding whether to renew a license, and we cannot assure you that our licenses will be renewed after expiration. If our licenses are renewed, they may be renewed with additional obligations, including payment obligations, or for reduced service areas. Failure to renew our licenses or receive renewed licenses with similar terms to our existing licenses, particularly for the Moscow, Ukraine, North-West and Krasnodar license areas, could significantly diminish our service area and decrease our subscriber numbers. For a description of our licenses and their respective expiration dates, see “Business—Current Operations—License Areas.”

We engage in transactions with related parties, which may present conflicts of interest, resulting in the conclusion of transactions on less favorable terms than could be obtained in arm’s-length transactions.

We, our principal shareholders and their affiliates have engaged in several significant transactions among us and may continue to do so. We have purchased interests in various mobile telecommunications companies from Sistema and T-Mobile and entered into arrangements with affiliates of Sistema for advertising and insurance services. In addition, we have entered into interconnection and telephone numbering capacity purchase agreements with MGTS, Telmos and MTU-Inform, which are majority-owned by Sistema as well as office leases with MGTS. Furthermore, we have entered into a number of arrangements with T-Mobile and its affiliates, including the agreements for the purchase of shares of UMC, and we have entered into a number of equipment lease agreements with Invest-Svyaz-Holding, one of our shareholders. Although we anticipate that all future related party transactions will be at arm’s-length, conflicts of interest may arise between us, our affiliates and our principal shareholders or their affiliates, resulting in the conclusion of transactions on terms not determined by market forces.

If the Ministry of Antimonopoly Policy and Support of Entrepreneurship were to conclude that we 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, adversely affecting our business strategy and our results of operation.

Our business has grown substantially through the acquisition and founding of companies, many of which required the prior approval or subsequent notification of the Ministry of Antimonopoly Policy and Support of Entrepreneurship (the “Ministry of Antimonopoly Policy”) 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 this approval or notification. While we 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 Ministry of Antimonopoly Policy were to conclude that an acquisition or creation 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, adversely affecting our business strategy and our results of operations.

In the event that minority shareholders were to contest successfully existing, or were to prevent future, approval of transactions between us and our subsidiaries and among our subsidiaries which require special approval in accordance with Russian legislation, this could limit our operational flexibility and adversely affect our results of operations.

We own less than 100% of a number of our subsidiaries. Russian law contains very strict and formalistic requirements applicable to various corporate transactions, such as reorganizations. In addition, under Russian law, certain transactions defined as “interested party transactions” require approval by disinterested members of the board of directors or shareholders of the companies involved. “Interested party transactions” include transactions in which a member of the board of directors, an officer of a company or any person that owns, together with any affiliates of that person, at least 20% of a company’s voting shares, or any person that is entitled to give binding instructions to a company, is interested, if that person, or any of that person’s relatives or affiliates, is one of the following:

- a party to, or a 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 a beneficiary of, a transaction with the company, whether directly or as a representative or intermediary;
- a member of the board of directors or an officer of a company which is a party to, or a beneficiary of, a transaction with the company, whether directly or as a representative or intermediary; or
- in other cases stipulated by the company’s charter.

We and our subsidiaries engage in various transactions, including reorganizations, that require special approvals under Russian law, and our subsidiaries engage in numerous transactions which require interested party transaction approvals in accordance with Russian law. These transactions have not always been properly approved, and therefore may be contested by minority shareholders. In the event that minority shareholders were to contest successfully such transactions, or prevent the approval of such transactions in the future, it could limit our operational flexibility and adversely affect our results of operations.

In addition, certain transactions between members of a consolidated corporate group may be considered interested party transactions under Russian law. While we generally endeavor to obtain all corporate approvals required under Russian law to consummate transactions, we have not always applied special approval procedures in connection with our consummation of transactions with or between our subsidiaries. In the event that a claim is filed in relation to certain transactions with or between our subsidiaries, such transactions are found to have been interested party transactions, and we are found to have failed to obtain the appropriate approvals therefor, such transactions may be declared invalid. The unwinding of any transactions concluded with or between our subsidiaries may have a negative impact on our business and results of operations.

Our controlling shareholders have the ability to exert significant influence over us and their interests may conflict with those of holders of the notes as they may make decisions that materially adversely affect your investment. In addition, because one of our controlling shareholders is also our competitor, it may have interests that conflict with those of holders of the notes.

Together our primary shareholders, T-Mobile and Sistema, control directly or indirectly approximately 77% of our voting shares and Sistema alone has a controlling interest over more than 50% of our shares. As a result, each of T-Mobile and Sistema have the ability to exert significant influence over certain actions requiring shareholder approval, including the election of directors and the declaration of dividends, and may have the ability to influence our policy. As such, decisions made

by T-Mobile or Sistema may influence our business, results of operations and financial condition and these decisions may conflict with the interest of the holders of the notes. For example, Sistema and T-Mobile have expressed their intent to vote in favor of annual dividend distributions of not less than the equivalent of 25% of Mobile TeleSystems OJSC's stand-alone net profits (as determined under Russian accounting standards). In this connection, as these controlling shareholders vote in favor of declaring dividends constituting a significant proportion of our net profits, our reliance on external sources of financing may increase, and our cash flow and ability to repay our debt obligations or make capital expenditure investments and acquisitions of other companies could be materially adversely affected. See "Operating and Financial Review and Prospects—Liquidity and Capital Resources" for a description of the dividend distribution approved by our shareholders for the year ended December 31, 2002.

Further, on April 16, 2003 Sistema exercised its rights under a call option agreement entered into with T-Mobile dated March 12, 2003 to acquire directly and indirectly from T-Mobile 199,322,614 shares of common stock amounting, in aggregate, to an additional 10% of our outstanding common stock. The acquisition was completed in April 2003. As a consequence, Sistema now has a controlling interest over more than 50% of our shares. Sistema and T-Mobile also entered into a shareholders' agreement dated March 12, 2003 governing certain important corporate actions.

Under the shareholders' agreement, T-Mobile undertakes to vote when necessary to ensure (in so far as it is able) that Sistema will have a majority of the members of our board of directors. However, certain actions will require T-Mobile's approval, including new issuances of our shares, actions which would dilute T-Mobile's shareholding in us and acquisitions by us with a value greater than 25% of the balance sheet value of our total assets, in accordance with Russian accounting standards. Under the shareholders' agreement, both Sistema and T-Mobile have a right of first refusal with respect to sales of our shares by the other party to third parties, subject to certain exceptions. Sistema and T-Mobile have also agreed to consult each other with respect to any dividend policy, with the expectation that annual distributions of not less than the equivalent of 25% of MTS OJSC's stand-alone net profits (as determined under Russian accounting standards) will be made as dividends. In addition, T-Mobile and Sistema have agreed to consult with each other where applicable as to the implementation of any mandatory listing of our shares on a Russian stock exchange. Subject to applicable law and regulations, any such local listing would be subject to certain restrictions and obligations as agreed to by T-Mobile and Sistema, including minimum liquidity requirements and a distribution limitation solely to Russian domestic investors.

The shareholders' agreement may, subject to a three-month remedy period, be terminated by either party if the other party holds less than 25% of our share capital.

Decisions made by Sistema or otherwise by Sistema and T-Mobile pursuant to the terms of the shareholders' agreement may conflict with the interests of the holders of the notes.

In addition, we compete directly with affiliates of Sistema. Sistema indirectly owns, through MGTS, 23.5% of Mobilnye Sistemy Svyazi, or MCC. Sistema also indirectly controls JSC Personal Communications, which operates a CDMA network in the Moscow license area. Ownership and involvement by this controlling shareholder in these competing businesses could result in the diversion of resources that otherwise could be invested by this shareholder in our business and could enable these other businesses to compete against us more effectively.

Failure to register the company and its subsidiaries with the Russian tax authorities in accordance with Russian law may have a material adverse effect on our business and results of operations.

The Law on Registration of Legal Entities in Russia, passed in 2001, conferred authority upon the Ministry of Taxes and Collections (the "tax authorities") to perform the primary state registration of all legal entities in Russia. This law also obliged all legal entities registered prior to its entry into force to

re-register with the tax authorities and obtain a new certificate evidencing such re-registration no later than January 1, 2003. Failure to re-register with the tax authorities could result in the imposition of fines by the tax authorities against the unregistered entity or the liquidation of such entity or both. We believe that we and our subsidiaries have duly registered and complied with the requirements of the law; however, if for any reason we have failed to properly register an entity or failed to comply with the registration law, actions may be taken against us which could have a material adverse effect on our business, operating performance and financial condition.

In the event that our purchase of the participation interests in UMC is successfully challenged and voided, our results of operations would be materially adversely affected.

The Ukrainian legal system, still in its infancy, is notably less developed than the Russian legal system and is plagued by the same deficiencies inherent in the Russian legal system. See “—Risks Relating to the Russian Federation—Risks Relating to the Russian Legal System and Russian Legislation” below. This is particularly true in respect of the regulation of legal entities, privatization and company law.

As a result of Ukraine’s weak and, in some cases, nonexistent legal framework, it is and has historically been difficult to transact business and properly form legal entities in Ukraine. In this connection, it is not clear whether our subsidiary UMC has met all of the legal requirements associated with its corporate structure, whether the capital contributions by its founders were properly made and whether amendments to its charter were properly registered. Consequently, the founding participants’ ability to dispose of their ownership interests in UMC could be challenged. In addition, there is some uncertainty as to whether Ukrtelecom was entitled to alienate its 51% stake in UMC while Ukrtelecom was in the process of privatization.

In the event that UMC’s existence as a legal entity (including its potential liquidation or dissolution) is successfully challenged by local authorities or third parties or our purchase of some or all of our participation interest in UMC is successfully challenged and voided on any of the foregoing or other basis, our results of operations would be materially adversely affected.

Risks Relating to Our Financial Condition

Changes in exchange rates could increase our costs, decrease our reserves or prevent us from repaying our debts.

Over the past several years, the ruble has fluctuated dramatically against the U.S. dollar, in the great majority of instances falling in value. The Russian Central Bank from time to time has imposed various currency-trading and transfer restrictions in attempts to support the ruble. The ability of the government and the Russian Central Bank to maintain a stable ruble will depend on many political and economic factors. These include their ability to finance budget deficits without recourse to printing money, to control inflation and to maintain sufficient foreign currency reserves to support the ruble.

Substantially all of our costs and expenditures, as well as liabilities, are either denominated in or tightly linked to the U.S. dollar. These include capital expenditures and borrowings, including our U.S. dollar-denominated Eurobonds. As a result, 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 our tariffs, 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 maintain our U.S. dollar-linked tariffs due to competitive pressures in the event that the ruble devaluates against the U.S. dollar, leading to a loss of revenue in U.S. dollar terms. We do not engage in any other hedging arrangements. Moreover, if the ruble declines and tariffs cannot keep pace, we could have difficulty repaying or refinancing our U.S. dollar-denominated indebtedness, including our U.S. dollar-denominated Eurobonds. The devaluation of the ruble also results in losses in the value of ruble-denominated assets, such as ruble deposits. These losses for us

were approximately \$1.1 million in 2000, \$2.3 million in 2001, \$3.5 million in 2002 and we had a gain of approximately \$1.4 million in the first six months of 2003. Continued devaluation of the ruble against the U.S. dollar could materially adversely affect us.

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 tax incentives for capital investment and 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.

To service our indebtedness and to refinance our indebtedness, we 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 past Eurobond offerings and bank loans. As at June 30, 2003, our consolidated total debt was approximately \$977.3 million. We also have approximately \$700.5 million of indebtedness that will become due during 2004, including our \$300 million floating rate notes issued in August 2003.

Our ability to make payments on and to refinance our indebtedness, including the indebtedness we will incur in connection with the offering of the notes, and to fund planned capital expenditures 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 our other indebtedness.

We cannot assure you that our business will generate sufficient cash flow from operations or that future borrowings will be available to us under our credit facilities in amounts sufficient to enable us to pay our indebtedness, or to fund our other liquidity needs. We will need 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 and adversely affect our business, financial condition, results of operations and business prospects.

Inflation could increase our costs and decrease our operating margins.

The Russian economy has been characterized by high rates of inflation, including a rate of 84.4% in 1998, although according to the Central Bank of Russia, it subsided to 15.1% during 2002. When the rate of inflation exceeds the rate of devaluation, resulting in real appreciation of the ruble against the U.S. dollar, as was the case for periods prior to 1998 and from 1999 through the current date, we can experience inflation-driven increases in dollar terms of certain of our costs. These include salaries and rents, which are sensitive to rises in the general price level in Russia. In this situation, due to competitive pressures, we may not be able to raise our tariffs sufficiently to preserve operating margins. Accordingly, high rates of inflation in Russia relative to the rate of devaluation could increase our costs and decrease our operating margins.

If we are unable to obtain adequate capital, we may have to limit our operations substantially, with a resulting negative impact on our operating results and loss of market share.

We will need to make significant capital expenditures, particularly in connection with the development, construction and maintenance of our GSM network. We spent approximately \$225 million in 2000, approximately \$441 million in 2001, approximately \$574 million in 2002 and expect to spend approximately \$700 million in 2003, of which approximately \$200 million is planned for investment in UMC, and approximately \$750 million in 2004 for the fulfillment of our capital spending plans, excluding expenditures relating to Mobile TeleSystems LLC, our unconsolidated subsidiary in Belarus. In addition, the acquisition of UMTS licenses and frequency allocations and the buildout of a UMTS network would require substantial additional capital expenditures. However, future financing may not be sufficient to meet our planned needs in the event of the following potential developments:

- lack of external financing services;
- changes in the terms of existing financing arrangements;
- construction of the networks at a faster rate or higher capital cost than anticipated;
- need for greater than anticipated service and customer support;
- pursuit of new business opportunities that require significant investment;
- acquisitions or development of any additional licenses;
- slower than anticipated subscriber growth;
- regulatory developments;
- deterioration in the Russian economy; or
- changes in existing interconnect arrangements.

To meet our financing requirements, we may need to attract additional equity or debt financing. If we cannot obtain adequate funds to satisfy our capital requirements, we may need to limit our operations significantly, which could negatively impact our market share and operating results.

Our inability to obtain permission from the Central Bank of Russia pursuant to currency control regulations may hinder our ability to enter into certain hard-currency-denominated transactions.

Certain payments in foreign currency are subject to prior permission by the Central Bank of Russia, including, with various exceptions, the following:

- direct investments, except investments from abroad in the charter capital of a Russian company;
- payments with respect to real estate, except acquisition of real estate by non-residents and lease payments by non-residents;
- portfolio investments;
- payments for export-import transactions with settlement over 90 days following completion; and
- other capital movement transactions.

These regulations are subject to substantial changes and varying interpretations, complicating both the process of determining whether permission of the Central Bank of Russia is required and the process of obtaining permission. If we are unable to obtain Central Bank of Russia permissions for hard-currency-denominated transactions requiring such permissions, we may be unable to enter into such transactions. In addition, in the event that we have failed to obtain Central Bank of Russia permissions for hard-currency-denominated transactions and borrowings requiring such permissions in

the past, such failure could result in severe penalties, including the unwinding of the relevant transactions, fines and administrative penalties assessed against us and criminal and administrative penalties assessed against our management which, in turn, would negatively affect our business.

As of June 30, 2003, we had outstanding debt (excluding capital lease obligations) of approximately \$908.5 million denominated in U.S. dollars and approximately \$10.1 million denominated in euro. Although we have Russian Central Bank licenses to make payments of principal and interest on these loans, there is no assurance that we will be able to obtain similar licenses, if required, for future financings. In addition, the revocation of any of our Central Bank licenses or a breach by us of the terms of a Central Bank license could result in cash flow difficulties and fines and penalties. The loss of a Central Bank license may also constitute an event of default under certain of our agreements, which may result in the acceleration of some or all of our outstanding hard-currency-denominated debt.

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

Russian transfer pricing rules entered into force in 1999, giving Russian tax authorities the right to make transfer pricing adjustments and impose additional tax liabilities in respect of all controlled transactions, provided that the transaction price differs from the market price by more than 20%. Controlled transactions include transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions or transactions with significant (by more than 20%) price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and courts. Due to the uncertainties in the interpretation of transfer pricing legislation, the tax authorities may challenge our prices and propose adjustments. If such price adjustments are upheld by the Russian courts and implemented, our future financial results could be adversely affected. In addition, we could face significant losses associated with the assessed amount of prior tax underpaid and related interest and penalties, which could have an adverse impact on our financial condition and results of operations.

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

Currency regulations established by the Russian Central Bank restrict investments by Russian companies outside of 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. Any balances maintained in rubles will give rise to losses if the ruble devalues against the U.S. dollar.

Additionally, Russian companies must repatriate 100% of offshore foreign currency earnings to Russia and convert 25% of those earnings into rubles within seven days from the date on which they were received, although Russian legislation allows the Central Bank of Russia to modify this conversion requirement. We earned around \$43 million, \$53 million, \$83 million and \$63 million in foreign currency in 2000, 2001, 2002 and the first six months of 2003, respectively, constituting around 8%, 6%, 6% and 6% of our total revenues, primarily from roaming agreements. This requirement further increases balances in our ruble-denominated accounts and, consequently, our exposure to devaluation risk.

Continued or increased 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.

Our major capital expenditures are generally denominated and payable in various foreign currencies, including the U.S. dollar and euro. As of June 30, 2003, we had \$208.3 million and €46.5 million committed under contracts with foreign suppliers for the purchase of network

infrastructure. To the extent such major capital expenditures involve the importation of equipment and related items, Russian legislation 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 hard currency 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.

Sistema may not fulfill its obligation to make payments to us in connection with our loan from Ericsson, which would have an adverse effect on the anticipated increase in our shareholders' equity and our cash position.

In December 1996, Rosico, our subsidiary that merged into us in June 2003, entered into a credit agreement with Ericsson Project Finance AB for a five-year credit facility, with an original principal amount of \$60 million and repayment now extended to February 2006. During 2003, Ericsson assigned this loan to Salomon Brothers Holding Company on the same terms and conditions.

As of June 30, 2003, the principal amount outstanding on this credit was \$27 million. In connection with our acquisition of Rosico in 1998, Sistema agreed to indemnify Rosico for this loan and all related obligations. Under the indemnification agreement, a significant portion of payments we receive from Sistema is in exchange for the issuance by us of long-term, ruble-denominated promissory notes with 0% interest and maturities from 2049 to 2052. The carrying amount of these notes is negligible for our financial statements.

Sistema, notwithstanding its obligation, did not make any payments to us under the indemnity until 2000. While Sistema has been making the scheduled payments to us under the indemnity since that time, any further failure by Sistema to meet its obligations could have an adverse effect on the anticipated increase in our shareholders' equity and on the anticipated improvement in our cash position.

We recorded the receivable from Sistema in our financial statements as both additional paid-in capital as well as a direct reduction to our shareholders' equity. As a result, as payments are made, they have a positive effect on our shareholders' equity and our cash position.

Our debt facilities and our controlling shareholder Sistema's debt facilities contain restrictive covenants, which may limit our ability to engage in various activities.

The indentures relating to this offering, our Eurobonds maturing in 2008 and our Eurobonds maturing in 2004 each contain covenants limiting the ability of the issuer, us and our subsidiaries to incur debt, create liens and lease properties sold or transferred by us. The indentures also contain covenants limiting our ability to merge or consolidate with another person or convey our properties and assets to another person, as well as our ability to sell or transfer any of our or our subsidiaries' GSM licenses for the Moscow, St. Petersburg, Krasnodar and Ukraine license areas. Failure to comply with these covenants could cause a default under the issuer's debt obligations and result in the debt and, consequently, our guarantees, becoming immediately due and payable, which would materially adversely affect our business, financial condition and results of operations.

In addition, in April 2003, Sistema issued \$350 million 10.25% notes, due in 2008. These notes are secured by 193,473,900 shares of our common stock, and the indenture relating to the offering contains covenants limiting, among other things, our ability to incur debt, create liens and dispose of our assets.

Sistema may also enter other agreements in the future that may further restrict our ability to engage in these and other activities. We understand that our assets, liabilities and results of operations are consolidated in Sistema's financial statements and, consequently, Sistema's other covenants now relate to us as well insofar as they cover Sistema's consolidated group.

If a change in control occurs, our Eurobond noteholders may require us to redeem notes not previously called for redemption, which will have a negative impact on our cash flow and results of operations.

The notes issued in connection with our Eurobond offerings provide that, 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. Under the terms of our Eurobonds maturing in 2004, 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; provided that the following transactions would not be deemed to result in a change in control:
 - (i) any acquisition by Sistema, T-Mobile or their respective subsidiaries that results in the 50% threshold being exceeded if, immediately following such transaction, each of Sistema (together with its subsidiaries) and T-Mobile (together with its subsidiaries) beneficially owns more than 25% of the total voting power of all shares of our common stock; and
 - (ii) any acquisition by us, our subsidiary or our employee benefit plan.
- 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 or another entity merges into us and, immediately following such transaction, Sistema and T-Mobile together do not beneficially own at least 50% of the total voting power of all shares of common stock of such entity and, individually, do not beneficially own more than 25% of the total voting power of all shares of common stock of such entity.

- We no longer beneficially own more than 50% of the issuer's share capital.

For the definition of a change in control under these notes see "Description of the Notes—Redemption at Option of Holders upon a Change in Control." Our Eurobonds maturing in 2008 and the Eurobonds offered hereby contain a similar change in control definition.

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 will have a negative impact on our cash flow and results of operations.

Risks Relating to Our Industry

We face increasing competition from existing licensees that may result in reduced operating margins, loss of market share and diminished value in our services, as well as lead us to make different pricing, service or marketing decisions.

The Russian mobile cellular telecommunication services market is becoming increasingly competitive. The trend in Russian government licensing policies has been to increase competition among mobile cellular 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, loss of market share and diminished value in our services, as well as different pricing, service or marketing policies.

Our principal competitors in the Moscow license area are VimpelCom and MegaFon. VimpelCom is 25% owned by the Russian financial industrial conglomerate Alfa Group and 25% owned by Telenor. It operates both D-AMPS and dual-band GSM networks and had a 48.9% market share in the Moscow license area as of June 30, 2003, according to Advanced Communications & Media Limited, or AC&M-Consulting. MegaFon, formerly operating in Moscow as “Sonic Duo,” began commercial operations in Moscow in November 2001. It has a dual-band GSM network in the Moscow license area and had a 4.9% market share as of June 30, 2003, according to AC&M-Consulting.

In the North-West region, where St. Petersburg is located, our principal competitor is MegaFon, currently the principal operator in that region with a 55% market share as of June 30, 2003 according to AC&M-Consulting. MegaFon, formerly known as North-West GSM, is part of the MegaFon group and was the first company to provide GSM-standard mobile cellular communications services in the North-West region. In addition, in 2002 and 2003, VimpelCom was awarded licenses to operate a GSM 900/1800 network in the North-West region, which includes St. Petersburg, and launched its operations there in April 2003.

We also face competition in the regional license areas from operators in the MegaFon group and VimpelCom’s regional operators, as well as from smaller, local operators.

In Ukraine we compete with Kyivstar, a GSM operator with over two million subscribers and a market share of 51.4% as of June 30, 2003 according to Ukrainian News. Kyivstar is majority-owned by the Norwegian telecommunications group Telenor. In addition, press reports have indicated that relatives of Ukrainian President Leonid Kuchma, including his daughter and brother-in-law, are involved in the ownership and top management of Kyivstar. This could result in Kyivstar receiving preferential treatment from the Ukrainian government in regulatory and other matters and potentially lead to arbitrary regulatory decisions against UMC.

See “Business—Business Overview—Sales and Marketing—Competition” for further description of our competitors.

The creation of MegaFon through the merger of Sonic Duo, North-West GSM and several other regional operators resulted in a new competitor that may receive preferential treatment from the federal government and benefit from the resources of its shareholders, potentially giving it a substantial competitive advantage over us.

Russia’s third largest mobile communications provider is MegaFon, which is comprised of the former North-West GSM, Sonic Duo, Mobicom-Caucasus, Mobicom-Kirov, Mobicom-Novosibirsk, Mobicom-Khabarovsk, MCC-Povolzhje, Volzhsky GSM and Ural GSM. The most established company in the MegaFon group is North-West GSM, which has been renamed and operates under the brand name MegaFon, and had approximately 2.0 million subscribers in the North-West region as of June 30, 2003, according to AC&M-Consulting.

The nine companies comprising the MegaFon group together hold licenses to provide GSM 900/1800 cellular communications service in all 89 regions of the Russian Federation, a territory populated by 145 million people. In addition, all of the MegaFon companies have instituted a unified intra-network roaming tariff and are expected to introduce unified tariffs in each of the regions in which they operate. These factors could undermine our plans to expand in regions outside of the Moscow license area and diminish the competitive advantage we hope to enjoy from our creation of a single, integrated national network. Operators in the MegaFon group currently, or are expected to, compete with us in the North-West region, which includes St. Petersburg, and in the South, Volga, Ural, Siberia and Far East regions.

According to press reports, MegaFon is majority owned by Telecominvest (31%), LV Finance (25.1%), and TeliaSonera (36%), a leading Swedish telecommunications operator. In turn,

Telecominvest is 15% owned by North-West Telecom, a subsidiary of Svyazinvest, and 29.5% by TeliaSonera. Svyazinvest is effectively controlled by the Russian federal government.

Press reports have pointed to the previous involvement of federal government officials, including the current Minister of Communications, in entities owned by MegaFon as a potential reason for preferential treatment in regulatory matters. This could result in an uneven regulatory playing field and give MegaFon an advantage over us in competing for additional frequency allocations or new licenses. For instance, the temporary loss of frequency allocation in Moscow we suffered in the fall of 2000 has been linked in press reports to MegaFon's need for frequency allocation.

MegaFon may also receive significant financial assistance from its major shareholders. The company has also announced its intention to conduct an initial public offering which, if consummated, could provide MegaFon with a substantial amount of capital to invest into its network.

A merger between our two largest competitors would constrain our ability to effectively compete in the Russian mobile communications market and negatively impact our results of operations.

In August 2003, Russian financial industrial conglomerate Alfa Group, which owns a 25.1% stake in VimpelCom, announced its purchase of LV Finance, which owns a 25.1% stake in MegaFon. This acquisition gives Alfa Group a 25.1% blocking stake in MegaFon and sparked speculation in the media that Alfa Group might seek to merge MegaFon and Vimpelcom, Russia's second and third largest mobile communications providers and our two largest competitors. Though it is unclear whether such merger might occur, in the event that it does, our ability to effectively compete against such merged entity may be constrained in relation to the combined networks, resources, subscriber bases and improved economies of scale of such company and, consequently, our results of operations may suffer.

Our reliance on the GSM standard may prevent us from competing effectively against other existing technologies and new technologies, causing us to lose subscribers and associated revenues.

The adoption of UMTS may also increase the competition we face. In Russia, the Ministry of Communications expects to complete preparatory work for license tenders for third-generation mobile cellular standards in the near future. The UMTS standard is significantly superior to existing second-generation standards such as GSM, and given our reliance on the GSM standard, we may not be able to develop a strategy compatible with this or any other new technology. The technology we currently use may become obsolete or uncompetitive, and we 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 our ability to expand in other areas.

The Ministry of Communications has granted licenses based on code division multiple access, or CDMA, technology 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 mobile and fixed services. Although CDMA technology is currently classified in Russia as a fixed radio telephone service, it may be used for mobile communications, and there is a risk that it may be offered for use via portable handsets. If CDMA operators were able to obtain permission to offer mobile CDMA services, they would operate in direct competition with us.

The regulatory environment for telecommunications in Russia is uncertain and may be subject to political influence, resulting in negative regulatory decisions on other than legal grounds.

We operate in an uncertain regulatory environment. There is no comprehensive legal framework with respect to the provision of telecommunication services in Russia and in other areas in which we currently or may in the future operate, although a number of laws, decrees and regulations apply to the telecommunications sector. In particular, in Russia, the telecommunications system is regulated by the

Ministry of Communications, largely through the issuance of licenses and instructions, and officials of the Ministry of Communications have a high degree of discretion.

In this environment, political influence could be exerted to affect regulatory decisions against us, and we cannot assure you that regulators will not challenge our compliance with applicable laws, decrees and regulations. Although Sistema, one of our principal shareholders, has no formal ties with the Mayor of Moscow, Yuri Luzhkov, it has been linked in press reports to him. We believe the likely source of such press reports is the fact that the controlling shareholder and Chairman of the Board of Sistema, Vladimir P. Evtushenkov, for many years worked at the government of Moscow as Mr. Luzhkov's advisor. Because Mr. Luzhkov has been, at times, politically adverse to President Putin, in the event of a political clash between the two politicians, some commentators in the press have suggested that President Putin could seek to exert pressure against Mr. Luzhkov through attacks on companies perceived as linked to him, such as Sistema and us. If those commentators are correct, this could result in regulatory decisions against us on other than legal grounds, potentially increasing our costs and leading to negative impacts on our business or reducing our rights under our licenses.

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

As our regional development program proceeds, we intend to integrate our 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, Letter No. 1805 of March 25, 1999, issued by the Ministry of Communications, requires 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 our recent acquisitions. As we are unable to buy licenses, we must rather purchase the company holding the license. We also must continue to operate through such company in its license area by entering into agency, lease, services and similar agreements.

To date, the Ministry of Communications has not challenged agreements between licensees and third parties in connection with the provision of services under a license. We have entered into a series of agreements with a number of our subsidiaries for the provision of network construction services, the lease of mobile switching centers and related services. The Ministry of Communications may change its position and view these agreements as violating the general prohibition on the transfer or assignment of licenses.

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. We intend to continue to merge with our wholly-owned subsidiaries as part of our efforts to integrate our networks. Failure to receive a new license as part of a merger would result in the loss of our ability to operate in that license area and might prevent us from attempting future mergers.

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

If we were categorized as a monopoly, our tariffs could be reduced and our commercial activities restricted, significantly affecting our results of operations.

Under Russian legislation, the Russian Ministry of Antimonopoly Policy 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 July 25, 2003, the Russian Ministry of

Antimonopoly Policy has categorized us and our subsidiaries CJSC Kuban GSM and UDN 900 as companies with a market share exceeding 35%. Tomsk Cellular Communications, which we purchased in September 2003, was also categorized as a company with a market share in excess of 35% as of July 25, 2003. This classification, in turn, gives the Ministry the power to impose certain restrictions on the businesses of those entities, including the pre-approval of direct acquisitions of assets or shares in other entities, as well as the pre-approval of related party transactions. While we do not believe that there is a basis to categorize any of our entities as a dominant force, any determination to this effect could result in the regulation of our tariffs and restrictions on our commercial activities. Therefore, we attempt to avoid classification as a dominant force in the market, which, in turn, negatively impacts our ability to expand.

If we or any of our subsidiaries were classified as a dominant market force, the imposition of government-determined tariffs could result in competitive disadvantages, a decrease in our subscriber base and a significant decline in revenues. Additionally, restrictions on expansion or government-mandated withdrawal from regions or markets would negatively affect our plans for expansion and could reduce our subscriber base. Moreover, we could be required to make additional license applications at additional unexpected cost.

The public switched telephone networks have reached capacity limits and need modernization, which may inconvenience our subscribers and will require us to make additional capital expenditures.

Due to the recent growth in fixed and mobile 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. See "Business—Business Overview—Sales and Marketing—Tariffs" for a description of our 11-digit federal telephone numbers. The overtaxing of these long distance lines may inconvenience our 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 our 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 we are financially strong relative to these public network operators, we may be compelled to make such investments on their behalf, placing an additional burden on our financial and human resources. Additionally, assuming we do make such investments, we may not own the assets resulting from such investment. While we cannot estimate the financial and operating burdens associated with such investments, they may be substantial.

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

The significant environmental damage suffered by Russia during the communist era has increased public sensitivity to health risks arising from technology. 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 or press reports in Russia of any litigation relating to such risks could materially adversely affect us, including in the following ways:

- reduced subscriber growth;
- reduced usage per subscriber;

- increased number of product liability lawsuits;
- increased difficulty in obtaining sites for base stations; and/or
- reduced financing available to the wireless communications industry.

Computer viruses may harm our network's operating ability.

As mobile phones increase in technological capacity, they are becoming increasingly subject to computer viruses. These viruses can replicate and distribute themselves throughout a network system, slowing the network through the unusually high volume of messages sent across the network, in addition to affecting data stored in individual handsets. We cannot be sure that we will not be the target of a virus, or if we are, that we will be able to maintain the integrity of the data in individual handsets of our subscribers or that such a virus will not overload our network, causing significant harm to our operations.

Risks Relating to the Russian Federation

Although the following risk factors relate specifically to the risks associated with conducting business in the Russian Federation, where a majority of our assets and operations are located, similar risks in each instance also apply to the conduct of business and our operations in Belarus and Ukraine.

Like the Russian Federation, Belarus and Ukraine are emerging markets subject to greater economic, political, legal and social risks than more developed markets. Moreover, in many respects, the risks inherent in transacting business in these two former Soviet states are more acute than those in Russia. This is particularly true with respect to the weak legal systems and underdeveloped economies in Ukraine and Belarus as well as with respect to the endemic state corruption, economic instability and weak physical infrastructures existing in these countries.

Economic Risks

Economic instability in Russia could adversely affect our business.

Since the dissolution of the Soviet Union, the Russian economy has 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 Russian 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 Russian population.

The Russian economy has 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 Russian Central Bank 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.

These problems were aggravated by the near collapse of the Russian banking sector after the events of August 17, 1998, as evidenced by the revocation 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.

There can be no assurance that recent trends in the Russian economy—such as the increase in the gross domestic product, a relatively stable ruble and a reduced rate of inflation—will continue or will not be abruptly reversed. A decline in international oil and gas prices, the strengthening of the ruble in real terms relative to the U.S. dollar and the consequences of a relaxation in monetary policy, or other factors, could adversely affect Russia's economy and our business in the future.

We are only able to conduct banking transactions with a limited number of creditworthy Russian banks as the Russian banking system remains underdeveloped, and another banking crisis could place severe liquidity constraints on our business, materially adversely affecting our business, financial position and results of operations.

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. 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 and lax supervision by the regulators, many banks do not follow existing Central Bank regulations with respect to lending criteria, credit quality, loan loss reserves or diversification of exposure. In Russia, bank deposits are not insured under any governmental program. Recently, there has been a rapid increase in lending by Russian banks, which many believe is being accompanied by a deterioration in the credit quality of the borrowers. The serious deficiencies in the Russian banking sector combined with the deterioration in the credit profile of the loan portfolios of Russian banks may result in the banking sector being more susceptible to market downturns or economic slowdowns. If a banking crisis were to occur, Russian companies would be subject to severe liquidity constraints due to the limited supply of domestic funding sources and the withdrawal of foreign funding sources that would occur during such a crisis.

There are currently a limited number of creditworthy Russian banks, most of which are located in Moscow and there are fewer in the regions outside of Moscow. Although we have tried to reduce our risk by receiving and holding funds in a number of Russian banks, including subsidiaries of foreign banks, another banking crisis or the bankruptcy or insolvency of the banks in which we receive or hold our funds could adversely affect our ability to complete banking transactions in Russia and could have a material adverse effect on our business, financial conditions and results of operations.

Russia's physical infrastructure is in very poor condition, which could disrupt normal business activity.

Russia's physical infrastructure 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. During the winter of 2000–2001, electricity and heating shortages in Russia’s far-eastern Primorye region seriously disrupted the local economy. Additionally, 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 are poor, with many roads not meeting minimum quality requirements. The federal government is actively considering plans to reorganize the nation’s 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 Russia’s physical infrastructure harms the national economy, disrupts the transportation of goods and supplies, adds costs to doing business in Russia and can interrupt business operations. These difficulties can impact us directly; for example, we have 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 notes.

Fluctuations in the global economy may adversely affect Russia’s economy and our business.

Russia’s economy is 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 adversely affect the Russian economy. 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. Any market downturn or economic showdown could severely limit our access to capital and could adversely affect the purchasing power of our customers and thus our business.

Political Risks

Governmental instability could adversely affect the value of investments in Russia and the value of the notes.

Since 1991, Russia has sought to transform itself from a one-party state with a centrally-planned economy to a pluralist democracy with a market-oriented 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, 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. Six different prime ministers, for example, headed governments between March 1998 and May 2000. On December 31, 1999, President Yeltsin unexpectedly resigned and Vladimir Putin was subsequently elected president on March 26, 2000. While President Putin has maintained governmental stability and even accelerated the reform process, he may adopt a different approach over time. Parliamentary elections are to be held in December of 2003 and the presidential election is to be held sometime in 2004. Future changes in government, major policy shifts or lack of consensus between President Putin and Russia’s parliament, or between them and powerful economic groups, could also disrupt or reverse economic and regulatory reforms. The value of investments in Russia and the notes could be reduced and our prospects could be harmed if governmental instability recurs, reform policies are reversed, or conflicts with powerful economic groups intensify.

Conflict between central and regional authorities and other conflicts could create an uncertain operating environment that would hinder our long-term planning ability and could negatively affect the value of investments in Russia.

The Russian Federation is a federation of republics, territories, regions, cities of federal importance and autonomous areas. The delineation of authority among the members of the Russian Federation and the federal governmental authorities is, in many instances, uncertain and sometimes 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 result in political instability. This lack of consensus hinders our long-term planning efforts and creates uncertainties in our operating environment, both of which may prevent us from efficiently carrying out our expansion plans.

Additionally, ethnic, religious, historical and other divisions have, on occasion, given rise to tensions, and in certain cases, to military conflict. Russian military forces have been engaged in Chechnya in the past and are currently involved in ground and air operations there. Violence and attacks relating to this conflict have also spread to other parts of Russia, including several terrorist attacks carried out by Chechen combatants in Moscow during 2002 and 2003. The spread of violence and terrorism, or its intensification, could have significant political and economic consequences including the imposition of a state of emergency in some or all of the Russian Federation. These events could materially adversely affect the value of investments in Russia, including in the value of the notes.

Risks Relating to the Russian Legal System and Russian Legislation

Weaknesses relating to the Russian legal system and Russian legislation create an uncertain environment for investment and business activity and, thus, could have a material adverse effect on an investment in the notes.

Risks associated with the Russian legal system include:

- inconsistencies between and among laws, Presidential decrees and Russian 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 Russian legislation;
- the relative inexperience of judges and courts in interpreting Russian legislation;
- corruption within the judiciary;
- a high degree of discretion on the part of governmental authorities, which could result in arbitrary actions such as revocations of our licenses; and
- poorly developed bankruptcy procedures that are subject to abuse.

Additionally, several fundamental Russian laws have only recently become effective. The recent nature of much of Russian legislation, the lack of consensus about the scope, content and pace of economic and political reform and the rapid evolution of the Russian legal system 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 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. Furthermore, we cannot assure you that regulators, judicial authorities or third parties will not challenge our compliance with applicable laws, decrees and regulations.

Lack of independence and experience of the judiciary, 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 an investment in the notes.

The independence of the judicial system and its immunity from economic, political and nationalistic influences in Russia remain largely untested. The court system 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 legislation and court decisions are readily available to the public or organized in a manner that facilitates understanding. The Russian judicial system can be slow. Enforcement of court orders can in practice be very difficult in Russia. All of these factors make judicial decisions in Russia difficult to predict and effective redress uncertain. Additionally, court claims are often used in furtherance of political aims. 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.

These uncertainties also extend to property rights. During Russia's transformation from a centrally planned economy to a market economy, legislation has been enacted 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. Some government entities have tried to renationalize privatized businesses. Expropriation or nationalization of any of our entities, their assets or portions thereof, potentially without adequate compensation, would have a material adverse effect on our business.

Unlawful or arbitrary government action may have an adverse effect on our business and the value of an investment in the notes.

Governmental authorities have a high degree of discretion in Russia and at times exercise their discretion arbitrarily, without hearing or prior notice, and sometimes in a manner that is contrary to law. 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 or arbitrary governmental actions have included withdrawal of licenses, sudden and unexpected tax audits, criminal prosecutions and civil actions. Federal and local government entities also used common defects in matters surrounding the documentation of financing activities as pretexts for court claims and other demands to invalidate such activities and/or to void transactions, often for political purposes. Unlawful or arbitrary government action, if directed at us, could have a material adverse effect on our business and on the value of the notes.

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

The Civil Code 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. The person capable of determining such decisions is called an effective parent. The person whose decisions are capable of being so determined is called 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 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 capability 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(s) or fail to take action(s) knowing that such action(s) or failure to take action(s) would result in losses. Accordingly, in our position as an effective parent, we could be liable in some cases for the debts of our effective subsidiaries. This liability could materially adversely affect us.

Shareholder rights provisions under Russian law may impose additional costs on us, which could cause our financial results to suffer.

Russian law provides that shareholders, including holders of our ADSs and GDRs, that vote against or abstain from voting on certain matters have the right to sell their shares to us at market value in accordance with Russian law. The decisions that trigger this right to sell shares include:

- 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 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 obligation to purchase shares in these circumstances, which is limited to 10% of our net assets calculated, according to the Russian accounting standards, at the time the matter at issue is voted upon, could have an adverse effect on our cash flow and our ability to service our indebtedness.

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

Russian 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. Because the telecommunications industry is widely viewed as strategically important to Russia, 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 the notes 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 adversely affect our financial results.

The new Federal Law on Communications will come 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. 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 adversely affect our financial condition and results of operations.

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

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

- income taxes;
- value-added taxes;
- turnover taxes;
- excise taxes; and
- social contributions.

Additionally, currently each region may establish a regional sales tax applicable to sales of goods and services to individuals at a rate of up to 5% (though sales tax will be abolished in the Russian Federation as of January 1, 2004). Moreover, financial statements of Russian companies are not consolidated for tax purposes. Therefore, each of our Russian entities pays its own Russian taxes and may not offset its profit or loss against the loss or profit, respectively, of another of our entities. In accordance with legislation that entered into force on January 1, 2002, domestic dividends are, with some exceptions, subject to withholding tax at 6%. Such tax requirements impose additional burdens and costs on our operations, including management resources, and are not found in countries with more developed tax systems.

The taxation system in Russia is subject to varying interpretations, frequent changes and inconsistent enforcement at the federal, regional and local levels. In some instances in the past, new taxes have been given 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 is aggressive in this regard, but that we consider to be in compliance with current law. Prior to 2003, we 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 we have begun paying this levy for periods commencing January 1, 2003. See “Regulation—Licensing of Telecommunications Services and Radio Frequency Allocation.” This uncertainty exposes us to potentially significant fines and penalties and to enforcement measures despite our best efforts at compliance, and could result in a greater than expected tax burden and suspension or termination of our licenses. To date, the system of tax collection has been relatively ineffective.

There is a risk of imposition of new taxes on us, which could adversely affect the value of the notes. During the past three years, the Russian government undertook a revision of the Russian tax system and passed certain laws implementing tax reform. The new laws reduce the number of taxes and the overall tax burden on businesses and simplify the tax laws. However, the new tax laws continue to rely heavily on the judgments of local tax officials and fail to address many existing problems. Many issues associated with the practical application of new legislation are unclear and this complicates our tax planning and related business decisions. This uncertainty may expose us to fines and penalties.

Even if further reforms of the tax code are enacted, they may not result in significant reduction of the tax burden for Russian companies and the establishment of a more efficient tax system. Conversely, additional tax collection measures may be introduced. Accordingly, we may have to pay significantly higher taxes, which could have a material adverse effect on our business.

The legislative framework governing bankruptcy in the Russian Federation differs substantially from that of the United States, potentially adversely affecting the value of the notes in the event of our insolvency.

Russian bankruptcy law often differs from comparable law in the United States, and is subject to varying interpretations. There is little precedent to predict how claims of noteholders against a Russian guarantor would be resolved in a bankruptcy of the guarantor. See “—Weaknesses relating to the Russian legal system and Russian legislation create an uncertain environment for investment and business activity and, thus, could have a material adverse effect on an investment in the notes.”

In addition, under Russian law, our obligation as guarantor of the notes would be subordinated to the following obligations:

- workplace injury obligations;
- severance pay and employment-related obligations;
- secured obligations; and
- tax and other payment obligations to the government.

In the event of our insolvency, this legislation may materially adversely affect our ability to make payments to the issuer and our guarantee of the notes.

Social Risks

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 in recent years have resulted in significant dislocations of authority. The local and international press have reported that significant organized criminal activity 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 commercial interests of the government officials or certain individuals. Additionally, published reports indicate that a significant number of Russian 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 the value of the notes.

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. 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 economy of Russia; and increased violence. Any of these could restrict our operations and lead to the loss of revenue, materially adversely affecting us.

Risks Relating to the Notes and the Trading Market

The lack of a public market for the notes could reduce the value of your investment.

There is no existing market for the offered notes. There can be no assurance that a liquid market will develop for the notes, that holders of the notes will be able to sell their notes or that such holders will be able to sell their notes for a price that reflects their value.

If we are unable to obtain permission from the Central Bank of Russia for purposes of making payments pursuant to the guarantee, we will not be able to make payments in U.S. dollars pursuant to the guarantee and the guarantee may not be enforceable.

We will directly guarantee the obligations of the issuer under the notes. The permission of the Central Bank of Russia is required in order to make payment in U.S. dollars pursuant to the guarantee. Without such permission, we will be unable to make such payments in U.S. dollars in the event that the holders of the notes seek to enforce the guarantee. Moreover, without such permission, it is possible that a Russian court would not enforce any court judgment or arbitration award obtained against us for failing to make payments under the guarantee.

We have applied for, but not yet received, permission from the Central Bank of Russia to make payments under the guarantee. We have agreed to use our best efforts to obtain this permission within 60 days after the closing date. There can be no assurance that such permission will be granted by the Central Bank of Russia in a timely manner or at all. Our inability to receive such permission will negatively affect the value of the notes. In addition, in the event we do not receive such permission, the holders of the notes will have a right until we have obtained such permission to require us to redeem the notes on the next interest payment date and we cannot assure you that we will have sufficient funds for such redemption. If the holders of the notes exercise this right, the holders of the notes will not have full recourse to us under the guarantee, as a permission of the Central Bank of Russia would not then have been obtained, and will have to rely for payment on the issuer of the notes, which could seek to enforce the agreement pursuant to which the issuer loaned the offering proceeds to us.

Our obligations under the guarantee to make payments on the notes are effectively subordinated to all of the liabilities of our subsidiaries.

Although we currently conduct most of our business and hold most of our key licenses directly, we operate a portion of our business through subsidiaries. In the event of a bankruptcy, liquidation or reorganization of a subsidiary, holders of that subsidiary's indebtedness and trade and other creditors of that subsidiary will have a claim to the assets of the subsidiary that is prior to our interest in those assets (except to the extent that we are recognized as a creditor through intercompany claims or loans). Therefore, in most circumstances, our obligations under the guarantee will effectively rank junior to all liabilities of our subsidiaries, including trade payables and the liquidation value of preferred stock of our subsidiaries. In addition, our subsidiaries may be subject to contractual or other restrictions that would prevent them from paying dividends or otherwise distributing cash to us. There can be no assurance that the assets of any of our subsidiaries will be sufficient to repay their indebtedness and other liabilities or that any subsidiary's assets will be available to make distributions to us that would be available to guarantee payments with respect to the notes.

Although the indenture restricts our and our subsidiaries' ability to incur debt, we or our subsidiaries may incur substantial additional indebtedness. As of June 30, 2003, our subsidiaries had total outstanding obligations that effectively rank senior to the notes of \$237.1 million, including trade payables.

Payments we make under the guarantee may be subject to Russian withholding tax.

Payments we make under the guarantee to a holder who is not a resident of the Russian Federation might, due to the lack of clarity in the law, be characterized as Russian source income that would be subject to a 30% withholding tax (if a holder is an individual) or 20% withholding tax (if a holder is not an individual) at source. If such payments are subject to withholding tax, we are obliged to pay additional amounts in order that every net payment made by us under the guarantee after deduction or withholding for any taxes is not less than the full amount then due and payable.

This tax may be reduced under many double tax treaties to which Russia is a party. For individual holders, advance relief will not be available, and obtaining a refund should be done by filing a personal tax return by April 30 following the end of each calendar year. For non-individual holders, the relief can be provided based on a confirmation of residence of the holder in a treaty country. The confirmation of a residence of a non-individual holder in a treaty country must be obtained in advance, and there is no assurance that it will be practically possible to do so. Obtaining a refund can be extremely difficult, if not impossible.

It is also not clear whether Russian tax law permits payments of additional amounts under the guarantee, should the withholding tax become applicable. This may be viewed as payment of taxes for a third person, which is restricted by the tax law.

Furthermore, the issuer may at its option redeem the notes if, as a result of any change in applicable tax legislation or interpretation, we become obliged to pay, additional amounts in order that every net payment made by us under the guarantee after deduction or withholding for any taxes is not less than the full amount then due and payable. If the issuer redeems the notes under such circumstances, the redemption price will be equal to 100% of the principal amount of the notes plus any interest and additional amounts due. See “Description of the Notes—Redemption for Tax Reasons.”

In addition, it is possible that payments under the guarantee to non-resident holders may be subject to withholding of Russian VAT at the current inclusive VAT rate of 20/120%. Effective January 1, 2004, the inclusive VAT rate will be reduced to 18/118%.

In certain circumstances, our paying agents may levy withholding tax on interest payments made in respect of the notes.

On June 3, 2003, the Council of the European Union adopted a directive regarding the taxation of savings income in the form of interest payments within the European Community which requires tax authorities in a member state to share information concerning payments of interest (or other similar income) made by a paying agent within its jurisdiction to or for the benefit of an individual resident in another member state with the tax authorities of such member state. The directive requires member states to adopt implementing legislation by January 1, 2004. Luxembourg and certain other countries have the option to operate a withholding system for a transitional period whereby paying agents in such countries will be required to levy a withholding tax. See “Taxation—Luxembourg—June 3, 2003 Council Directive on Taxation of Savings Income in the Form of Interest Payments.” We currently have paying agents for the Notes in Luxembourg, the United Kingdom and the United States. Where any obligation to withhold amounts in respect of payments on the notes to individuals arises as a result of this European directive, we will not have an obligation to pay additional amounts. See “Description of the Notes—Payment and Paying Agents” and “—Taxation and Additional Amounts.”

Tax might be withheld on dispositions of our notes, reducing their value.

If a non-resident holder sells notes to a Russian resident, there is a risk that the proceeds from such disposal may be subject to a withholding tax on any gain realized, subject to any available treaty

relief. There is no assurance that advance treaty relief would be granted and obtaining a refund can be extremely difficult, if not impossible. Where proceeds from disposal of the notes are received from a source within Russia by an individual non-resident holder, the individual income tax could be charged at 30%. The tax law is unclear as to whether the tax should be withheld from proceeds or paid by an individual non-resident holder based on a personal tax return. The individual income tax may be reduced or eliminated pursuant to the provisions of any applicable tax treaty. However, advance relief will not be available and obtaining a refund should be done by submission of a personal tax return.

Proceeds from the sale of notes received by non-resident holders who are not individuals should not be subject to Russian taxation. However, it is not clear how the tax authorities will, in practice, apply the Russian Tax Code that became effective on January 1, 2002. For example, the tax authorities have recently confirmed that a portion of proceeds allocable to accrued interest may be subject to 20% withholding tax. Withholding tax on interest may be reduced or eliminated in accordance with the provisions of any applicable double taxation treaty. However, there is no assurance that advance treaty relief would be granted and obtaining a refund can be extremely difficult, if not impossible. The imposition or possibility of imposition of this withholding tax could adversely affect the value of the notes.

In addition, the issuer may, at its option, redeem the notes if, as a result of any change in applicable tax legislation, we or the issuer becomes obliged to pay, on the occasion of the next payment of interest due under the notes, additional amounts in order that every net payment made by the issuer on the notes after deduction or withholding for any taxes not be less than the amount then due and payable. If the issuer redeems the notes under such circumstances, the redemption price will be equal to 100% of the principal amount of the notes plus any accrued interest and additional amounts due. See “Description of Notes—Redemption.”

Foreign judgments may not be enforceable against us.

Our presence outside the United States may limit your legal recourse against us. We are incorporated under the laws of the Russian Federation. Substantially all of our directors and executive officers named in this offering memorandum reside outside the United States. All or a substantial portion of our assets and the assets of our officers and directors are located outside the United States. As a result, you may not be able to effect service of process within the United States on us or on our officers and directors. Similarly, you may not be able to obtain or enforce U.S. court judgments against us, our officers and directors, including actions based on the civil liability provisions of the federal securities laws of the United States.

In addition, 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 the recognition and enforcement of judgments in civil cases exists between the Russian Federation and the country where the judgment is rendered. No such treaty exists between the United States and the Russian Federation, or the United Kingdom and the Russian Federation, for the reciprocal enforcement of foreign court judgments. The indenture provides that controversies, claims and causes of action brought by any party thereto against us may 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. However, 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, Russian courts’ inability to enforce such orders, and corruption.

Financial turmoil in emerging markets could cause the price of the notes to suffer.

Financial turmoil in Russia and other emerging markets in 1997 and 1998 adversely affected market prices in the world securities markets for companies that operate in those developing economies. Financial turmoil in these countries could cause decreases in the value of the notes, even if the Russian economy remains relatively stable.

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 document 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 document has been derived from official data of Russian government agencies. The official data published by Russian federal, regional and local governments are 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 document 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 with manipulating economic data to hide the actual output of various companies.

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

The methodology for calculation of subscriber numbers varies substantially in the mobile 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 between different mobile cellular communications companies may be difficult to draw.

ISSUER OF NOTES

General

The issuer, Mobile TeleSystems Finance S.A., is a société anonyme organized for an unlimited duration under the laws of Luxembourg and was incorporated on December 10, 2001. The issuer has an issued share capital of \$125,000 divided into 1,000 shares with a par value of \$125 per share, 999 of which we own directly and one of which we beneficially own through De Luxe Holding S.A. All 1,000 shares are fully paid. The corporate purpose of the issuer, as set forth in its articles of incorporation, is:

- the holding of participations directly or indirectly, in any form whatsoever, in Luxembourg and foreign companies;
- the acquisition by purchase, subscription, or in any other manner as well as the transfer by sale, exchange or otherwise of stock, bonds, debentures, notes and other securities of any kind; and
- the ownership, administration, development and management of its portfolio.

The issuer may, for example:

- hold interests in partnerships;
- borrow in any form and proceed to issue bonds and debentures;
- lend funds including the proceeds of such borrowings and issues to its subsidiaries, affiliated companies or to any other company;
- give guarantees in favor of its subsidiaries, affiliated companies or any other companies;
- grant assistance to affiliated companies;
- take any controlling and supervisory measures; and
- carry out any operation that it may deem useful in the accomplishment and development of its purposes.

The registered office of the issuer is 3 avenue Pasteur, L-2311 Luxembourg. The issuer is registered with the Register of Commerce and Companies in Luxembourg under number B 84 895.

The articles of incorporation of the issuer have been published in the Mémorial C, Journal Officiel du Grand-Duché de Luxembourg, Recueil des Sociétés et Associations No. 501 of 29 March, 2002. Any person interested in inspecting them may do so at the Register of Commerce and Companies in Luxembourg. In connection with the listing of the notes on the Luxembourg Stock Exchange, the constitutional documents of the issuer and a legal notice relating to the issue of the notes will be deposited prior to the listing at the Register of Commerce and Companies in Luxembourg, where such documents may be examined and copies obtained free of charge.

Capitalization

The following table sets forth the capitalization of the issuer:

	At June 30, 2002	At June 30, 2003
	(Amounts in thousands)	
Indebtedness:		
\$250,000,000 10.95% notes issued on December 21, 2001 and due 2004	\$248,405	\$249,009
\$50,000,000 10.95% notes issued on March 20, 2002 and due 2004	50,743	50,457
\$400,000,000 9.75% notes issued on January 30, 2003 and due 2008	—	400,000
Total indebtedness	<u>\$299,148</u>	<u>\$699,466</u>
Shareholders' equity:		
Share capital (authorized, issued and fully paid) 1,000 shares of par value \$125 .	\$ 125	\$ 125
Retained earnings	23	419
Total shareholders' equity	<u>\$ 148</u>	<u>\$ 544</u>
Total capitalization	<u>\$299,296</u>	<u>\$700,010</u>

The issuer had no other securities outstanding as of the dates indicated.

Business

The issuer was formed as a finance subsidiary to assist us in our financing activities. Since the date of its formation, the issuer has not engaged in any business other than the issuance of an aggregate principal amount of \$250,000,000 10.95% notes on December 21, 2001, due 2004, the issuance of an aggregate principal amount of \$50,000,000 10.95% notes on March 20, 2002, due 2004, the issuance of an aggregate principal amount of \$400,000,000 9.75% notes on January 30, 2003, due 2008, the issuance of an aggregate principal amount of \$300,000,000 floating rate notes on August 5, 2003, due 2004, and this offering and the related transactions. Upon the closing of the offering of the notes, the only material assets of the issuer will be five intercompany loans made to us. The issuer has no subsidiaries.

Directors

The directors of the issuer are Ilya Chuprinko, company director, residing in the Russian Federation; Dmitry Saprykin, company director, residing in the Russian Federation; and Andrey Vinogradov, company director, residing in the Russian Federation.

Recent Developments

Subsequent to December 31, 2002, the issuer issued \$400 million 9.75% notes on January 30, 2003, and lent the proceeds to us pursuant to an intercompany loan agreement. The notes were issued under an indenture dated January 30, 2003 and mature on January 30, 2008. Interest on the notes is payable in arrears on January 30 and July 30 of each year, commencing on July 30, 2003. The issuer also issued \$300 million floating rate notes on August 5, 2003, and lent the proceeds to us pursuant to an intercompany loan agreement. The floating rate notes were issued under an indenture dated August 5, 2003 and mature on August 5, 2004. Interest on the notes is payable quarterly on November 5, 2003, February 5, 2004, May 5, 2004 and August 5, 2004. The notes issued in connection with both offerings are listed on the Luxembourg Stock Exchange and are guaranteed by us. See “Business—History.”

USE OF PROCEEDS

The net proceeds we will receive from the offering, after deducting discounts and fees to the initial purchasers, but before deducting expenses incurred in connection with the offering, will be approximately \$396,680,000. The issuer will lend these proceeds to us pursuant to a loan agreement.

We intend to use approximately \$200 million of the net proceeds from the loan to prepay a \$100 million loan we obtained from Credit Suisse First Boston International and a \$100 million loan we obtained from ING Bank (Eurasia) ZAO and ING (Ireland) Limited to finance certain capital expenditures and for general corporate purposes, including dividends. See “Operating and Financial Review and Prospects—Recent Developments—CSFBi Loan” and “—ING Loan.” Over time, we intend to use the remaining proceeds to repay certain of our existing indebtedness that was incurred for the acquisitions of mobile operators in Russia and Ukraine.

Prior to the use of these net proceeds, we intend to hold them in U.S. dollar-denominated, interest-bearing bank accounts in Russia. We may also consider investing the net proceeds in short-term, interest-bearing, U.S. dollar- or euro-denominated instruments.

CAPITALIZATION

The following table sets forth our consolidated capitalization, including short-term debt, at June 30, 2003, on a historical basis and as adjusted to give effect to the application of the net proceeds of our August 5, 2003 Eurobond offering and this offering. For further information regarding our financial condition, see “Selected Financial Data,” “Operating and Financial Review and Prospects” and our financial statements located elsewhere in this document.

	At June 30, 2003	
	Historical	As Adjusted
	(Amounts in thousands)	
Short-term debt:		
Capital lease obligations	\$ 14,603	\$ 14,603
Ericsson loan	7,650	7,650
Dresdner loans	33,200	33,200
Financing derivatives ⁽¹⁾	59,965	59,965
Other debt and promissory notes	85,548	85,548
\$300,000,000 floating rate notes due 2004 issued on August 5, 2003	—	97,000 ⁽²⁾
Total short-term debt	<u>\$ 200,966</u>	<u>\$ 297,966</u>
Long-term debt:		
Capital lease obligations	\$ 7,237	\$ 7,237
Ericsson loan	19,350	19,350
Dresdner loans	10,000	10,000
Other debt and promissory notes	40,251	40,251
\$250,000,000 10.95% notes due 2004 issued on December 21, 2001	249,009	249,009
\$50,000,000 10.95% notes due 2004 issued on March 20, 2002	50,457	50,457
\$400,000,000 9.75% notes due 2008 issued on January 30, 2003	400,000	400,000
\$400,000,000 8.375% notes due 2010 issued on October 14, 2003	—	400,000 ⁽³⁾
Total long-term debt	<u>\$ 776,304</u>	<u>\$1,176,304</u>
Total debt	<u>\$ 977,270</u>	<u>\$1,474,270</u>
Shareholders' equity:		
Common stock, 0.1 ruble par value, 2,096,975,792 shares authorized and 1,993,326,138 issued	\$ 50,558	\$ 50,558
Treasury shares ⁽⁴⁾	(10,206)	(10,206)
Additional paid in capital	558,762	558,762
Unearned compensation	(212)	(212)
Shareholder receivable	(31,087)	(31,087)
Retained earnings	835,481	835,481
Total shareholders' equity	<u>\$1,403,296</u>	<u>\$1,403,296</u>
Total capitalization⁽⁵⁾	<u><u>\$2,380,566</u></u>	<u><u>\$2,877,566</u></u>

⁽¹⁾ Represents the amount payable under our call option agreements for the purchase of the remaining 47.3% of common shares and 50.0% of preferred shares of TAIF Telcom. See Note 2 to our unaudited condensed consolidated financial statements.

⁽²⁾ Assuming \$200 million of the proceeds from this offering will be used to partially repay our Floating Rate Notes in 2004.

⁽³⁾ On September 22, 2003, we entered into a loan facility agreement with Credit Suisse First Boston International in the amount of \$100 million. On September 23, 2003, we entered into a loan facility agreement with ING Bank (Eurasia) ZAO and ING (Ireland) Limited in the amount of \$100 million. Amounts borrowed under each of these loans bear interest at LIBOR +2.25% per annum. We intend to repay both of these loans out of the proceeds of this offering. See “Use of Proceeds.”

- (4) Upon completion of our initial public offering on July 6, 2000, selected directors, key advisors and executives of MTS received 3,587,987 shares of our common stock representing 0.18% of our issued and outstanding shares. See “Management—Management Stock Bonus and Stock Option Plans.” The terms of our stock option plan allow our directors and executives, together with management, to receive up to an additional 9,966,631 shares of our common stock, representing 0.5% of our issued and outstanding shares. These 9,966,631 shares, which were issued to Rosico in our initial public offering, were transferred to one of our wholly-owned subsidiaries, MTS CJSC, in connection with our merger with Rosico in June 2003. Please refer to Note 18 to our audited consolidated financial statements.
- (5) There have been no material changes in our capitalization since June 30, 2003 except as discussed in “Operating and Financial Review and Prospects—Recent Developments.” All of our charter capital has been fully paid in.

SELECTED CONSOLIDATED HISTORICAL FINANCIAL DATA

The selected consolidated financial data below shows our historical financial information for the five-year period ended December 31, 2002, and for the six-month periods ended June 30, 2002 and 2003. The selected consolidated financial data as of and for the years ended December 31, 2000, 2001 and 2002 are derived from the audited consolidated historical financial statements, prepared in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP), included elsewhere in this document. The selected consolidated financial data as of and for the six months ended June 30, 2002 and 2003 are derived from unaudited consolidated financial statements prepared in accordance with U.S. GAAP included elsewhere in this document, and reflect normal and recurring adjustments that are necessary for a fair statement of the results for the interim periods presented. Results for interim periods are not necessarily indicative of results for the full year. In addition, the following table presents selected financial information as of and for the years ended December 31, 1998 and 1999 derived from our audited consolidated financial statements not included in this document. The selected financial data should be read in conjunction with our financial statements included elsewhere in this document, “Risk Factors” and “Operating and Financial Review and Prospects.”

Key industry data and certain MTS operating data are also provided below.

	Years Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003 ⁽²⁾
	(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)						
Statement of operations data:							
Net revenues:							
Service revenues ⁽¹⁾ . .	\$ 313,282	\$ 314,568	\$ 484,469	\$ 830,308	\$ 1,274,287	\$ 522,386	\$ 992,673
Connection fees . . .	8,697	12,755	14,885	21,066	24,854	12,228	16,166
Equipment sales . . .	16,344	31,004	36,358	41,873	62,615	29,288	43,295
Total net revenues	338,323	358,327	535,712	893,247	1,361,756	563,902	1,052,134
Cost of services and products:							
Interconnection and line rental	43,617	38,958	41,915	75,278	113,052	55,081	78,908
Roaming expenses . .	13,223	21,725	41,178	68,387	83,393	28,713	45,269
Cost of equipment . .	14,658	29,932	39,217	39,828	90,227	38,119	73,639
Total cost of services and products	71,498	90,615	122,310	183,493	286,672	121,913	197,816
Operating expenses ⁽³⁾	67,470	74,612	110,242	134,598	229,056	91,672	168,944
Sales and marketing expenses	15,657	23,722	76,429	107,729	171,977	64,795	135,564
Depreciation and amortization	19,629	53,766	87,684	133,318	209,680	90,678	174,774
Impairment of investment	—	—	—	10,000	—	—	—
Net operating income	164,069	115,612	139,047	324,109	464,371	194,844	375,036
Currency exchange and translation loss (gain) ⁽⁴⁾	25,125	3,238	1,066	2,264	3,474	690	(1,408)

	Years Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003 ⁽²⁾
	(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)						
Other expenses							
(income):							
Interest income . . .	\$ (2,181)	\$ (801)	\$ (7,626)	\$ (11,829)	\$ (8,289)	\$ (5,497)	\$ (8,823)
Interest expenses, net of amounts capitalized ⁽⁵⁾	8,302	11,805	11,335	6,944	44,389	20,687	42,813
Other expenses (income), net . . .	4,838	(829)	(502)	(2,672)	(2,454)	2,721	855
Total other expenses (income), net . .	10,959	10,175	3,207	(7,557)	33,646	17,911	34,845
Income before provision for income taxes and minority interest .	127,985	102,199	134,774	329,402	427,251	176,243	341,599
Provision for income taxes	62,984	18,829	51,154	98,128	110,417	53,954	96,412
Minority interest in net (loss) income .	(1,027)	(2,291)	(6,428)	7,536	39,711	14,688	36,445
Net income before cumulative effect of a change in accounting principle	66,028	85,661	90,048	223,738	277,123	107,601	208,742
Cumulative effect of a change in accounting principle, net of income taxes of \$9,644 in 2001 . . .	—	—	—	(17,909)	—	—	—
Net income	\$ 66,028	\$ 85,661	\$ 90,048	\$ 205,829	\$ 277,123	\$ 107,601	\$ 208,742
Dividends declared .	\$ 10,119	\$ 11,879	\$ 13,631	\$ 2,959	\$ — ⁽⁶⁾	\$ —	\$ 111,412
Pro forma net income giving effect to the change in accounting principle, had it been applied retroactively	\$ 59,439	\$ 78,258	\$ 93,108	\$ 223,738	\$ 277,123	\$ 107,601	\$ 208,742
Net income per share, basic and diluted	\$ 0.047	\$ 0.052	\$ 0.050	\$ 0.104	\$ 0.140	\$ 0.054	\$ 0.105
Dividends declared per share	\$ 0.01	\$ 0.01	\$ 0.01	—	— ⁽⁶⁾	—	\$ 0.06
Weighted average common shares outstanding	1,397,945,938	1,634,527,040	1,806,968,096	1,983,359,507	1,983,359,507	1,983,359,507	1,983,359,507

	Years Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003 ⁽²⁾
	(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)						
Consolidated cash flow data:							
Cash provided by operating activities	\$ 103,486	\$ 116,801	\$ 190,914	\$ 338,201	\$ 412,772	\$ 107,315	\$ 395,341
Cash used in investing activities (of which capital expenditures) . .	(122,051)	(115,184)	(423,349)	(441,523)	(697,921)	(279,671)	(702,226)
Cash (used in) provided by financing activities	(103,132)	(118,338)	(224,898)	(441,200)	(574,272)	(242,016)	(383,239)
	(9,624)	(11,557)	298,543	247,592	100,817	65,297	385,338
Consolidated balance sheet data (end of period):							
Cash, cash equivalents and short-term investments	\$ 20,884	\$ 10,000	\$ 245,828	\$ 304,933	\$ 64,661	\$ 111,823	\$ 143,561
Property, plant and equipment, net . .	167,975	250,270	439,307	856,056	1,344,633	1,142,199	1,866,543
Total assets	614,165	682,047	1,101,332	1,727,492	2,283,296	2,015,679	3,299,942
Total debt (long-term and short-term) ⁽⁷⁾ .	110,155	112,123	52,773	325,840	454,485	418,211	977,270
Total shareholders' equity:	269,942	343,724	801,084	1,018,279	1,302,044	1,128,489	1,403,296
including capital stock	49,276	49,276	40,352	40,352	40,352	40,352	40,352
Key financial ratios (end of period):							
Total debt/total capitalization ⁽⁸⁾ . .	28.0%	24.6%	6.2%	24.2%	25.9%	27.0%	41.1%
Key industry data (end of period):							
Estimated population in Russia (millions) ⁽⁹⁾	146.7	145.9	144.8	143.9	145.2	143.5	144.5
Russian cellular subscribers (thousands) ⁽¹⁰⁾ . . .	718	1,360	3,400	8,040	18,001	11,370	25,130
Industry penetration ⁽¹⁰⁾ . . .	0.5%	0.9%	2.3%	5.5%	12.4%	8.1%	17.3%

	Years Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003 ⁽²⁾
	(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)						
MTS operating data:⁽¹¹⁾							
MTS—total subscribers (end of period, thousands) ⁽¹²⁾ . . .	114	306	1,194	2,650	6,644	4,370	11,340
MTS share of total Russian subscribers (end of period) ⁽¹⁰⁾	16%	23%	35%	33%	38%	37%	37%
Average monthly usage per Russian subscriber (minutes) ⁽¹³⁾	384	224	151	157	159	167	162
Average monthly revenue per Russian subscriber (in U.S. dollars) ⁽¹⁴⁾ \$	302	\$ 124	\$ 54	\$ 36	\$ 23	\$ 25	\$ 19
Churn ⁽¹⁵⁾	31.2%	20.7%	21.6%	26.8%	33.9%	7.7%	11.0%

- (1) Service revenues represent subscription fees, usage charges and value-added service fees, as well as roaming fees charged to other operators for their subscribers, or guest roamers, utilizing our network. Guest roaming fees were \$56.5 million, \$44.0 million, \$43.2 million, \$52.6 million and \$83.4 million for the years ended December 31, 1998, 1999, 2000, 2001 and 2002, respectively, and \$34.1 million and \$62.8 million for the six months ended June 30, 2002 and 2003, respectively.
- (2) Our results of operations for the six months ended June 30, 2003 include the results of operations for UMC for the months of March through June.
- (3) Operating expenses include taxes (other than income taxes), primarily revenue and property-based taxes, of \$16.5 million, \$15.6 million, \$26.9 million, \$25.3 million and \$39.1 million for the years ended December 31, 1998, 1999, 2000, 2001 and 2002, respectively, and \$16.3 million and \$17.9 million for the six months ended June 30, 2002 and 2003, respectively.
- (4) On a day-to-day basis, we are exposed to exchange losses on cash balances and other monetary assets and liabilities denominated in currencies other than the U.S. dollar, primarily rubles, hryvnas and euro. See Note 2 to our audited consolidated financial statements included elsewhere in this document.
- (5) Capitalized interest expenses were \$1.2 million, \$1.3 million, \$0.9 million, \$nil and \$nil for the years ended December 31, 1998, 1999, 2000, 2001 and 2002, respectively, and \$nil and \$nil for the six months ended June 30, 2002 and 2003, respectively.
- (6) On June 30, 2003, our shareholders approved cash dividends of \$1.12 per ADS (\$0.056 per share) for a total of \$111.4 million. This distribution is reflected in our financial statements for the six months ended June 30, 2003.
- (7) Includes notes payable, bank loans, equipment financing, capital lease obligations and financing derivatives.
- (8) Calculated as book value of total debt divided by the sum of the book values of total shareholders' equity and total debt at the end of the relevant period. See note 7 above for the definition of "total debt."
- (9) Source: Goskomstat; the December 31, 2002 and June 30, 2003 population statistics provided by Goskomstat take into account the All-Russian Population Census undertaken by the Russian government in October 2002.
- (10) Source: Sotovik, J'Son & Partners and AC&M-Consulting.
- (11) Source: Sotovik, J'Son & Partners, AC&M-Consulting and our data.
- (12) We define a "subscriber" as an individual or organization whose account does not have a negative balance for more than 61 days. For the "Jeans" tariffs only, introduced in November 2002, we define "subscriber" as an individual or organization whose account does not have a negative balance for more than 183 days. For a description of our "Jeans" tariffs, see "Business—Business Overview—Sales and Marketing—Tariffs."
- (13) Average monthly minutes of usage per subscriber is calculated by dividing the total number of minutes of usage during a given period by the average number of our subscribers during such period and dividing by the number of months in such period.
- (14) We calculate our average monthly service revenue per subscriber by dividing our service revenues for a given period, including guest roaming fees, by the average number of our subscribers during that period and dividing by the number of months in that period.
- (15) We define "churn" as the total number of subscribers who cease to be a "subscriber" as defined in note 12 during the period (whether involuntarily due to non-payment or voluntarily, at such subscriber's request), expressed as a percentage of the average number of our subscribers during that period.

UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

In March 2003, we purchased a 57.7% stake in Ukrainian Mobile Communications, or UMC, for \$194.2 million plus acquisition costs of \$1.4 million. We purchased a 16.33% stake from KPN, a 16.33% stake from Deutsche Telekom AG, and a 25.0% stake from Ukrtelecom. In June 2003, we purchased an additional 26.0% stake in UMC from Ukrtelecom for \$87.6 million pursuant to a call option agreement, which increased our ownership in UMC to 83.7%. In August 2003, we purchased the remaining 16.33% stake in UMC from TDC Mobile International A/S for \$91.7 million pursuant to a put and call option agreement, which increased our ownership in UMC to 100%.

The following unaudited pro forma condensed combined financial information gives effect to the acquisition of 100% of the outstanding voting interest of UMC by us, under the purchase method of accounting. This pro forma information is presented for illustrative purposes only. The pro forma adjustments are based upon available information and assumptions that management believes are reasonable. The pro forma condensed combined financial information does not purport to represent what our results of operations or financial position would actually have been if the acquisition had in fact occurred on the dates specified below, nor do they purport to project our results of operations or financial position for any future period or as of any date, respectively. See Note 2 to our unaudited condensed consolidated financial statements as of June 30, 2003 for further descriptions of the acquisition of UMC by us.

The following unaudited pro forma condensed combined financial information for the year ended December 31, 2002 is based on our historical consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America or U.S. GAAP, and included elsewhere in this document and unaudited management financial information of UMC prepared in accordance with U.S. GAAP and included elsewhere in this document. UMC does not as a matter of course prepare financial statements in accordance with U.S. GAAP; however, management has prepared this financial information using the best currently available estimates and judgments, and this financial information presents, to the best of management's knowledge and belief, the financial position of the company as of December 31, 2002 and the results of its operations and cash flows for the year then ended in accordance with U.S. GAAP.

The following unaudited pro forma condensed combined financial information as of and for the six months ended June 30, 2003 is based on our unaudited historical consolidated financial statements prepared in accordance with U.S. GAAP, and included elsewhere in this document and unaudited management financial information of UMC prepared in accordance with U.S. GAAP. UMC does not as a matter of course prepare financial statements in accordance with U.S. GAAP; however, management has prepared this financial information using the best currently available estimates and judgments, and this financial information presents, to the best of management's knowledge and belief, the results of operations of the company for the period from January 1, 2003 to February 28, 2003.

Under the purchase method of accounting, tangible and identifiable intangible assets acquired and liabilities assumed are recorded at their estimated fair values. The estimated fair values and useful lives of assets acquired and liabilities assumed are based on a preliminary valuation and are subject to final valuation adjustments which may result in a revision of the values assigned to some of the acquired tangible and intangible assets and/or their respective estimated useful lives. We are currently undertaking a study to determine the allocation of the purchase price to the various assets acquired, including tangible assets, licenses and customer base. Based on currently available information, we estimate that costs allocated to licenses will be amortized under the straight-line method over the remaining contractual term of the respective licenses of approximately 9 to 13 years, while the acquired customer base will be amortized over the estimated average subscriber life of approximately 22 months.

The unaudited pro forma condensed combined statement of operations for the year ended December 31, 2002 was prepared by combining our consolidated statement of operations for the year

ended December 31, 2002 with UMC's statement of operations for the year ended December 31, 2002, giving effect to the purchase of 100% of the outstanding voting interest of UMC as though it had occurred at January 1, 2002.

The unaudited pro forma condensed combined statement of operations for the six months ended June 30, 2003 was prepared by combining our consolidated statement of operations for the six months ended June 30, 2003 with UMC's statement of operations for the period from January 1, 2003 to February 28, 2003, giving effect to the purchase of 100% of the outstanding voting interest of UMC as though it had occurred at January 1, 2002.

The unaudited pro forma condensed combined balance sheet as of June 30, 2003 was prepared by adjusting our historical balance sheet at June 30, 2003, which included the effect of the acquisition of 57.7% and 26.0% of the outstanding voting interest of UMC in March 2003 and June 2003, respectively, for the acquisition of the additional 16.3% of the outstanding voting interest, giving effect to the purchase of 16.3% of the outstanding voting interest of UMC as though each such purchase had been completed at June 30, 2003.

The unaudited pro forma condensed combined financial information does not give effect to any restructuring costs or to any potential cost savings or other operating efficiencies that could result from the acquisition.

You should read the financial information in this section along with our audited consolidated financial statements for the year ended December 31, 2002, our unaudited condensed consolidated financial statements for the six months ended June 30, 2003 and UMC's unaudited management financial information included elsewhere in this document.

UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF OPERATIONS

For the year ended December 31, 2002

(Amounts in thousands, except share and per share amounts)

	<u>MTS historical</u>	<u>UMC historical⁽¹⁾</u>	<u>Pro forma adjustments</u>	<u>MTS pro forma combined</u>
Net revenues	\$ 1,361,756	\$296,398	\$ (4,538) ⁽²⁾	\$ 1,653,616
Cost of services and products	286,672	68,407	(4,538) ⁽²⁾	350,541
Gross profit	1,075,084	227,991	—	1,303,075
Operating expenses	229,056	46,087	—	275,143
Sales and marketing expenses	171,977	33,926	—	205,903
Depreciation and amortization	209,680	42,851	34,938 ⁽³⁾⁽⁴⁾	287,469
Net operating income	464,371	105,127	(34,938)	534,560
Interest expense	44,389	4,241	36,556 ⁽⁵⁾	85,186
Other (income) expense, net	(7,269)	3,273	—	(3,996)
Net income before provision for income taxes and minority interest	427,251	97,613	(71,494)	453,370
Provision for income taxes	110,417	32,424	(10,482) ⁽⁶⁾	132,359
Minority interest	39,711	—	—	39,711
Net income	<u>\$ 277,123</u>	<u>\$ 65,189</u>	<u>\$(61,012)</u>	<u>\$ 281,300</u>
Weighted average number of shares outstanding	1,983,359,507			1,983,359,507
Earnings per share, basic and diluted . .	\$ 0.140			\$ 0.142

UNAUDITED PRO FORMA CONDENSED COMBINED STATEMENT OF OPERATIONS

For the six months ended June 30, 2003

(Amounts in thousands, except share and per share amounts)

	<u>MTS historical</u>	<u>UMC historical for the period from January 1, 2003 to February 28, 2003⁽⁷⁾</u>	<u>Pro forma adjustments</u>	<u>MTS pro forma combined</u>
Net revenues	\$ 1,052,134	\$56,244	\$ (802) ⁽²⁾	\$ 1,107,576
Cost of services and products	197,816	14,670	(802) ⁽²⁾	211,684
Gross profit	854,318	41,574	—	895,892
Operating expenses	168,944	7,131	—	176,075
Sales and marketing expenses	135,564	7,075	—	142,639
Depreciation and amortization	174,774	8,208	19,659 ⁽³⁾⁽⁴⁾	202,641
Net operating income	375,036	19,160	(19,659)	374,537
Interest expense	42,813	693	2,907 ⁽⁵⁾	46,413
Other (income) expense, net	(9,376)	1,385	—	(7,991)
Net income before provision for income taxes and minority interest	341,599	17,082	(22,566)	336,115
Provision for income taxes	96,412	7,081	(9,545) ⁽⁶⁾	93,948
Minority interest	36,445		(10,799) ⁽⁸⁾	25,646
Net income	<u>\$ 208,742</u>	<u>\$10,001</u>	<u>\$ (2,222)</u>	<u>\$ 216,521</u>
Weighted average number of shares outstanding	1,983,359,507			1,983,359,507
Earnings per share, basic and diluted	\$ 0.105			\$ 0.109

UNAUDITED PRO FORMA CONDENSED COMBINED BALANCE SHEET

As of June 30, 2003
(Amounts in thousands)

	<u>MTS historical</u>	<u>Pro forma adjustments</u>	<u>MTS pro forma combined</u>
Current assets	\$ 566,640	\$(91,700) ⁽⁹⁾	\$ 474,940
Property plant and equipment, net	1,866,543	29 ⁽³⁾	1,866,572
Licenses and intangible assets, net	808,423	63,752 ⁽⁴⁾	872,175
Other assets	58,336		58,336
Total assets	<u>\$3,299,942</u>	<u>\$(27,919)</u>	<u>\$3,272,023</u>
Current liabilities	\$ 814,529	—	\$ 814,529
Long-term debt	769,067	—	769,067
Other liabilities	180,526	16,767 ⁽¹⁰⁾	197,293
Minority interest	132,524	(44,686) ⁽⁸⁾	87,838
Common stock	50,558		50,558
Additional paid in capital	558,762		558,762
Retained earnings	835,481		835,481
Other	(41,505)		(41,505)
Total liabilities and shareholders' equity	<u>\$3,299,942</u>	<u>\$(27,919)</u>	<u>\$3,272,023</u>

NOTES TO UNAUDITED PRO FORMA CONDENSED COMBINED FINANCIAL INFORMATION

1. The historical statement of operations information of UMC for the year ended December 31, 2002 is derived from unaudited management financial information of UMC prepared in accordance with U.S. GAAP and included elsewhere in this document. UMC does not as a matter of course prepare financial statements in accordance with U.S. GAAP; however, management has prepared this financial information using the best currently available estimates and judgments, and this financial information presents, to the best of management's knowledge and belief, the financial position of the company as of December 31, 2002 and the results of operations of the company for the year then ended.
2. Adjustments represent the elimination of roaming revenues and the related roaming costs between UMC and us for the respective period.
3. Adjustments relate to the difference between the fair value of UMC's tangible assets acquired and their book value at the date of the acquisition and the related depreciation expense. For the purpose of the presentation of the above unaudited pro forma condensed combined financial information, the allocation of the purchase price to tangible assets was performed based on a preliminary purchase price allocation. We are currently undertaking a study to determine the final allocation of the purchase price to tangible assets, and as a result of the final allocation, the reported values and/or useful lives of certain fixed assets may change, which will result in a change of the related depreciation expense. See Note 2 to our unaudited condensed consolidated financial statements as of June 30, 2003.
4. Adjustments relate to the difference between the purchase price allocated to the intangible assets of UMC and their respective book values at the date of the acquisition and the related amortization expense. For the purpose of the presentation of the above unaudited pro forma condensed combined financial information, the allocation of the purchase price to various identified intangibles, including GSM licenses, acquired customer base and software was performed based on a preliminary purchase price allocation. We are currently undertaking a study to determine the final allocation of the purchase price to those intangible assets, and as a result of the final allocation, the reported values and/or useful lives of certain intangible assets may change, which will result in a change of the related amortization expense. See Note 2 to our unaudited condensed consolidated financial statements as of June 30, 2003.

GSM licenses are amortized over the remaining contractual life of the respective licenses, which expire on various dates between March 31, 2012 and June 18, 2016. The acquired customer base is amortized over the estimated average subscriber life of approximately 22 months.
5. Adjustments represent the additional interest expense related to debt incurred by us to effect the acquisition of UMC. The total purchase price of \$374.9 million (including acquisition costs of \$1.4 million) was financed by cash raised through the placement of \$400.0 million 9.75% notes.

For the purposes of the unaudited condensed combined pro forma financial information, the purchase price, and the related additional indebtedness, has been calculated as if we acquired 100.0% of the outstanding voting interest of UMC on January 1, 2002.

	<u>Purchase price</u> (Amounts in thousands)
Purchase of the 25.0% of the outstanding voting interest from Ukrtelecom	\$ 84,200
Purchase of the 16.33% of the outstanding voting interest from KPN	55,000
Purchase of the 16.33% of the outstanding voting interest from Deutsche Telekom AG	55,000
Acquisition costs	1,438
Exercise of MTS' option to purchase 26.0% of the outstanding voting interest from Ukrtelecom	87,600
Exercise of MTS' option to purchase 16.33% of the outstanding voting interest from TDC Mobile International A/S	<u>91,700</u>
Total purchase price used in the preparation of the unaudited condensed combined financial information	<u>\$374,938</u>

6. Adjustments represent the deferred income tax benefit, related to the amortization of acquired intangible assets.
7. Our historical statement of operations for the six months ended June 30, 2003 include the results of operations of UMC for the period from March 1, 2003 to June 30, 2003, reflecting the acquisition of 57.7% of the outstanding voting interest of UMC by us on March 4, 2003 and the acquisition of an additional 26.0% on June 4, 2003. For the purpose of the presentation of the unaudited pro forma condensed combined financial information, the results of operations of UMC for the period from January 1, 2003 to February 28, 2003 were added to our historical statement of operations.
8. Adjustment represents the elimination of minority interest, related to 26.0% of the outstanding voting interest of UMC for the period from March 1, 2003 to June 4, 2003 and to 16.33% of the outstanding voting interest of UMC for the period from March 1, 2003 to June 30, 2003 and as of June 30, 2003.
9. Adjustment represents the use of cash and sale of short term investments to finance the acquisition of the additional 16.33% of the outstanding voting interest of UMC from TDC Mobile International A/S.
10. Adjustment represents the additional deferred tax liability, related to the differences between the values of tangible and intangible assets of UMC for tax and accounting purposes.

OPERATING AND FINANCIAL REVIEW AND PROSPECTS

Operating Results

The following is a discussion of our financial condition and results of operations for the years ended December 31, 2000, 2001 and 2002 and for the six months ended June 30, 2002 and 2003 and of the material factors that we believe are likely to affect our consolidated prospective financial condition. You should read this section together with the information contained under the heading “Risk Factors” and our financial statements and the related notes, which appear elsewhere in this document. Our consolidated financial statements have been prepared in accordance with U.S. GAAP.

Basis of Presentation of Financial Results

We maintain our records and prepare our statutory financial statements in accordance with Russian accounting principles and tax legislation, and UMC prepares its statutory financial statements in accordance with Ukrainian accounting principles and tax legislation. The financial statements presented in this document have been prepared from Russian and Ukrainian accounting records for presentation in accordance with U.S. GAAP. These financial statements differ from the financial statements issued for statutory purposes in Russia and Ukraine in that they reflect adjustments not recorded in our statutory books, which are required to present the financial position, results of operations and cash flows in accordance with U.S. GAAP.

We report to the Russian tax authorities in rubles and to the Ukrainian tax authorities in hryvnas, and our accounting records are maintained in these currencies. The financial statements in this document have been prepared in accordance with U.S. GAAP and are stated in U.S. dollars. Accordingly, transactions and balances not already measured in U.S. dollars, mainly rubles, hryvnas and euro, have been translated into U.S. dollars in accordance with the relevant provision of SFAS No. 52, “Foreign Currency Translation.” Under SFAS No. 52, revenues, costs, capital and non-monetary assets and liabilities are translated at historical exchange rates prevailing on the transaction date. Monetary assets and liabilities are translated at exchange rates prevailing on the balance sheet dates. Exchange gains and losses arising from remeasurement of monetary assets and liabilities that are not denominated in U.S. dollars are credited or charged to operations.

Prior to January 1, 2003, the Russian economy was considered hyperinflationary, and we were required to follow the remeasurement method prescribed by SFAS No. 52 for hyperinflationary economies. Following this method, the U.S. dollar has been designated as our functional currency. Effective January 1, 2003, the Russian economy is no longer hyperinflationary, but we have continued to use the remeasurement method of SFAS No. 52 as we believe that the U.S. dollar is the appropriate functional currency for MTS OJSC and the majority of its subsidiaries due to the pervasive use of the U.S. dollar in our operations.

For the purposes of the following discussion, all references to “us” include MTS OJSC and our consolidated subsidiaries.

Basis of Segmental Reporting

We have adopted segmental reporting based on legal entities for the presentation of our results. We have two reportable segments—MTS OJSC, which operates primarily in the Moscow license area and several areas outside of the Moscow license area and UMC, which operates in Ukraine. We also have several operating divisions, which we have grouped into a separate segment which we call “Russian regions,” as discussed below. The Moscow license area, which encompasses the City of Moscow and the Moscow region, remains our principal market in terms of revenues; however, we do not currently produce discrete financial information for the Moscow license area. As a result, our segmental disclosure is currently based on financial and operational data for the legal entity,

MTS OJSC, the operations of which encompass an area larger than the Moscow license area. We use MTS OJSC as a proxy for the Moscow license area. See Note 25 to our audited consolidated financial statements for further details. The MTS OJSC segment was previously comprised of MTS OJSC and Rosico. However, as Rosico was merged into MTS OJSC in June 2003, we now refer to the segment as MTS OJSC.

We provide only limited analysis by segment below under the heading “Year Ended December 31, 2001, Compared to Year Ended December 31, 2000” as this presentation is not meaningful due to our limited presence in the regions outside the Moscow license area prior to 2001. We purchased 83.7% of Ukrainian Mobile Communications, a mobile service operator in Ukraine, in a series of transactions beginning in March 2003, and in July 2003 we purchased the remaining 16.3%. See “Business—Regional Expansion.” Due to this reason, we provide limited comparative analysis by segment with respect to UMC.

Overview

We are a leading provider of mobile cellular communications services in the Russian Federation. As of June 30, 2003, we had licenses to operate in 58 regions of the Russian Federation and had commenced commercial operations in 49 of these regions.

To date, we have increased our revenues by increasing our number of subscribers through organic growth, as well as through acquisitions.

	At December 31,			At June 30,	
	2000	2001	2002	2002	2003
	(in thousands)				
Subscribers⁽¹⁾					
Russia	1,194	2,650	6,644	4,367	9,318
MTS OJSC ⁽³⁾ subscribers	1,194	2,275	3,746	2,372	5,176
Including subscribers in the Moscow license area . .	1,106	2,035	3,082	2,351	4,133
Russian regions	n.m. ⁽⁴⁾	375	2,898	1,635	4,142
UMC	n.a. ⁽²⁾	n.a. ⁽²⁾	n.a. ⁽²⁾	n.a. ⁽²⁾	2,023
Total subscribers	<u>1,194</u>	<u>2,650</u>	<u>6,644</u>	<u>4,367</u>	<u>11,341</u>

⁽¹⁾ We define a subscriber as an individual or organization whose account does not have a negative balance for more than 61 days. For the “Jeans” tariff only, introduced in November 2002, we define a “subscriber” as an individual or organization whose account does not have a negative balance for more than 183 days. We do not include our subscribers in Belarus in our operating information, because our joint venture in Belarus is accounted for as an equity investment and therefore is not consolidated in our financial statements.

⁽²⁾ Not applicable. We did not own UMC on these dates.

⁽³⁾ Mobile TeleSystems OJSC was created on March 1, 2000 through the merger of MTS CJSC and RTC CJSC, a wholly-owned subsidiary.

⁽⁴⁾ Not meaningful. In 2000, the number of subscribers outside of the MTS OJSC segment was insignificant.

We consider subscribers who are disconnected from our network, whether involuntarily due to non-payment or voluntarily, at such subscribers’ request, for more than sixty-one days in any given period as churned subscribers (or one hundred and eighty three days in the case of our “Jeans” brand tariff introduced in November 2002). We view the subscriber churn (the ratio of disconnected subscribers to the average number of subscribers in any given period) as a measure of market

competition and customer dynamics. The following table shows our subscriber churn in Russia for the periods indicated.

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002 ⁽¹⁾	2003 ⁽¹⁾
Subscriber Churn					
Russia	21.6%	26.8%	33.9%	7.7%	11.0%
Ukraine	n.a. ⁽²⁾	n.a. ⁽²⁾	n.a. ⁽²⁾	n.a. ⁽²⁾	10.5% ⁽³⁾

⁽¹⁾ Half-year data are not comparable to annual data.

⁽²⁾ Not applicable. We did not own UMC during these periods.

⁽³⁾ Calculated based on the months of March through June, 2003. May not be comparable to half-year data.

The trend of increasing churn is due to the continued growth of competition in our license areas, an increase in seasonal subscribers who use our network only during the summer months of May through October, and a general increase in migrating subscribers. Historically, UMC's churn has been higher than that of our Russian operations. UMC is taking steps to reduce churn by improving its customer service.

While our subscribers and revenues have been constantly growing, our average monthly service revenues per subscriber have been decreasing. We calculate average monthly service revenue per subscriber by dividing our service revenues for a given period, including guest roaming fees, by the average number of our subscribers during that period and dividing by the number of months in that period. The following table shows average monthly service revenue per subscriber and average monthly minutes of use per subscriber for the periods indicated.

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003
Average monthly service revenue per subscriber					
Russia	\$54	\$36	\$23	\$25	\$19
Ukraine	n.a. ⁽¹⁾	n.a. ⁽¹⁾	n.a. ⁽¹⁾	n.a. ⁽¹⁾	\$17 ⁽²⁾
Average monthly minutes of use per subscriber					
Russia	151	157	159	167	162
Ukraine	n.a. ⁽¹⁾	n.a. ⁽¹⁾	n.a. ⁽¹⁾	n.a. ⁽¹⁾	94 ⁽²⁾

⁽¹⁾ Not applicable. We did not own UMC during these periods.

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

Average monthly service revenue per subscriber for Russia decreased from \$25 for the six months ended June 30, 2002 to \$19 for the six months ended June 30, 2003. We expect to see a continued decline in average monthly revenues per subscriber due to tariff decreases and the increasing ratio of mass-market subscribers in our subscriber mix. See "Risk Factors—Risks Relating to Our Business—Increased competition and a more diverse subscriber base have resulted in declining average monthly service revenues per subscriber which may adversely affect our results of operations," "—Trend Information—Sales" below and "Business—History."

Revenues

Our principal sources of revenue are:

- service revenues, including usage fees, monthly subscription fees, roaming fees and value-added service fees;
- connection fees; and
- revenues from sales of equipment, primarily handsets and accessories.

We set our fees and prices with reference to the competitive environment and we expect price competition to increase in the future. Our fees are not currently regulated by any organization or governmental authority.

Service Revenues

Usage fees include amounts charged directly to our subscribers, both for their usage of our network and for their usage of other operators' GSM networks when roaming outside of our service area. We generally bill our subscribers for all incoming and outgoing calls, except for incoming local calls originated by one of our subscribers and received by another one of our subscribers. However, we currently have in place certain promotions whereby our "Jeans" tariff subscribers receive all incoming calls from certain other mobile providers free of charge. Moreover, due to recently-passed amendments to the Ukrainian telecommunication laws, all mobile operators in Ukraine, including UMC, are prohibited from charging subscribers for incoming calls in Ukraine. See "Risk Factors—Risks Relating to our Business—Government regulation of our tariffs in Ukraine could negatively affect our business and results of operations."

The charges for outgoing calls to other cellular operators and to the public service telephone network are higher than charges for outgoing calls within our network. The usage fees charged for a call originating or terminating on our network depend on a number of factors, including the subscriber's tariff plan, call duration, the time of day when the call was placed, call destination and whether the call was incoming or outgoing. Usage fees represented 65.3% of our total net revenues in 2000, 69.3% in 2001 and 67.3% in 2002, and 67.7% and 69.3% for the six months ended June 30, 2002 and 2003, respectively. We generally expect usage fees to grow as a percentage of total net revenues. The further development of our "Jeans" tariff, which has no monthly subscription fee, will support this trend. However, usage fees declined as a percentage of revenues for the year ended December 31, 2002 due to the introduction of new tariff plans based on monthly subscription fees. The percentage of total net revenues represented by usage fees as compared to monthly subscription fees will continue to be affected by changes in our tariff plans, as well as the relative product mix between usage fee-based tariff plans versus monthly subscription fee-based tariff plans.

Monthly subscription fees consist of fixed monthly charges for network access. Monthly subscription fees represented 17.1% of our total net revenues in 2000, 16.9% in 2001 and 18.2% in 2002, and 18.9% and 19.1% for the six months ended June 30, 2002 and 2003, respectively. Many of our monthly subscription fee-based tariff plans also include a usage fee-based component for minutes used over certain number of pre-paid minutes. The percentage of total net revenues represented by usage fees as compared to monthly subscription fees will continue to be affected by the factors discussed in the previous paragraph.

Roaming fees include amounts charged to other GSM operators for their subscribers, i.e., guest roamers, utilizing our network while traveling in our service area. We bill other GSM operators for calls of guest roamers carried on our network. Roaming fees represented 8.1% of our total net revenues in 2000, 6.7% in 2001 and 6.7% in 2002, and 6.0% and 6.0% for the six months ended June 30, 2002 and 2003, respectively. We generally expect roaming fees to decline as a percentage of

total net revenues as we expect the increase in our subscribers to continue to outpace the increase in guest roamers.

We offer our subscribers an array of value-added services, including call forwarding, call waiting, call barring, call identification, voice mail, itemized billing and Short Messaging Service (SMS). For the year ended December 31, 2002 and the six months ended June 30, 2003, monthly average SMS usage was 10 and 17 text messages sent per subscriber in Russia, respectively. These services have historically comprised a small proportion of total net revenues and are primarily reflected as usage fees, but we generally expect value-added services as a proportion of total net revenues to increase slightly with subscriber growth. We expect that revenue from value-added services will vary based upon penetration rates, customer usage, pricing and advertising and promotional programs.

Connection Fees

Connection fees consist of charges paid to us by subscribers for initial connection to our network. We defer connection fees and recognize them as revenues over the estimated average subscriber life as described in Note 3 to our audited consolidated financial statements. Connection fees represented 2.8% of our total net revenues in 2000, 2.3% in 2001 and 1.8% in 2002, and 2.2% and 1.5% for the six months ended June 30, 2002 and 2003, respectively. We expect connection fee revenues to remain at a low level as a percentage of total net revenues.

Equipment Sales (Handsets and Accessories)

A portion of our subscribers purchase their handsets and accessories directly from us and indirectly from dealers who purchase such handsets and accessories from us. Since 1998, we have offered subscribers dual-band and tri-band handsets that operate in the 900 and 1800 MHz bands, and 900, 1800 and 1900 MHz bands, respectively. Revenue from the sale of handsets and accessories represented 6.8% of our total net revenue in 2000, 4.7% in 2001, 4.6% in 2002, and 5.2% and 4.1% for the six months ended June 30, 2002 and 2003, respectively. We have subsidized our handset sales since 2001 as discussed under “—Sales and Marketing” below. Our average selling price of handsets declined significantly between 2000 and 2002 and the price of handsets continued to decline during the first half of 2003.

We expect that as subscribers are added to our network and the price of handsets continues to decrease, our sales of handsets and accessories as a percentage of total net revenues will decline, as discussed under “—Cost of Services and Products—Costs of Equipment” below.

Expenses

Our principal expenses are:

- cost of services and products, including interconnection and line rental, cost of equipment and roaming expenses;
- operating expenses, such as salaries, rent and other general and administrative expenses, including provisions for doubtful accounts;
- sales and marketing expenses;
- depreciation of property, network equipment and amortization of telephone numbering capacity, license costs and other intangible assets; and
- provisions for income taxes.

Cost of Services and Products

Interconnection and line rental. Interconnection and line rental charges include charges payable to other operators for access to, and use of their networks, which are necessary in the course of providing service to our subscribers as described under “Business—Business Overview—Network Technology—Interconnect Arrangements and Telephone Numbering Capacity.”

We expect unit interconnect costs to decline, although the aggregate amount payable by us will increase as our subscriber base and traffic volumes increase. We expect the cost of leasing telecommunication lines to vary based on the number of base stations, base station controllers, the number and capacity of leased lines utilized and competition among providers of leased lines, as well as availability and usability of substitutes such as microwave links owned by us. We expect that expenses relating to leased lines will decrease as a percentage of total net revenues as we continue to expand the use of our own fiber-optic network in our license areas.

Roaming Expenses. Roaming expenses consist of amounts charged by other GSM operators under agreements for roaming services provided to our subscribers while outside our service area.

Costs of Equipment. Cost of equipment includes primarily the cost of handsets and accessories sold to dealers and subscribers, handset subsidies and the cost of production of SIM cards. We have entered into supply agreements with various producers and suppliers of handsets and accessories to satisfy our requirements at what we believe to be competitive prices. We expect the demand for our handsets and accessories to continue to decrease, due to the availability of cheaper “gray” handsets in our markets, as well as the fact that many new subscribers already own a handset, either purchased on the gray market or because they are churn clients from other operators. We expect the cost per handset to decline due to our ability to work directly with suppliers to secure volume discounts, technological advances and competitive pressures in the market for handsets.

In 2001, we introduced handset subsidies in connection with marketing initiatives. Handset subsidies as a percentage of total net revenue from sales of equipment were 28.8% in 2001 and 6.6% in 2002, and 5.9% and 27.0% for the six months ended June 30, 2002 and 2003, respectively. As of June 30, 2003, we provided subsidies of up to \$20 on purchases made in our integrated sales offices of relatively inexpensive handsets. We do not subsidize purchases of handsets that are not purchased at one of our integrated sales offices. Our principal competitors also provide certain handset subsidies and we expect to continue to provide handset subsidies. In Ukraine, UMC subsidizes handsets for contract subscribers. For the six months ended June 30, 2003 UMC’s revenues from subsidized handsets were \$4.2 million, with a direct cost of \$19.3 million, resulting in net handset subsidies of \$15.1 million. Handset subsidies at MTS OJSC are included in sales and marketing expenses for all periods presented; for the six months ended June 30, 2003, these amounted to \$0.3 million.

Included in the cost of sales of handsets are the production costs of SIM cards which we distribute to all new subscribers. These costs amounted to \$7.0 million in 2000, \$13.4 million in 2001 and \$26.3 million in 2002, and \$12.7 million and \$25.8 million for the six months ended June 30, 2002 and 2003, respectively.

Operating Expenses

Our operating expenses consist primarily of:

- employee salaries;
- social contributions payable to the government;
- taxes other than income taxes, e.g., taxes based on sales and property taxes;
- general and administrative expenses;

- provision for doubtful accounts; and
- rent.

General and administrative expenses include costs relating to the technical support group for network development, the finance and accounting group and the billing department. Rent expenses include lease payments for base station sites and office space. Total operating expenses are expected to increase over time to reflect the increasing costs and staff required to service our growing subscriber base, but we expect they will decline on a per subscriber basis.

We generally expect our provision for doubtful accounts as a percentage of net revenues to remain stable as a result of our continued use of our advance payment system, whereby subscribers' fees are debited from amounts paid by subscribers into their accounts in advance of line usage. In the future, our provision for doubtful accounts may increase if we increase the availability of tariff plans under the credit payment system. See "Business—Business Overview—Advertising and Marketing—Tariffs." However, our operating expenses for the six months ended June 30, 2003 included \$17.4 million provision related to dealer and subscriber fraud. See "Risk Factors—Our failure to implement the necessary infrastructure to manage our growth could have a material negative affect on our profits and results of operations."

Sales and Marketing

Our sales and marketing expenses consist of:

- dealer commissions on new connections; and
- expenses for advertising and promotion.

Sales and marketing expenses reflect, among other things, advertising, promotions and other costs associated with the expansion of services into our regional license areas and are expected to increase as subscriber numbers and market competition increase. In addition, we expect these costs to increase as we implement our strategy to further develop our brand and introduce value-added services.

Under our current policy, dealers receive a commission per subscriber connected based on their monthly sales volume. See "Business—Sales and Distribution." Effective 2001, we changed our accounting policy and began expensing dealer commissions on new connections as incurred instead of amortizing them over the estimated average subscriber life, as described in Note 4 to our audited consolidated financial statements.

We measure subscriber acquisition costs to monitor the cost-effectiveness of our sales and marketing. We define subscriber acquisition costs as total sales and marketing expenses and handset subsidies described in "Cost of Services and Products" above for the period per gross additional subscriber. The following table shows subscriber acquisition costs for the periods indicated:

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003
Subscriber Acquisition Costs					
Russia	\$ 69	\$56	\$35	\$ 41	\$ 29
MTS OJSC	\$ 69	\$65	\$48	\$ 52	\$ 34
Russian regions	n.m. ⁽¹⁾	\$22	\$20	\$ 24	\$ 21
UMC	n.a. ⁽²⁾	n.a. ⁽²⁾	n.a. ⁽²⁾	n.a. ⁽²⁾	\$ 40 ⁽³⁾

⁽¹⁾ Not meaningful. In 2000, the number of subscribers outside of the MTS OJSC segment was insignificant.

⁽²⁾ Not applicable. We did not own UMC during these periods.

⁽³⁾ Calculated based on the months of March through June, 2003. Subscriber acquisition costs for UMC are higher than those of our Russian operations, due in part to the significantly higher level of handsets subsidies as a percentage of revenue for UMC.

Depreciation of Property, Plant and Equipment and Amortization Expenses

We expect depreciation expense, which is principally associated with the acquisition of network equipment, to increase significantly in line with our planned network development program and the build out associated with our regional license areas. Correspondingly, we also expect amortization of telephone numbering capacity, license costs and other intangible assets to increase in line with our planned development programs and the expansion of our subscriber base, including subscribers in our regional license areas. From January 1, 2002, we no longer amortize goodwill (see “—Recent Implementation of New Accounting Standards” below in this section). At that date, we reclassified the carrying value of goodwill of \$22 million to licenses.

Research and Development, Patents and Licenses, Etc.

Our research and development activities were not significant for the last three years and primarily included activities focused on new telecommunication technologies and evaluation of new or improved services and systems. Expenditures on research and development are recognized as expenses when they are incurred. We did not spend any significant amounts during the last three financial years or the six months ended June 30, 2003 on our research and development activities.

Provision for Income Taxes

Taxation on income of Russian companies is regulated by a number of laws, government decrees and implementation instructions. From January 1, 2002, the new Chapter 25 “Income Tax of Organizations” of the Tax Code became effective, which to some extent consolidates and simplifies income tax regulations.

The income tax base for Russian companies is defined as income received from sales of goods, works and services and property rights and income from non-sale operations, reduced by the amount of certain business expenses incurred in such operations. During each of the past three years, these expenses were computed according to several special deductibility regulations. These regulations combined very detailed guidance as to what can be deducted for income tax purposes with specified limitations and restrictions on deductibility. For example, there were ceilings on deductibility of advertising or entertainment expenses. Deductions were limited or denied for a number of items commonly seen as fully deductible under Western tax systems, such as:

- interest on loans;
- advertising and business travel expenses above a stated limit;
- non-mandatory insurance expenses; and
- training expenses.

The new income tax legislation significantly liberalized the deductibility rules for business expenses. Therefore, starting January 1, 2002, the following business expenses are deductible:

- interest on loans (with certain exceptions);
- management expenses;
- secondment expenses; and
- training expenses (with certain exceptions).

Interest paid on loans, including the loans from our subsidiary, Mobile TeleSystems Finance S.A., made to us in connection with the offerings of our notes, is deductible to the extent the interest rate does not exceed 15%. The deductibility rules for advertising and business travel expenses were also revised and relaxed significantly.

The tax legislation that was in force prior to 2002 established certain benefits and concessions for companies engaged in the production and service industries. Notably, taxable income could be reduced

by amounts reinvested for specific purposes. However, the total reduction from this form of incentive together with certain other reductions could not exceed 50% of the taxable income for the period. The most significant reinvestment purposes that benefited from these concessions were technical re-equipment, reconstruction, expansion and development of production facilities, and the installation of new facilities. We used these concessions extensively in prior years. The new income tax legislation does not provide for special tax concessions related to investments in infrastructure.

In 2000, our income tax rate was 30%. From January 1, 2001, the statutory income tax rate increased to 35%. As a result of this increase, we recognized a deferred income tax charge of \$10 million in our 2000 consolidated financial statements. Effective January 1, 2002, the statutory income tax rate was reduced to 24%. This reduction resulted in the recognition of net deferred tax benefit of \$22 million in our 2001 consolidated financial statements.

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. We believe that we have adequately provided for tax liabilities in our 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.

Recent Acquisitions

As discussed in “Business—History” “—Acquisitions” and “—Regional Expansion,” we completed a number of acquisitions in 2000, 2001 and 2002, and in the first half of 2003 to increase our potential subscriber base, enhance our roaming capability and strengthen our competitive position. With respect to our recent acquisition of UMC, see “Unaudited Pro Forma Condensed Combined Financial Information.”

Results of Operations

The following table sets forth selected financial and operational information by segment:

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003 ⁽³⁾
	(in thousands)				
Subscribers (end of period)⁽¹⁾⁽²⁾					
MTS OJSC	1,194	2,275	3,746	2,732	5,176
Including subscribers in the Moscow license area	1,106	2,035	3,082	2,351	4,133
Russian regions	n.m. ⁽⁴⁾	375	2,898	1,635	4,142
UMC	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	2,023
Total subscribers	<u>1,194</u>	<u>2,650</u>	<u>6,644</u>	<u>4,367</u>	<u>11,341</u>
Revenues					
MTS OJSC	\$534,433	\$831,857	\$1,044,877	\$455,509	\$ 654,324
Russian regions	1,279	64,780	370,309	123,594	310,556
UMC	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	130,443
Eliminations ⁽⁶⁾	—	(3,390)	(53,430)	(15,201)	(43,189)
Net revenues as reported	<u>\$535,712</u>	<u>\$893,247</u>	<u>\$1,361,756</u>	<u>\$563,902</u>	<u>\$1,052,134</u>

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003 ⁽³⁾
	(in thousands)				
Costs of services and products					
MTS OJSC	\$121,124	\$168,323	\$ 235,957	\$105,471	\$ 139,413
Russian regions	1,186	17,144	93,882	32,965	63,956
UMC	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	26,542
Eliminations ⁽⁶⁾	—	(1,974)	(43,168)	(16,523)	(32,095)
Cost of services and products as reported . .	<u>\$122,310</u>	<u>\$183,493</u>	<u>\$ 286,671</u>	<u>\$121,913</u>	<u>\$ 197,816</u>
Operating expenses					
MTS OJSC	\$110,242	\$121,055	\$ 173,377	\$ 71,525	\$ 109,345
Russian regions	—	13,543	58,107	20,147	44,847
UMC	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	18,109
Eliminations ⁽⁶⁾	—	—	(2,428)	—	(3,357)
Operating expenses as reported	<u>\$110,242</u>	<u>\$134,598</u>	<u>\$ 229,056</u>	<u>\$ 91,672</u>	<u>\$ 168,944</u>
Sales and marketing expenses					
MTS OJSC	\$ 76,429	\$102,806	\$ 125,841	\$ 49,434	\$ 85,928
Russian regions	—	5,516	49,782	17,012	35,322
UMC	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	15,477
Eliminations ⁽⁶⁾	—	(593)	(3,646)	(1,651)	(1,163)
Sales and marketing expenses as reported . .	<u>\$ 76,429</u>	<u>\$107,729</u>	<u>\$ 171,977</u>	<u>\$ 64,795</u>	<u>\$ 135,564</u>
Depreciation and amortization					
MTS OJSC	\$ 85,796	\$114,923	\$ 144,004	\$ 66,909	\$ 89,491
Russian regions	1,888	18,395	65,676	23,769	61,926
UMC	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	23,935
Eliminations ⁽⁶⁾	—	—	—	—	(578)
Depreciation and amortization as reported .	<u>\$ 87,684</u>	<u>\$133,318</u>	<u>\$ 209,680</u>	<u>\$ 90,678</u>	<u>\$ 174,774</u>
Operating income					
MTS OJSC	\$141,147	\$316,894	\$ 365,698	\$165,964	\$ 230,147
Russian regions	(2,100)	8,039	102,862	29,701	104,505
UMC	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	n.a. ⁽⁵⁾	46,380
Eliminations ⁽⁶⁾	—	(824)	(4,189)	(821)	(5,996)
Operating income as reported	<u>\$139,047</u>	<u>\$324,109</u>	<u>\$ 464,371</u>	<u>\$194,844</u>	<u>\$ 375,036</u>

(1) We define a subscriber as an individual or organization whose account does not have a negative balance for more than sixty-one days. For the “Jeans” tariff only, introduced in November 2002, we define a “subscriber” as an individual or organization whose account does not have a negative balance for more than one hundred and eighty-three days. The subscriber information is provided as of the end of the periods presented.

(2) We do not include our subscribers in Belarus in our operating information, because our joint venture in Belarus is not consolidated in our financial statements.

(3) Our results of operations for the six months ended June 30, 2003 include the results of UMC for the months of March through June 2003 only.

(4) Not meaningful. In 2000, the number of subscribers outside of the MTS OJSC segment was insignificant.

(5) Not applicable. We did not own UMC during these periods.

(6) Represents the elimination of intercompany sales, operating expenses, sales and marketing expenses and the related operating income, primarily for intercompany roaming arrangements and management and marketing support provided by MTS OJSC to regional companies, as well as of other intercompany transactions.

Six Months Ended June 30, 2003, Compared to Six Months Ended June 30, 2002

Our results of operation for the six months ended June 30, 2003 include the results of UMC for the months of March through June 2003.

Revenues and cost of services and products

Consolidated revenues for the six months ended June 30, 2003 increased 86.6% to \$1,052.1 million from \$563.9 million for the six months ended June 30, 2002. This increase was primarily due to the significant growth in our subscribers from 4.4 million as of June 30, 2002 to 11.3 million as of June 30, 2003, of which 1.8 million were added through the acquisition of UMC. UMC's contribution to consolidated net revenues after intercompany eliminations was \$129.0 million. The increase in our subscriber base was partially offset by a decrease in tariffs in the Moscow license area, an increase of mass market subscribers in our subscriber mix and our continued expansion into the regions of Russia outside of the Moscow license area where tariffs are lower. As a result, average monthly service revenue per subscriber in Russia decreased 24% from \$25 per subscriber for the six months ended June 30, 2002 to \$19 for the six months ended June 30, 2003.

For the six months ended June 30, 2003, service revenues increased by \$470.3 million, or 90%, to \$992.7 million compared to \$522.4 million for the six months ended June 30, 2002 due to the growth in the number of our subscribers, as explained above. Connection fees increased by only \$3.9 million, or 32.2%, compared to the six months ended June 30, 2002 due to the introduction of tariff plans without connection fees, including our Jeans tariff, and low connection fee tariff plans. Equipment revenues increased by \$14.0 million, or 47.8%, for the six months ended June 30, 2003, compared to the six months ended June 30, 2002 due to subscriber growth in the first half of 2003, offset by a decrease in the average selling price of handsets.

Consolidated cost of services and products for the six months ended June 30, 2003 increased by 62.3% to \$197.8 million from \$121.9 million for the six months ended June 30, 2002. The increase in costs was primarily attributable to subscriber growth and the inclusion of four months of UMC's results, which added \$25.1 million to consolidated cost of services and products after intercompany eliminations.

Consolidated gross margin was 81.2% for the six months ended June 30, 2003 and 78.4% for the six months ended June 30, 2002 due to the factors discussed above. We believe that this slight increase in our consolidated gross margin is due to lower interconnection and line rental charges payable to other operators for access to their networks relative to our increasing revenues because as we have expanded our network, more calls are placed and completed solely within our network, thereby avoiding the need to pay such charges to other operators while still fully earning the related revenues from such calls. We also believe that this slight increase can be explained in part by lower costs of leasing telecommunication lines relative to our increasing revenues as we build out our own fiber-optics network in our license areas.

MTS OJSC revenues for the six months ended June 30, 2003 increased 43.6% to \$654.3 million from \$455.5 million for the six months ended June 30, 2002. As a result of our marketing efforts, our subscriber base in the MTS OJSC license areas has increased from 2.4 million as of June 30, 2002 to 5.2 million as of June 30, 2003. The increase in the MTS OJSC subscriber base was partially offset by a decrease in tariffs in the Moscow license area and an increase of mass market subscribers in our subscriber mix.

MTS OJSC cost of services and products for the six months ended June 30, 2003 increased 37.1% to \$139.4 million from \$101.7 million for the six months ended June 30, 2002. This was primarily due to the \$18.9 million and \$11.3 million increases in roaming expenses and cost of equipment, respectively, resulting from an increase in the number of subscribers. Roaming expenses increased to \$49.9 million,

or 7.6% of segment revenues, in the first half of 2003 from \$31.0 million, or 6.8% of segment revenues, in the first half of 2002. Cost of equipment increased to \$42.5 million or 6.5% of segment revenues for the six months ended June 30, 2003 from \$31.2 million or 6.8% of segment revenues for the six months ended June 30, 2002.

MTS OJSC gross margin increased 45.5% to \$514.9 million in the first half of 2003 from \$353.8 million in the first half of 2002. MTS OJSC's gross margin percentage increased to 78.7% in the first half of 2003 from 77.7% in the first half of 2002, which increase is explained by the same factors discussed above with respect to the increase in the consolidated gross margin.

Russian regions revenues for the six months ended June 30, 2003 increased 151.3% to \$310.6 million from \$123.6 million for the six months ended June 30, 2002. The growth in revenues resulted from our continued expansion into the regions through organic growth and acquisitions. Our subscriber base in the Russian regions increased from 1.6 million as of June 30, 2002 to 4.1 million as of June 30, 2003.

Russian regions cost of services and products for the six months ended June 30, 2003 increased 93.9% to \$64.0 million from \$33.0 million for the six months ended June 30, 2002 due to subscriber growth.

Russian regions gross margin increased \$156.0 million, or 172.2%, from \$90.6 million in the first half of 2002 to \$246.6 million in the first half of 2003, primarily due to the increase in the number of subscribers. Our gross margin percentage for the Russian regions increased to 79.4% in the first half of 2003 from 73.3% in the first half of 2002 primarily as a result of the increase in revenues from subscriber growth being greater than the growth in costs, due to economies of scale in the Russian regions.

Operating expenses

Consolidated operating expenses for the six months ended June 30, 2003 increased 84.2% to \$168.9 million from \$91.7 million for the six months ended June 30, 2002. The increase in operating expenses was largely attributable to subscriber growth and the acquisition of UMC, which contributed \$18.1 million to consolidated operating expenses for the six months ended June 30, 2003. For the first half of 2003, we experienced an increase of \$24.0 million in salaries and related social contributions for additional personnel and an increase in network repair and maintenance expenses of \$14.1 million due to the expansion and aging of our network, as compared to the prior period. Our operating expenses for the six months ended June 30, 2003 also included a \$17.4 million provision related to dealer and subscriber fraud. See "Risk Factors—Our failure to implement the necessary infrastructure to manage our growth could have a material negative affect on our profits and results of operations." Operating expenses as a percentage of net revenues were, however, relatively stable at 16.1% and 16.3% for the six months ended June 30, 2003 and 2002, respectively.

MTS OJSC operating expenses for the six months ended June 30, 2003 increased 52.9% to \$109.3 million from \$71.5 million for the six months ended June 30, 2002. The most significant increases were in the areas of bad debt, related to dealer and subscriber fraud as discussed above (\$17.4 million), salaries and related social contributions for additional personnel (\$6.5 million) and network repair and maintenance expenses affected by the aging of our network (\$7.3 million). Operating expenses as a percentage of segment revenues increased to 16.7% for the six months ended June 30, 2003, compared to 15.7% for the six months ended June 30, 2002 as a result of these factors.

Russian regions operating expenses for the six months ended June 30, 2003 increased 122.9% to \$44.8 million from \$20.1 million for the six months ended June 30, 2002 as result of our acquisitions during 2002 and the first half of 2003, and the expansion of the existing regional operations. Operating expenses as a percentage of segment revenues decreased to 14.4% for the six months ended June 30, 2003, compared to 16.3% for the six months ended June 30, 2002, primarily due to the commencement

of commercial operations by Telecom XXI, our subsidiary in St. Petersburg, in December 2001 and the consolidation of Kuban GSM in March 2002 and BM-Telecom in May 2002, which have relatively low ratios of operating expenses to revenues, and economies of scale in other Russian regions.

Sales and marketing expenses

Consolidated sales and marketing expenses for the six months ended June 30, 2003 increased 109.3% to \$135.6 million from \$64.8 million for the six months ended June 30, 2002. The increase in sales and marketing expenses was largely related to subscriber growth and the acquisition of UMC, which contributed \$15.5 million to the consolidated sales and marketing expenses for the six months ended June 30, 2003. The increase related primarily to an increase of \$45.4 million in commissions paid to dealers and an increase of \$26.8 million in advertising and promotion expenses. The increase in commissions paid to dealers was primarily due to an increase in the volume of sales through dealers, partially offset by a decrease in the amounts payable to dealers for every customer connected to our network. The increase in advertising and promotion expenses related to the launch of the “Jeans” brand in November 2002, increased marketing efforts and a higher cost of television commercials. Sales and marketing expenses as a percentage of net revenues were 12.9% for the six months ended June 30, 2003 as compared to 11.5% for the six months ended June 30, 2002.

MTS OJSC sales and marketing expenses for the six months ended June 30, 2003 increased 73.9% to \$85.9 million from \$49.4 million for the six months ended June 30, 2002. Sales and marketing expenses as a percentage of segment revenues increased to 13.1% for the six months ended June 30, 2003 from 10.8% for the six months ended June 30, 2002. This increase in sales and marketing expenses as a percentage of segment revenues can be explained by our strategy of pursuing distinct and separate marketing of our MTS and “Jeans” brand identities. Moreover, MTS OJSC has traditionally incurred the costs of our national television advertising campaign, which costs have experienced significant inflation in the last year. We do not allocate a portion of these television advertising costs to the Russian regions segment even though sales in these regions benefit from this advertising.

Russian regions sales and marketing expenses for the six months ended June 30, 2003 increased 107.6% to \$35.3 million from \$17.0 million for the six months ended June 30, 2002, as a result of our acquisitions during 2002 and the first half of 2003 and the expansion of the existing regional operations. Sales and marketing expenses as a percentage of segment revenues decreased to 11.4% for the six months ended June 30, 2003 from 13.8% for the six months ended June 30, 2002. Revenues for the six months ended June 30, 2003 grew faster than sales and marketing expenses for the six months ended June 30, 2002, in part due to certain national television advertising campaigns, the cost of which were charged to MTS OJSC.

Depreciation and amortization expenses

Consolidated depreciation and amortization of network equipment, telephone numbering capacity, license costs and other intangible assets for the six months ended June 30, 2003 increased 92.7% to \$174.8 million from \$90.7 million for the six months ended June 30, 2002. Depreciation and amortization expenses as a percentage of net revenues increased to 16.6% for the six months ended June 30, 2003 from 16.1% for the six months ended June 30, 2002. This increase was attributable to the increased asset base resulting from our continuing expansion of our network and acquisitions of regional operations in Russia and the amortization of license costs, acquired customer base and tangible assets of UMC, which contributed \$23.9 million to consolidated depreciation and amortization during the first half of 2003.

MTS OJSC depreciation and amortization for the six months ended June 30, 2003 increased 33.8% to \$89.5 million from \$66.9 million for the six months ended June 30, 2002 but declined as a

percentage of segment revenues to 13.7% from 14.7%. The increased depreciation and amortization costs related to an increase in the continued build out of our network.

Russian regions depreciation and amortization for the six months ended June 30, 2003 increased 160.1% to \$61.9 million from \$23.8 million for the six months ended June 30, 2002 and increased as a percentage of segment revenues to 19.9% from 19.2%. The increase in the depreciation and amortization expense is associated with the expansion of our network in St. Petersburg and the north-west of Russia, consolidation of assets of acquired businesses and amortization of license costs recognized in the acquisitions of Kuban GSM, BM-Telecom and other regional operators.

Operating Income

Consolidated operating income for the six months ended June 30, 2003 increased 92.5% to \$375.0 million, including \$46.4 million relating to the inclusion of the results of UMC as from March 1, 2003, from \$194.8 million for the six months ended June 30, 2002. Operating income as a percentage of net revenues was at 35.6% for the six months ended June 30, 2003 and 34.6% for the six months ended June 30, 2002.

MTS OJSC operating income for the six months ended June 30, 2003 increased 38.7% to \$230.1 million from \$166.0 million for the six months ended June 30, 2002 but declined as a percentage of segment revenues to 35.2% from 36.4%. Our increased operating income primarily resulted from the growth of our subscriber base, but our operating income was adversely affected by higher operating expenses and lower tariffs.

Russian regions operating income for the six months ended June 30, 2003 increased 251.9% to \$104.5 million, or 33.7% of segment revenues, from \$29.7 million, or 24.0% of segment revenues, for the six months ended June 30, 2002. The increased operating income in the Russian regions was primarily due to the increased profitability of the St. Petersburg operations for the six months ended June 30, 2003, partially offset by higher depreciation and amortization expenses.

Gain on foreign currency exchange

Consolidated gain on foreign currency exchange for the six months ended June 30, 2003 was \$1.4 million, compared to a \$0.7 million loss for the six months ended June 30, 2002. We conduct our operations primarily within the Russian Federation and Ukraine. We are subject to currency fluctuations, including the U.S. dollar versus the ruble and the U.S. dollar versus the euro. See “Risk Factors—Risks Relating to our Financial Condition—Changes in exchange rates could increase our costs, decrease our reserves or prevent us from repaying our debt” and “—Quantitative and Qualitative Disclosures about Market Risks—Foreign Currency Risk.”

Interest expense

Consolidated interest expense for the six months ended June 30, 2003 increased 106.8% to \$42.8 million from \$20.7 million for the six months ended June 30, 2002 primarily as the result of interest expense related to our \$50 million and \$400 million notes issuances in March 2002 and January 2003, respectively.

MTS OJSC interest expense for the six months ended June 30, 2003 increased 106.4% to \$35.5 million from \$17.2 million for the six months ended June 30, 2002 as a result of the interest expense related to our \$50 million and \$400 million notes issuances in March 2002 and January 2003, respectively.

Russian regions interest expense for the six months ended June 30, 2003 increased 68.6% to \$5.9 million from \$3.5 million for the six months ended June 30, 2002. This increase related primarily to debt assumed in our acquisition of BM-Telecom in May 2002.

Provision for income taxes

Consolidated provision for income taxes for the six months ended June 30, 2003 increased 78.5% to \$96.4 million from \$54.0 million for the six months ended June 30, 2002. The effective tax rate decreased to 28.1% in the first half of 2003 from 30.6% in the first half of 2002 as a result of a lower level of non-deductible expenses for the six months ended June 30, 2003. In addition, the deferred income tax benefit increased \$13.7 million to \$17.1 million for the six months ended June 30, 2003 from \$3.4 million for the six months ended June 30, 2002 as a result of the increase in the amortization of licenses and other intangible assets of the regional operators acquired during 2002 and the first half of 2003.

MTS OJSC provision for income taxes for the six months ended June 30, 2003 increased 19.1% to \$59.3 million from \$49.8 million for the six months ended June 30, 2002. The effective tax rate for MTS OJSC decreased to 28.3% for the six months ended June 30, 2003 from 32.4% for the six months ended June 30, 2002 as a result of a lower level of non-deductible expenses.

Russian regions provision for income taxes for the six months ended June 30, 2003 increased \$18.1 million, or 441.5%, to \$22.2 million from \$4.1 million for the six months ended June 30, 2002. The effective tax rate for the Russian regions was 23.0% for the six months ended June 30, 2003, a significant increase from the effective tax rate for the six months ended June 30, 2002, which was 17.8%. The increase in the tax rate was due to higher taxes we were required to pay as our loss-making regional companies turned profitable.

Minority interest

Minority interest for the six months ended June 30, 2003 increased by \$21.8 million to \$36.5 million from \$14.7 million for the six months ended June 30, 2002 primarily due to minority shareholders' interest in net income of Kuban GSM of \$12.0 million, Telecom-900 of \$7.8 million, UMC of \$10.8 million and Recom of \$5.3 million.

Net income

Net income for the six months ended June 30, 2003 increased by \$101.1 million, or 94.0%, to \$208.7 million, compared to \$107.6 million for the six months ended June 30, 2002, as a result of the foregoing factors.

Year Ended December 31, 2002, Compared to Year Ended December 31, 2001

Revenues and cost of services and products

Consolidated revenues for the year ended December 31, 2002 increased 52.5% to \$1,361.8 million from \$893.2 million for the year ended December 31, 2001. This increase was primarily due to the significant growth in our subscribers from 2.65 million as of December 31, 2001 to 6.64 million as of December 31, 2002, an increase of 151%. The increase in our subscriber base was partially offset by a decrease in tariffs in the Moscow license area and our continued expansion into the regions outside of the Moscow license area where tariffs are lower. As a result, average monthly service revenue per subscriber decreased 36.4% from \$36.0 per subscriber in 2001 to \$22.9 in 2002.

For the year ended December 31, 2002 service revenues increased by \$444.0 million, or 53.5%, from the year ended December 31, 2001 due to the growth in the number of our subscribers. Connection fees increased by only \$3.8 million, or 18.0%, compared to the year ended December 31, 2001 due to the introduction of tariff plans without connection fees and low connection fee tariff plans. Equipment revenues increased by \$20.7 million, or 49.5%, for the year ended December 31, 2002, compared to the year ended December 31, 2001 due to subscriber growth in 2002, offset by a decrease in the average selling price of handsets.

Consolidated cost of services and products for the year ended December 31, 2002 increased 56.2% to \$286.7 million from \$183.5 million for the year ended December 31, 2001. The increase in costs was primarily attributable to subscriber growth. Consolidated gross margin remained at 79% for the years ended December 31, 2001 and 2002.

MTS OJSC revenues for the year ended December 31, 2002 increased 25.6% to \$1,044.9 million from \$831.9 million for the year ended December 31, 2001. Although mobile penetration in the Moscow license area is higher than in the Russian regions, we continued to attract new subscribers in the Moscow market by introducing new tariff plans and actively marketing our services. As a result of these efforts, our subscriber base in the Moscow license area increased from 2.0 million as of December 31, 2001 to 3.1 million as of December 31, 2002.

MTS OJSC cost of services and products for the year ended December 31, 2002 increased 40.2% to \$236.0 million from \$168.3 million for the year ended December 31, 2001. This was primarily due to the cost of equipment increasing by \$27.2 million to \$62.2 million for the year ended December 31, 2002 from \$35.0 million for the year ended December 31, 2001, resulting from an increase in the number of subscribers. This represents an increase as a percentage of segment revenues to 6.0% from 4.2%. Interconnection and line rental charges increased to \$84.9 million in 2002 from \$68.2 million in 2001, but declined slightly as a percentage of segment revenues to 8.1% from 8.2%. Roaming expenses increased to \$88.9 million, or 8.5% of segment revenues, in 2002 from \$65.1 million, or 7.8% of segment revenues, in 2001.

MTS OJSC gross margin increased 21.9% to \$808.9 million in 2002 from \$663.5 million in 2001. However, our gross margin percentage decreased from 79.8% in 2001 to 77.4% in 2002 primarily as a result of lower revenue per minute of use due to the introduction of lower tariffs during 2002.

Russian regions revenues for the year ended December 31, 2002 increased 471.5% to \$370.3 million from \$64.8 million for the year ended December 31, 2001. The growth in revenues resulted from our continued expansion into the regions through organic growth and acquisitions. Our subscriber base in the Russian regions increased from 375,000 as of December 31, 2001 to 2.9 million as of December 31, 2002. Our acquisitions of Kuban GSM and other regional operators, added approximately 640,000 subscribers. Additional subscribers were attracted through active marketing campaigns in Kuban, St. Petersburg and other license areas.

Russian regions cost of services and products for the year ended December 31, 2002 increased 449.1% to \$93.9 million from \$17.1 million for the year ended December 31, 2001 due to subscriber growth.

Russian regions gross margin increased \$231.0 million, or 480.7%, from \$47.6 million in 2001 to \$276.4 million in 2002, primarily due to acquisitions of Kuban GSM and other regional operators during 2002 as well as the launch of commercial operations in St. Petersburg in the end of 2001. Our gross margin percentage for the Russian regions increased to 74.6% in 2002 from 73.5% in 2001 primarily as a result of the increase in revenues from subscriber growth being greater than the growth in costs, due to economies of scale in the Russian regions.

Operating expenses

Consolidated operating expenses for the year ended December 31, 2002 increased 70.2% to \$229.1 million from \$134.6 million for the year ended December 31, 2001. Operating expenses as a percentage of net revenues increased to 16.8% for the year ended December 31, 2002, compared to 15.1% for the year ended December 31, 2001. The increase in operating expenses was primarily due to an increase of \$40.3 million in salaries and related social contributions for additional personnel, an increase of \$13.8 million in taxes other than income taxes and an increase in network repair and maintenance expenses of \$9.8 million.

MTS OJSC operating expenses for the year ended December 31, 2002 increased 43.2% to \$173.4 million from \$121.1 million for the year ended December 31, 2001. The most significant increases were in the areas of salaries and related social contributions and network repair and maintenance expenses, as discussed above. Operating expenses as a percentage of segment revenues increased to 16.6% for the year ended December 31, 2002, compared to 14.6% for the year ended December 31, 2001.

Russian regions operating expenses for the year ended December 31, 2002 increased 330.4% to \$58.1 million from \$13.5 million for the year ended December 31, 2001. Operating expenses as a percentage of segment revenues decreased to 15.7% for the year ended December 31, 2002, compared to 20.9% for the year ended December 31, 2001 primarily due to the consolidation of Kuban GSM, with a relatively low ratio of operating expenses to revenues and the commencement of commercial operations in St. Petersburg.

Sales and marketing expenses

Consolidated sales and marketing expenses for the year ended December 31, 2002 increased 59.6% to \$172.0 million from \$107.7 million for the year ended December 31, 2001. The increase in sales and marketing expenses of \$64.2 million resulted from an increase of \$58.3 million in commissions paid to dealers and an increase of \$13.8 million in advertising and promotion expenses, offset by a decrease of \$7.9 million in handset subsidies. The increase in commissions paid to dealers primarily resulted from the increase in the volume of sales through dealers. Sales and marketing expenses as a percentage of net revenues was 12.1% for the year ended December 31, 2001 and 12.6% for the year ended December 31, 2002.

MTS OJSC sales and marketing expenses for the year ended December 31, 2002 increased 22.4% to \$125.8 million from \$102.8 million for the year ended December 31, 2001. Sales and marketing expenses as a percentage of segment revenues fell to 12.0% for the year ended December 31, 2002 from 12.4% for the year ended December 31, 2001.

Russian regions sales and marketing expenses for the year ended December 31, 2002 increased to \$49.8 million from \$5.5 million for the year ended December 31, 2001. Sales and marketing expenses as a percentage of segment revenues increased to 13.4% for the year ended December 31, 2002 from 8.5% for the year ended December 31, 2001. This increase resulted primarily from increased advertising expenses in 2002 in connection with our expansion into the regional markets.

Depreciation and amortization expenses

Consolidated depreciation and amortization of network equipment, telephone numbering capacity and license costs for the year ended December 31, 2002 increased 57.3% to \$209.7 million from \$133.3 million for the year ended December 31, 2001. Depreciation and amortization expenses as a percentage of net revenues increased to 15.4% for the year ended December 31, 2002 from 14.9% for the year ended December 31, 2001. This increase was attributable to the increased asset base resulting from our continuing expansion of our network, increased numbering capacity to support our growing subscriber base and the amortization of license costs recognized in the acquisitions of Kuban GSM, BM-Telecom, Telecom-900, Telecom XXI and other regional operators during 2001 and 2002.

MTS OJSC depreciation and amortization for the year ended December 31, 2002 increased 25.3% to \$144.0 million, or 13.8% of segment revenues, compared to \$114.9 million, also 13.8% of segment revenues, for the year ended December 31, 2001. The increased depreciation and amortization costs related to an increase in the continued build out of our network.

Russian regions depreciation and amortization for the year ended December 31, 2002 increased 257.1% to \$65.7 million from \$18.4 million for the year ended December 31, 2001 but declined as a

percentage of segment revenues to 17.7% from 28.4%. The increase in the depreciation and amortization expense is associated with the consolidation of assets of acquired businesses and amortization of license costs recognized in the acquisitions of Kuban GSM, BM-Telecom, Telecom-900, Telecom XXI and other regional operators during 2001 and 2002.

Impairment of investment

Impairment of investment for the year ended December 31, 2001 was \$10 million. This charge related to payments made to the government of Belarus in connection with our tender for a license in Belarus which, at that time, we believed would not be recoverable. See Note 22 to our audited consolidated financial statements. We did not record any impairment charges for the year ended December 31, 2002.

Operating Income

Consolidated operating income for the year ended December 31, 2002, increased 43.3% to \$464.4 million from \$324.1 million for the year ended December 31, 2001. Operating income as a percentage of net revenues for the year ended December 31, 2002 decreased to 34.1% from 36.3% for the year ended December 31, 2001.

MTS OJSC operating income for the year ended December 31, 2002 increased 15.4% to \$365.7 million from \$316.9 million for the year ended December 31, 2001 but declined as a percentage of segment revenues to 35.0% from 38.1%. Our increased operating income primarily resulted from the growth of our subscriber base, partially offset by higher operating expenses and lower tariffs.

Russian regions operating income for the year ended December 31, 2002 increased to \$102.9 million, or 27.8% of segment revenues, from \$8.0 million, or 12.4% of segment revenues, for the year ended December 31, 2001. The increased operating income in the Russian regions was due to the benefits of lower costs of operations resulting from the significant expansion in the regions, partially offset by lower average monthly service revenue per unit and higher depreciation and amortization expenses.

Loss on foreign currency exchange

Consolidated loss on foreign currency exchange for the year ended December 31, 2002 increased to \$3.5 million from \$2.3 million for the year ended December 31, 2001. The ruble continued to devalue against the dollar during 2002 resulting in the increased loss. See “Risk Factors—Risks Relating to our Financial Condition—Changes in exchange rates could increase our costs, decrease our reserves or prevent us from repaying our debt” and “—Quantitative and Qualitative Disclosures about Market Risks—Foreign Currency Risk.”

Interest expense

Consolidated interest expense for the year ended December 31, 2002 increased to \$44.4 million from \$6.9 million for the year ended December 31, 2001 as the result of interest expense related to our \$250 million and \$50 million notes issuances in December 2001 and March 2002, respectively.

MTS OJSC interest expense for the year ended December 31, 2002 increased \$36.2 million from \$5.0 million for the year ended December 31, 2001 as a result of the interest expense related to our \$250 million and \$50 million notes issuance in December 2001 and March 2002, respectively.

Russian regions interest expense for the year ended December 31, 2002 increased to \$8.2 million from \$1.9 million for the year ended December 31, 2001. This increase related primarily to debt assumed in our acquisitions of Kuban GSM and BM-Telecom in 2002.

Provision for income taxes

Consolidated provision for income taxes for the year ended December 31, 2002 increased 12.5% to \$110.4 million from \$98.1 million for the year ended December 31, 2001. The effective tax rate decreased to 25.8% in 2002 from 29.8% in 2001 as a result of a decrease in the corporate income tax rate from 35% to 24% effective January 1, 2002. The decrease in the corporate income tax rate was partially offset by the elimination in 2002 of investment tax concessions related to investments in infrastructure that were used extensively by us, that approximated \$27.1 million in 2001. In addition, effective January 1, 2002 tax rules were changed such that expenses previously not deductible for tax purposes became deductible. Non-deductible expenses decreased \$35.4 million from \$44.4 million in 2001 to \$9.0 million in 2002.

MTS OJSC provision for income taxes for the year ended December 31, 2002 increased 11.0% to \$102.6 million from \$92.4 million for the year ended December 31, 2001. The effective tax rate for the Moscow license areas decreased to 27.4% for the year ended December 31, 2002 from 32.0% for the year ended December 31, 2001.

Russian regions provision for income taxes for the year ended December 31, 2002 increased \$23.0 million from a \$5.7 million income tax benefit to an \$18.0 million income tax expense for the year ended December 31, 2001, primarily due to the consolidation of the profitable Kuban GSM operations as well as the improved profitability of other regional operations.

Minority interest

Minority interest for the year ended December 31, 2002 increased by \$32.2 million to \$39.7 million, compared to \$7.5 million for the year ended December 31, 2001 primarily due to minority shareholders' interest in net income of Telecom-900 of \$12.2 million and Kuban GSM of \$8.7 million.

Cumulative effect of a change in accounting principle

In 2001, we changed our accounting method regarding recognition of subscriber acquisition costs. There were no changes in accounting principles in 2002. For more information see "Year Ended December 31, 2001, Compared to Year Ended December 31, 2000—Cumulative effect of change in accounting principle."

Net income

Net income for the year ended December 31, 2002 increased by \$71.3 million, or 34.6%, to \$277.1 million, compared to \$205.8 million for the year ended December 31, 2001, as a result of the foregoing factors.

Year Ended December 31, 2001, Compared to Year Ended December 31, 2000

Revenues and cost of service and products

Consolidated revenues for the year ended December 31, 2001 increased 66.7% to \$893.2 million from \$535.7 million for the year ended December 31, 2000, primarily due to the significant increase in our subscribers from 1.2 million to 2.7 million and an increase in the average monthly minutes of use from 151 to 157 minutes of use, slightly offset by a decrease in certain tariffs. For the year ended December 31, 2001 service revenues increased by \$345.8 million and connection fees increased by \$6.2 million compared to the year ended December 31, 2000 due to growth in the number of subscribers. Equipment revenues increased by \$5.5 million for the year ended December 31, 2001 compared to the year ended December 31, 2000 due to increased sales volume offset by decreased average selling price of handsets.

Consolidated cost of services and products for the year ended December 31, 2001 increased 50.0% to \$183.5 million from \$122.3 million for the year ended December 31, 2000. Increases in the cost of services and products were primarily due to an increase of \$60.6 million in payments to other operators for interconnection expense, line rental and roaming, as a result of volume increases, while cost of equipment remained relatively consistent at \$39.8 million due to lower level of equipment sales. Cost of services and products as a percentage of revenues decreased by 2.3%, due to subscriber growth that was not materially offset by a decrease in tariffs, and our increasing reliance on our own optic-fiber network, which decreased interconnection and line rental expenses per revenue unit. Gross margin increased from 77.2% in 2000 to 79.5% in 2001, primarily as a result of the lower costs of operations in the regions.

MTS OJSC revenues for the year ended December 31, 2001 increased 55.7% to \$831.9 million from \$534.4 million for the year ended December 31, 2000, primarily due to the increase in number of subscribers.

Russian regions revenues for the year ended December 31, 2001 increased to \$64.8 million from \$1.3 million for the year ended December 31, 2000, reflecting the acquisition of Telecom-900.

MTS OJSC cost of services and products for the year ended December 31, 2001 increased 39.0% to \$168.3 million compared to \$121.1 million for the year ended December 31, 2000, primarily due to growth in subscribers. Gross margin for 2001 increased to 79.8% compared to 77.3% in 2000.

Russian regions cost of services and products for the year ended December 31, 2001 increased to \$17.1 million from \$1.2 million for the year ended December 31, 2000, as a result of the consolidation of the operating results of Telecom-900 in 2001. Gross margin percentage increased from 7.3% in 2000 to 73.5% in 2001 as a result of the acquisition of Telecom-900.

Operating Expenses

Consolidated operating expenses for the year ended December 31, 2001 increased 22.1% to \$134.6 million from \$110.2 million for the year ended December 31, 2000. Increases in operating expenses were primarily due to an increase of \$10.7 million in salaries and related social contributions for additional personnel, an increase of \$7.4 million in repair and maintenance expenses and an increase of \$2.2 million in rent expenses. Operating expenses as a percentage of net revenues decreased to 15.1% in 2001 from 20.5% in 2000, as personnel cost and costs related to expansion of the network per revenue unit decreased. The overall increase in operating expenses included \$13.5 million attributable to the increase in regional operations, which primarily related to the acquisition of Telecom-900 in 2001.

Sales and marketing expenses

Sales and marketing expenses for the year ended December 31, 2001 increased 41.0% to \$107.7 million from \$76.4 million for the year ended December 31, 2000, primarily as a result of the significant increase in the level of business activity and the expansion of sales and marketing support infrastructure. During late 2001, we increased our expenditures on advertising, marketing and other customer-related activities in response to increased competition to accelerate subscriber growth and to increase market penetration. We also introduced handset subsidies beginning in the second quarter of 2001. Sales and marketing expenses as a percentage of total revenues decreased from 14.3% in 2000 to 12.1% in 2001.

Depreciation and amortization expenses

Depreciation and amortization of network equipment, telephone numbering capacity, license costs and goodwill for the year ended December 31, 2001 increased 52.0% to \$133.3 million from

\$87.7 million for the year ended December 31, 2000. This increase was attributable to the increased asset base resulting from our continuing expansion of our network, increased numbering capacity to support our growing subscriber base and the amortization of license costs and goodwill recognized in the acquisitions of Telecom XXI and Telecom-900. Nevertheless, as a percentage of total revenues, depreciation and amortization for the year ended December 31, 2001 decreased to 14.9% from 16.4% for the year ended December 31, 2000.

Impairment of investment

Impairment of investment for the year ended December 31, 2001 was \$10 million as described under “Year Ended December 31, 2002, compared to Year Ended December 31, 2001—Impairment of Investment.” We did not record any impairment charges for the year ended December 31, 2000.

Operating income

Operating income for the year ended December 31, 2001 increased 133.2% to \$324.1 million from \$139.0 million for the year ended December 31, 2000, and operating income as a percentage of revenues for 2001 increased to 36.3% from 26.0% for 2000, as a result of the foregoing factors.

Loss on foreign currency exchange

Loss on foreign currency exchange for the year ended December 31, 2001 increased to \$2.3 million from \$1.1 million for the year ended December 31, 2000. The ruble continued to devalue against the dollar during 2001 resulting in the increased loss. See “Risk Factors—Risks Relating to our Financial Condition—Changes in exchange rates could increase our costs, decrease our reserves or prevent us from repaying our debt” and “—Quantitative and Qualitative Disclosures about Market Risks—Foreign Currency Risk.”

Interest expense

Interest expense for the year ended December 31, 2001 decreased 38.9% to \$6.9 million from \$11.3 million for the year ended December 31, 2000, due to the full year impact of European Bank for Reconstruction and Development debt repayments in October 2000.

Provision for income taxes

Provisions for income taxes for the year ended December 31, 2001 increased 91.6% to \$98.1 million from \$51.2 million for the year ended December 31, 2000. These provisions comprised a current income tax charge of \$138.1 million for 2001 and \$52.1 million for 2000, and deferred tax benefit \$40.0 million for 2001 and \$0.9 million for 2000. The reduction in the statutory income tax rate from 35% to 24% resulted in the recognition of a deferred tax benefit of approximately \$22 million in 2001. Accordingly, provisions for income taxes as a percentage of income before provision for income tax and minority interest decreased to 29.8% in 2001, from 38.0% in 2000.

Cumulative effect of a change in accounting principle

Cumulative effect of a change in accounting principle. In 2001, we changed our accounting method regarding recognition of subscriber acquisition costs. Prior to 2001, payments to dealers for acquiring new subscribers 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 were amortized as a component of sales and marketing expense on a straight-line basis over the estimated average subscriber life. Starting 2001, we expense subscriber acquisition costs as incurred. The change was made to facilitate the comparison of our results with other telecommunication companies.

As a cumulative effect of this change, the remaining balance of capitalized subscriber acquisition cost as of December 31, 2000 in the amount of \$17.9 million (net of \$9.6 million in taxes) was expensed and included in income during the year ended December 31, 2001 as described in Note 4 to our audited consolidated financial statements.

Net income

Net income for the year ended December 31, 2001 increased by \$115.8 million, or 128.7%, to \$205.8 million from \$90.0 million for the year ended December 31, 2000, as a result of the foregoing factors.

Contractual Obligations and Commercial Commitments

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 principal obligations under these contracts due by the periods indicated as of June 30, 2003:

	June 30, 2004	June 30, 2005– June 30, 2006	June 30, 2007– thereafter	Total
		(in thousands)		
Contractual Obligations:				
Notes payable	\$ —	\$300,000	\$400,000	\$ 700,000
Bank loans	126,932	49,600	19,467	195,999
Capital leases	18,367	9,371	273	28,011
Financing derivatives	59,000	—	—	59,000
Service agreements	44,618	7,558	—	52,176
Committed Investments:				
Purchases of property, plant and equipment	258,020	67,887	—	325,907
Total	<u>506,937</u>	<u>434,416</u>	<u>419,740</u>	<u>1,361,093</u>

Subsequent to June 30, 2003, we have incurred substantial additional indebtedness. See “—Recent Developments.”

Liquidity and Capital Resources

Historically, we have relied on our operating cash flows to finance most of our capital expenditure needs, including purchases of property, plant and equipment and intangible assets. While cash provided by our operations has steadily increased, our continued network expansion and acquisitions of regional operators has required additional equity and debt financing. In July 2000, we completed our initial public offering on the New York Stock Exchange. The proceeds from the offering, net of underwriting discount, were \$349 million. In December 2001 and March 2002, we raised approximately \$294 million through bond offerings by MTS Finance S.A., our beneficially wholly-owned subsidiary. In January and August 2003, we raised an additional approximately \$396 million and \$297 million, respectively, through a bond offering by MTS Finance S.A. We expect to continue to finance most of our capital expenditure needs through our operating cash flows, and to the extent required, to incur additional indebtedness through borrowings or additional capital raising activities to finance our remaining capital expenditure requirements, future acquisitions of regional operators in Russia and the CIS or to refinance existing debt. Our cash requirement relating to potential acquisitions of regional operators and intangible assets can vary significantly based on market opportunities. Historically, a significant portion of our intangible asset purchases have been related to the installation and build out of our GSM network and expansion into new license areas; however future expenditures may be significantly higher, in particular if licenses

relating to new technologies become available. Property, plant and equipment expenditures are generally more predictable and it is likely that most of the funding for these purchases will continue to be funded by operating cash flows. We expect that we will need to make expenditures and devote significant management resources over the next three years in relation to our reporting and internal controls to ensure our compliance with certain provisions of the Sarbanes-Oxley Act of 2002 that will apply to us from the fiscal year ending December 31, 2005 and to enhance our ability to comply with the reporting covenants contained in our Eurobond indentures.

Our primary shareholders have expressed their intent to vote in favor of annual dividend distributions of not less than the equivalent of 25% of Mobile TeleSystems OJSC's stand-alone net profits (as determined under Russian accounting standards). On June 30, 2003, our shareholders approved cash dividends totaling \$111.4 million, which is reflected in our unaudited financial statements for the six months ended June 30, 2003. We generally intend to finance our dividend requirements through operating cash flow, and accordingly, the payment of dividends by us may make us more reliant on external sources of capital to finance our capital expenditures and acquisitions. There can be no assurances that such financing will be available to us on commercially acceptable terms, or at all. See "Risk Factors—Risks Relating to Our Business—Our controlling shareholders have the ability to exert significant influence over us and their interests may conflict with those of holders of the notes as they may make decisions that may materially adversely affect your investment."

Cash Flows

A summary of our cash flows follows:

	Year Ended December 31,			Six Months Ended June 30,	
	2000	2001	2002	2002	2003
	(in thousands)				
Liquidity and capital resources data:					
Cash flows from operating activities	\$ 190,914	\$ 338,201	\$ 412,772	\$ 107,315	\$ 395,341
Cash flows from financing activities	\$ 298,543	\$ 247,592	\$ 100,817	\$ 65,297	\$ 385,338
Cash flows from investing activities	\$(423,349)	\$(441,523)	\$(697,921)	\$(279,671)	\$(702,226)
Capital expenditures ⁽¹⁾	\$(224,898)	\$(441,200)	\$(574,272)	\$(242,016)	\$(383,239)

⁽¹⁾ We define capital expenditures as cash to acquire property, plant and equipment and intangible assets.

During 2000, 2001, 2002 and the first half of 2003, our operating activities generated positive cash flows due to the growth of our subscriber base 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 installation and build out of our network in the Moscow license area and the acquisition of regional operators, including our initial investment in UMC in the first half of 2003, the acquisition of Kuban GSM and other regional operators in 2002 and the acquisition of Telecom XXI, Telecom-900 and other regional operators in 2001. We expect for the foreseeable future to continue to have negative cash flows from investing activities as we continue to expand our network in the Moscow region, into the CIS and into the regions outside of the Moscow license area. In particular, we expect to make significant investments into our operations in Ukraine. We intend to finance our future investments primarily through net cash flows from operations and the incurrence of additional indebtedness. To the extent our shareholders agree to declare dividends constituting a significant proportion of our net profit, as discussed above, our reliance on external sources of financing to fund our capital expenditures and acquisitions may increase. The availability of financing is influenced by many factors including our profitability, operating cash flows, debt levels, contractual restrictions and market conditions.

For the six months ended June 30, 2003, net cash provided by operating activities was \$395.3 million, an increase of 268.4% from the six months ended June 30, 2002. The increase was

primarily attributable to cash flows generated from the expansion of our subscriber base through organic growth and through the acquisition of regional operators. Consequently, net income adjusted for non-cash items increased, which was partially offset by increases in working capital. UMC's operations provided \$50.8 million net cash for the period from March 1, 2003 to June 30, 2003.

Net cash used in investing activities was \$702.2 million, of which \$383.2 million related to the purchase of property, plant and equipment and intangible assets; \$238.9 million was used to acquire the 83.7% stake in UMC; \$62.9 million was used to acquire 52.7% of the common shares and 50% of the preferred shares of TAIF Telcom; and \$17.2 million was used for advances to our affiliates, primarily to our joint venture in Belarus. See "Business—History," "—Acquisitions" and "—Regional Expansion." We financed our acquisitions of UMC and TAIF Telcom primarily from the proceeds of the \$400 million 9.75% Eurobond offering in January 2003. Net cash provided by financing activities was \$385.3 million, of which net proceeds of \$396.1 million was a result of the Eurobond offering in January 2003 referred to above.

During the year ended December 31, 2002, net cash provided by operating activities was \$412.8 million, an increase of 22% from the year ended December 31, 2001. The increase was primarily attributable to an increase in net income, adjusted for non-cash items, offset by a decrease in trade accounts payable, a decrease in income tax payable, and an increase in inventory. Net cash used in investing activities was \$697.9 million, of which \$502.0 million related to purchases of property, plant and equipment. Net cash provided by financing activities was \$100.8 million, of which \$50.8 million related to the proceeds from 10.95% notes issued in March 2002 and \$52.9 million from loans.

During 2001, net cash provided by operating activities was \$338.2 million, an increase of 77.1% from 2000. The increase is primarily attributable to increases in net income, adjusted for non-cash items, income tax payable and trade accounts payable and a decrease in accounts receivable, offset by increases in receivables from related parties and VAT receivables. Net cash used in investing activities was \$441.5 million, of which \$396.7 million related to purchases of property, plant and equipment. Net cash provided by financing activities was \$247.6 million, which was primarily from the issuance of our notes. This was offset by repayment of certain debt obligations.

During 2000, net cash provided by operating activities was \$190.9 million, an increase of 63.5% from 1999. The increase was primarily attributable to increases in net income, adjusted for non-cash items, offset by a decrease in trade accounts payables and increase in inventory. Net cash used in investing activities was \$423.3 million, of which \$195.0 million related to purchases of property plant and equipment. Net cash provided by financing activities was \$298.5 million. The increase is primarily attributable to proceeds from issuance of capital stock and payments on receivable from Sistema in the amounts of \$348.6 million and \$27.1 million, respectively, offset by repayment of short-term and long-term loans and dividends paid in the amounts of \$62.7 million and \$14.4 million, respectively.

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 June 30, 2003, we had a working capital deficit of \$247.9 million compared to a deficit of \$65.9 million as of December 31, 2002. The increase in working capital deficit was primarily attributable to the dividends of \$111.4 million that were approved by our shareholders on June 30, 2003 but not paid until September 2003, UMC's working capital deficit of \$68.5 million, our call options in respect of the remaining 47.3% of common shares and 50% preferred shares of TAIF Telcom, further discussed in Note 2 to our unaudited condensed consolidated financial statement, of \$60.0 million, and additional short-term debt issued to finance capital expenditures of approximately \$39.6 million, offset by the proceeds of our \$400 million Eurobond offering in January 2003, which as of June 30, 2003 had not all been used for capital expenditures and acquisitions. Consequently, cash and cash equivalents increased by \$78.9 million to \$113.6 million at June 30, 2003. Accrued expenses and other current liabilities

increased by \$207.3 million to \$309.6 million primarily due to the dividends declared, the acquisition of UMC, increased accrued interest, property taxes and subscriber deposits. Subsequent to June 30, 2003, our working capital deficit increased as a result of the issuance of the \$300 million Floating Rate Notes in August 2003, and the application of proceeds for the financing of capital expenditures and acquisitions. We also recently incurred \$200.0 million in indebtedness, which we intend to repay out of the proceeds of this offering. See “—Recent Developments.”

As of December 31, 2002, we had a working capital deficit of \$65.9 million compared to positive working capital of \$168.2 million as of December 31, 2001. Cash and short term investments decreased by \$184.9 million and \$55.3 million, respectively. The change in working capital was primarily due to the proceeds of our 2001 Eurobond offering being spent to acquire regional operators and for capital expenditures in 2002. VAT receivables increased by \$71.8 million in connection with the installation of property, plant and equipment not yet in use.

As of December 31, 2001, we had positive working capital of \$168.2 million compared to \$147.2 million as of December 31, 2000. Cash and short-term investments increased by \$59.1 million following our \$250 million Eurobond issuance in the fourth quarter of 2001, and VAT receivables increased by \$64.5 million while the remaining current assets remained consistent. These increases were offset by an increase in accounts payable and accrued liabilities of \$81.7 million and an increase in subscriber deposits of \$19.1 million while the remaining current liabilities remained relatively consistent between years.

As of December 31, 2000, we had positive working capital of \$147.2 million compared with a working capital deficit of \$65.9 million at December 31, 1999. This \$213.1 million increase in our working capital from December 31, 1999 is primarily attributable to the increase in cash following the completion of our initial public offering, which provided \$170 million of new short-term investments, \$50.6 million in new deposits, an increase of \$7.0 million in inventory, and decreases of \$14.3 million and \$3.9 million in short-term debt which was repaid and trade accounts payables, respectively. These positive factors were partially offset by increases of \$15.1 million in income tax payable and \$21.6 million in subscriber prepayments and deposits, as well as a decrease of \$8.9 million in trade receivables.

Short- and Long-term Indebtedness

As of June 30, 2003, we had indebtedness of approximately \$977.3 million, of which \$21.8 million were capital lease obligations. The following chart provides a summary of our material indebtedness as of June 30, 2003:

Indebtedness	Currency of denomination	Amount outstanding as of June 30, 2003 (in thousands of U.S. dollars)	Annual interest rate (Actual interest rate at June 30, 2003)
Notes payable	USD	\$400,000	9.75%
Notes payable	USD	299,466	10.95%
Financing derivatives	USD	59,965	8%
Dresdner Bank	USD	43,200	LIBOR+1.95%–3.35% (3.09%–4.49%)
Ericsson	USD	27,000	LIBOR+4% (5.14%)
Raiffeisenbank	USD	20,000	LIBOR+2.85% (3.99%)
Deutsche Telekom	USD	15,961	LIBOR+5%–7% (6.14%–8.14%)
TDC	USD	13,676	LIBOR+5%–7% (6.14%–8.14%)
Citibank	USD	10,000	LIBOR+3.5% (4.64%)
MBRD	USD	6,200	6%
Motorola	USD	4,583	2.48%–8.23%
KfW	EUR	5,407	LIBOR+0.95–4% (2.09%–5.14%)
WestLB International	EUR	4,659	EURIBOR+2% (4.15%)
Ruble denominated debt ⁽¹⁾ . .	RBL	36,891	13.4%–23%
Capital lease obligations	various	21,840	n.a.
Other debt	various	8,422	(7%–15%)
Total:		<u>\$977,270</u>	
Less current portion		<u>\$200,966</u>	
Total long-term debt:		<u>\$776,304</u>	

⁽¹⁾ Includes \$20.4 million of indebtedness under the Sberbank and Rosbank facilities described in “Description of Existing Indebtedness.”

The terms of certain of our outstanding debt obligations are described in “Description of Existing Indebtedness” and in Note 14 to our audited consolidated financial statements.

Trend Information

Sales

During 2002, our revenues increased by 52.5% from \$893.2 million to \$1,361.8 million and our subscriber base increased by 66.4% from 3.99 million to 6.64 million. These trends continued for the six months ended June 30, 2003 as compared to the first half of 2002, with our revenues increasing 86.6% from \$563.9 million to \$1,052.1 million. Our subscriber base increased to 11.3 million subscribers as of June 30, 2003.

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 lower tariffs generally in the regions. This trend continued in the first six months of 2003. Average monthly service revenue per subscriber in Russia for the six months ended June 30, 2003 decreased to \$19, compared to \$25 for the six months ended June 30, 2002. In 2002, more than half of our subscriber growth occurred outside of the Moscow license area. However, as a result of competition generally and the tariff structure in the regions, our average revenue per subscriber in the Russian regions remains lower than in the Moscow license area (though costs are generally lower there, as well). As of June 30, 2003, for the first time,

within Russia, we have more subscribers in the Russian regions than in our Moscow license area. See “Risk Factors—Risks Relating to Our Business—Increased competition and a more diverse subscriber base have resulted in declining average monthly service revenues per subscriber which may adversely affect our results of operations.” We generally expect to see a continued decline in average monthly service revenue per subscriber due to the introduction of lower tariff plans in connection with our 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 and to 2.3 million subscribers at September 1, 2003, and we expect this trend to continue, assuming the Ukrainian economy continues to grow. Consistent with the general trends in Russia, we also expect average revenue per subscriber to decrease at UMC. A recently-passed amendment to the Ukrainian telecommunications laws forbids Ukrainian mobile operators, including UMC, from charging subscribers for incoming calls in Ukraine. We have adjusted our tariffs in Ukraine in an effort to offset the loss of incoming call revenue, but the law may nonetheless have an overall negative impact on UMC revenues. See “Risk Factors—Risks Relating to Our Business—Governmental regulation of our tariffs in Ukraine could negatively affect our revenues and results of operations.”

Churn

Our subscriber churn in Russia increased from 26.8% in 2001 to 33.9% in 2002. Churn in Russia increased to 11.0% for the six months ended June 30, 2003, compared to 7.7% for the six months ended June 30, 2002. We believe that the trend of increasing churn is due to the continued growth of competition and the growing number of mass-market subscribers in our 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. As tariff plans become more affordable and the economic situation in the Russian Federation improves, we expect to see a growing number of mass-market subscribers in our overall subscriber mix. In addition, our churn numbers for the six months ended June 30, 2003 include only limited churn statistics relating to our Jeans tariff plan, as the plan was introduced in November 2002 and subscribers are not counted as “churned” for 182 days. See “—Operating Results—Overview” for our definition of churn.

Capital Expenditures

We expect that capital expenditures will remain a large portion of our cash outflows in connection with our acquisitions in the regions of Russia and the continued installation and build out of our network. We spent \$574.3 million on capital expenditures in 2002 and \$383.2 million for the six months ended June 30, 2003, primarily relating to property, plant and equipment and intangible assets for network installation and build out. We expect to invest approximately \$700 million in 2003, of which approximately \$200 million will be spent in Ukraine, and approximately \$750 million in 2004 to develop our networks in Russia and Ukraine, excluding expenditures relating to our unconsolidated equity investments in Belarus.

These estimates do not include expenditures for acquisitions or any expenditures associated with the development of our network in Belarus. Our actual capital expenditures may vary significantly from our estimates.

Dividend Policy

As discussed above under “Liquidity and Capital Resources” our controlling shareholders have expressed their intent to vote in favor of annual dividends, which we expect to be no less than the equivalent of 25% of Mobile TeleSystems OJSC’s stand-alone net profits (as determined under Russian

accounting standards). To the extent that significant dividends are declared, our cash flow will be impacted and our need for external funding may increase.

Critical Accounting Policies and Estimates

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 the audited consolidated financial statements included elsewhere herein.

Revenue Recognition

Our revenues consist of service revenue, connection fees and equipment sales. Service revenues include (a) subscription fees, (b) usage charge, (c) value added service fees, (d) roaming fees charged to other operators for guest roamers utilizing our network and (e) prepaid phone cards. We recognize all of our service revenues based on the period in which the service is utilized. Customers are billed based on the type of service provided. Our connection fees are deferred at the time the subscriber enters into the agreement and recognized over the estimated average subscriber life. We estimate the average subscriber life based on our historical trends. We recognize our equipment sales upon the delivery of equipment to a customer. We also estimate the amount of uncollectible receivables each period and record valuation allowances based on historical collection rates, the age of unpaid amounts and information about the creditworthiness of the customers. Estimates of revenue adjustments and uncollectible accounts receivable are revised each period and any changes are recorded in the period they become known.

Impairment of Long-Lived Assets

We evaluate the recoverability of the carrying amount of our long-lived assets whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable. In assessing the recoverability of our long-lived assets, we must make assumptions regarding the estimated future cash flows and other factors to determine whether there are indications of impairment and, if so, the fair value of the respective assets. If these estimates or the related assumptions change in the future, we may be required to record impairment charges for these assets.

License Costs

We capitalize the cost of licenses acquired in business combinations and directly from government organizations. As the telecommunication industry in Russia does 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. 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 telecommunication infrastructure improvements, which in the aggregate could total approximately \$110.2 million, as of June 30, 2003. However, no decisions regulating the terms and conditions of such payments have been formulated. 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.

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 on an annual basis.

Taxation

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. While most of our tax declarations have been inspected without significant penalties, these inspections do not eliminate the possibility of re-inspection.

We believe that we have adequately provided for tax liabilities in our financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

We recognize deferred tax assets and liabilities 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 carry forwards using enacted tax rates expected to be in effect at the time these differences are realized. We record valuation allowances for deferred tax assets when it is more likely than not that these assets will not be realized.

Recent Implementation of New Accounting Standards

In June 2001, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 143, “Accounting for Asset Retirement Obligations.” SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation be 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. We have adopted SFAS No. 143 effective January 1, 2003. The adoption of SFAS No. 143 did not have a material impact on our results of operations or our financial position.

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 not 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 require 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, we reclassified the gain on extinguishment of our 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 our 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 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. We have adopted the provisions of SFAS No. 146 effective January 1, 2003. The

adoption of SFAS No. 146 did not have a material impact on our results of operations or 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 disclosures about the guarantor’s obligations under certain guarantees that it has issued. We have 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 our results of operations or financial position.

In January 2003, FASB issued FASB Interpretation No. 46, “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51” (“FIN 46”). FIN 46 clarifies the application of Accounting Research Bulletin 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 from other parties. Under FIN 46, an enterprise is required to consolidate certain entities (so-called “variable interest entities”), if it is the primary beneficiary of the variable interest entity. The primary beneficiaries of a variable interest entity is the party that absorbs a majority of the entity’s expected losses or receives the majority of the entity’s residual returns. FIN 46 also requires additional disclosure regarding the use of variable interest entities. We adopted the disclosure requirements of FIN 46 effective 2002; consolidation provisions of FIN 46 will become effective on January 1, 2004. We do not believe that the adoption of the consolidation provisions of FIN 46 will have a material effect on our results of operations or financial position.

Future Implementation of New Accounting Standards

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. SFAS No. 149 is effective (with certain exceptions) for contracts entered into or modified and for hedging relationships designated after June 30, 2003. We do not expect the adoption of SFAS No. 149 to have a material impact on our 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 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. We are required to adopt SFAS No. 150 effective August 1, 2003. We do not expect the adoption of SFAS No. 150 to have a material impact on our 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. EITF Issue No. 00-21 is effective prospectively for all arrangements entered into during fiscal periods after June 15, 2003, and we may elect to apply the provisions of EITF Issue No. 00-21 to existing arrangements and record the impact as a cumulative effect of a change in accounting principle in the statement of operations. We are currently assessing the impact of adopting EITF Issue No. 00-21.

Quantitative and Qualitative Disclosures about Market Risk

We are exposed to market risk from changes in both foreign currency exchange rates and interest rates. Foreign exchange risks exist to the extent our costs are denominated in currencies other than dollars. We are subject to market risk deriving from changes in interest rates, which may affect the cost of our financing. We do not use financial instruments, such as foreign exchange forward contracts, foreign currency options, interest rate swaps and forward rate agreements, to manage these market risks. We do not hold or issue derivative or other financial instruments for trading purposes.

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 debt. At December 31, 2002, approximately \$87.4 million, or 19% of our total indebtedness, including capital leases, was variable interest debt, while \$367.1 million, or 81% of our total indebtedness, including capital leases, was fixed rate debt. At June 30, 2003, approximately \$139.9 million, or 14.3% of our total indebtedness, including capital leases, was variable interest debt, while \$837.4 million, or 85.7% of our total indebtedness, including capital leases, was fixed rate debt. Currently, we do not use derivative financial instruments such as swaps, futures, options or forward rate agreements to manage interest rate risk. However, in connection with the \$28.8 million Ericsson loan shown in the table below, we have, under the terms of the Rosico acquisition agreement, received a commitment from Sistema whereby Sistema agrees to fund Rosico for the full and timely repayment of the loan, as described under “Operating and Financial Review and Prospects—Liquidity and Capital Resources” above.

Russian legislation effectively prohibits us from acquiring financial instruments denominated in foreign currencies, which prevents us from economically hedging against interest rate risks that may exist under our current or future indebtedness.

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 June 30, 2003.

Contractual Maturity Date as of June 30, 2003

Bank	Currency	2003	2004	2005	2006	Total	Annual interest rate (Actual interest rate at June 30, 2003)
(amounts in thousands of U.S. dollars)							
Dresdner Bank . .	USD	\$ 11,100	\$ —	\$ —	\$ —	\$ 11,100	LIBOR+1.95% (3.09%)
Dresdner Bank . .	USD	—	10,000	—	—	10,000	LIBOR+3.35% (4.49%)
Dresdner Bank . .	USD	20,000	—	—	—	20,000	LIBOR+3.2% (4.34%)
Dresdner Bank . .	USD	2,100	—	—	—	2,100	LIBOR+3.2% (4.34%)
Raiffeisenbank . . .	USD	20,000	—	—	—	20,000	LIBOR+2.85% (3.99%)
Ericsson	USD	7,650	9,900	9,450	—	27,000	LIBOR+4% (5.14%)
Citibank	USD	10,000	—	—	—	10,000	LIBOR+3.5% (4.64%)
TDC	USD	13,676	—	—	—	13,676	LIBOR+5%–7% (6.14%–8.14%)
Deutsche Telekom	USD	15,961	—	—	—	15,961	LIBOR+5%–7% (6.14%–8.14%)
KfW	EUR	2,923	1,242	1,242	—	5,407	LIBOR+0.95%–4% (2.09%–5.14%)
WestLB	EUR	—	—	—	4,659	4,659	EURIBOR+2% (4.15%)
Total variable debt		<u>\$103,410</u>	<u>\$21,142</u>	<u>\$10,692</u>	<u>\$4,659</u>	<u>\$139,903</u>	
Weighted average interest rate . . .		4.88%	4.83%	5.14%	4.20%	4.87%	

At June 30, 2003, the fair value of our debt approximated its book value.

In addition to the variable interest indebtedness listed above, on August 5, 2003 we issued \$300 million Floating Rate Notes due 2004, bearing interest at LIBOR + 4% (which equaled 5.1% on August 5, 2003), and we also recently incurred \$200.0 million in variable interest indebtedness, which we intend to repay out of the proceeds of this offering, as further discussed in “—Recent Developments” below.

Foreign Currency Risk

The Russian economy has been characterized by high levels of inflation and an unstable currency. Prior to August 17, 1998, the Russian Central Bank sought to maintain the value of the ruble against the U.S. dollar, including, immediately prior to August 17, 1998, at a level between 5.25 and 7.15 rubles per U.S. dollar. On August 17, 1998, due to the burden of short-term debt and the reduction in the Russian Central Bank’s reserves, the Russian government and the Russian Central Bank withdrew their support for the falling ruble.

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

These rates may differ from the actual rates used in preparation of our financial statements and other financial information provided herein.

	Rubles per U.S. dollar			
	High	Low	Average ⁽¹⁾	Period End
Year ended December 31,				
1998	20.99	5.96	10.12	20.65
1999	27.00	20.65	24.67	27.00
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

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

Month ended	Rubles per U.S. dollar	
	High	Low
January 2003	31.88	31.78
February 2003	31.85	31.55
March 2003	31.60	31.38
April 2003	31.38	31.10
May 2003	31.12	30.62
June 2003	30.76	30.32
July 2003	30.53	30.25
August 2003	30.50	30.28
September 2003	30.70	30.45

Source: Russian Central Bank.

Our principal exchange rate risk involves changes in the value of the ruble relative to the U.S. dollar. As a result of inflation and the continued devaluation of the ruble, we link our monetary assets and transactions, when possible, to the U.S. dollar, which under SFAS No. 52 is reported in this

document as our functional currency. We have not entered into any significant currency hedging arrangements.

Substantially all 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 include salaries, interconnection costs, roaming expenses, cost of customer equipment, capital expenditures and borrowings. In order to hedge against a significant portion of this risk, we also denominate our tariffs, which are payable in rubles, in units linked to the U.S. dollar and require accounts to be settled at the official exchange rate of the Russian Central Bank on the date of payment.

If the ruble continues to decline against the U.S. dollar and tariffs 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 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 bank or deposit accounts. Generally, as the value of the ruble declines, our net ruble monetary asset position results in currency remeasurement losses.

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 tax incentives for capital investment and the depreciation of our property, plant and equipment since their basis for tax purposes is denominated in rubles at the time of the investment or acquisition. Any increased tax liability would increase our total expenses.

We would experience a loss of \$9.2 million in the fair value of our ruble-denominated net monetary assets as a result of a hypothetical 10% change in the U.S. dollar to ruble exchange rate at June 30, 2003. We are unable to estimate future loss of earnings as a result of such change.

Inflation

The Russian economy has been characterized by high rates of inflation:

<u>Year</u>	<u>Inflation rate</u>
1998	84.4%
1999	36.5%
2000	20.2%
2001	18.6%
2002	15.1%

As noted above, we denominate our tariffs in units linked to the U.S. dollar. While substantially all of our costs are denominated in U.S. dollars or are tightly linked to the U.S. dollar, certain of our costs, such as salaries and rents, are sensitive to rises in the general price level in Russia. When, however, the rate of inflation exceeds the rate of devaluation, resulting in real appreciation of the ruble versus the U.S. dollar, as was the case for periods prior to 1998, and in 1999 through June 30, 2003. We would expect inflation-driven increases in these costs to put pressure on our margins. While we could seek to raise our tariffs to compensate for such increase in costs, competitive pressures may not permit increases that are sufficient to preserve operating margins. Accordingly, high rates of inflation in Russia relative to the rate of devaluation could materially adversely affect our results of operations.

Recent Developments

Potential Ruble Bond Issuance

In March 2003, our Board of Directors approved the issuance of ruble-denominated bonds in an amount up to 5 billion rubles (approximately \$161 million). We may launch this transaction during 2004, depending on market conditions.

Exercise of TDC Option

On July 28, 2003, we completed the purchase of a 16.3% stake in UMC from TDC for \$91.7 million pursuant to a put and call option agreement. Our purchase of this stake increased our ownership interest in UMC to 100%. For a description of the terms of our acquisition of UMC, see “Business—Regional Expansion.”

Change in Management

On August 11, 2003, our board of directors appointed Vassily V. Sidorov as Acting President, effective September 1, 2003, and nominated Mr. Sidorov for the post of President, which will be voted upon at a shareholders’ meeting to be held in October 2003. Prior to his appointment as our acting president, Mr. Sidorov served as First Vice President for Finance and Investments at Sistema Telecom. Our former president, Mikhail Smirnov was appointed to the position of general director of the Moscow City Telephone Network (MGTS), a fixed line operator that is majority-owned by Sistema and its affiliates.

In July 2003, Nikolai N. Tsekhomsky was appointed as our Vice President—Finance/Chief Financial Officer. Mr. Tsekhomsky formerly served as our Financial Director from September 2002 until his appointment as Chief Financial Officer.

Acquisitions from MCT Corporation

In August 2003, we reached an agreement to acquire, in a series of related transactions, equity interests in five Russian regional mobile phone companies from MCT Corporation for a total of \$71 million. We agreed to purchase a 43.7% stake in Uraltel and 100% of Vostok Mobile BV, which holds a 50% stake in Primtelefon. We also agreed to purchase Vostok Mobile South, which holds 50% stakes in Astrakhan Mobile and Volgograd mobile, as well as an 80% stake in Mar Mobile GSM. We also entered into agreements to acquire the remaining 20% of Mar Mobile GSM and another 2.95% stake in Uraltel from existing shareholders unrelated to MCT Corporation for approximately \$1 million. The total net debt of the five mobile phone companies was approximately \$25.0 million as of the date of the agreements.

On August 13, 2003, our 100% owned subsidiary, Telecom-900, completed the purchase of the 43.7% and 2.95% stakes in Uraltel. The transaction increased Telecom-900’s ownership in Uraltel to 99.85%. On August 26, 2003, we completed the acquisition of Vostok Mobile BV. On October 7, 2003 and October 9, 2003, we completed the purchase of the 20% stake in Mar Mobile GSM and 100% of Vostok Mobile South, respectively.

Acquisition of Sibchallenge

In August 2003, we completed the acquisition of a 100% stake in Sibchallenge, a cellular operator in the Krasnoyarsk region, for \$45.4 million. Sibchallenge holds licenses to provide GSM 900/1800 and DAMPS mobile services in the Krasnoyarsk region of Siberia. According to sotovik.ru, an independent market research agency, it had a subscriber base of approximately 130,000 and 40% of the local market share as of June 30, 2003. Krasnoyarsk has a population of approximately three million. Mobile penetration in the region was estimated by sotovik.ru at approximately 11% as of June 30, 2003. As of

the date of our acquisition, the company's net debt (borrowings minus cash and cash equivalents) was \$9.4 million.

Acquisition of Tomsk Cellular Communications

In September 2003, we purchased Siberian operator Tomsk Cellular Communications for \$47 million. Tomsk Cellular Communications operates a GSM 900/1800 network in eastern Siberia. It had approximately 180,000 subscribers and 80% local market share as of the date of our acquisition according to AC&M-Consulting.

Acquisition of Kubtelesot

In September 2003, we acquired 100% of Kubtelesot for \$107 million. Kubtelesot owns 47.3% of CSJC Kuban GSM, and our purchase of this stake increased our ownership interest in Kuban GSM to 100%.

Additional Indebtedness

We completed a \$300 million Eurobond offering through Mobile TeleSystems Finance S.A. on August 5, 2003. The floating rate notes were issued under an indenture dated August 5, 2003 and mature on August 5, 2004, unless earlier redeemed at our option. Interest on the notes is payable quarterly on November 5, 2003, February 5, 2004, May 5, 2004 and August 5, 2004.

In September 2003, Mobile TeleSystems LLC entered into a loan agreement with ZAO Citibank for \$4.5 million with an interest rate of LIBOR + 4.15%. This loan matures in September 2004 and is guaranteed by us.

In September 2003, UMC entered into a \$60 million unsecured syndicated credit facility with ING Bank (Eurasia) ZAO, ZAO Standard Bank and Commerzbank Aktiengesellschaft with an interest rate of LIBOR + 4.15%. This loan is guaranteed by us and matures on September 12, 2006. The proceeds will be used by UMC to refinance its existing indebtedness. As of October 10, 2003, \$48 million was outstanding under this facility.

UMC is currently negotiating an export credit agency-backed facility with an agency in Germany in the amount of approximately €45 million with an interest rate of EURIBOR + 0.65% to finance significant part of its capital expenditure program in 2003–2004. The facility will be guaranteed by us.

Mobile TeleSystems LLC is currently negotiating an export credit agency-backed credit facility in the amount of approximately \$60 million for the purchase of network equipment. The loan will be guaranteed by us.

ING Loan

On September 23, 2003, we entered into a loan facility agreement with ING Bank (Eurasia) ZAO and ING (Ireland) Limited in the amount of \$100 million, to be used to finance our current capital expenditures, which we have fully drawn. Amounts outstanding under this loan facility agreement bear interest at LIBOR + 2.25% per annum. We intend to repay the loan out of the proceeds of this offering. See "Use of Proceeds."

CSFBi Loan

On September 22, 2003, we entered into a loan facility agreement with Credit Suisse First Boston International in the amount of \$100 million, to be used for general corporate purposes, which we have fully drawn. Amounts outstanding under this loan facility agreement bear interest at LIBOR + 2.25% per annum. We intend to repay the loan out of the proceeds of this offering. See "Use of Proceeds."

BUSINESS

Business Overview

We are a leading provider of mobile cellular communications services in the Russian Federation and employ technology based primarily on Global System for Mobile Communications, or GSM. As of June 30, 2003, we had approximately 9.3 million subscribers in Russia, making us the largest mobile cellular operator in Russia in terms of subscribers, and 2.0 million subscribers in Ukraine. Our unconsolidated joint venture in Belarus, Mobile TeleSystems LLC, had approximately 170,200 subscribers as of June 30, 2003. In addition, we were the largest mobile operator in Russia in terms of net revenues, generating \$535.7 million during 2000, \$893.2 million during 2001, \$1.4 billion during 2002 and \$1.1 billion during the first six months of 2003. As of September 1, 2003, we had approximately 9.5 million subscribers in Russia and 2.3 million subscribers in Ukraine. Mobile TeleSystems LLC in Belarus had approximately 251,600 subscribers as of September 30, 2003.

As of June 30, 2003, we had licenses to operate in 58 regions of Russia with a population of approximately 110.2 million people, or approximately 76% of the country's total population. As of June 30, 2003, we had commenced commercial operations in 49 of these regions, with a combined population of approximately 100.4 million people, including approximately 17 million in the Moscow license area and approximately 14 million in the North-West license area, which includes St. Petersburg. Since June 30, 2003, we have launched operations in nine additional regions and acquired licenses for 18 additional regions, covering a population of approximately 17.5 million.

The Moscow license area, which encompasses the City of Moscow and the Moscow region, remains our principal market in terms of revenues, although today more than one-half of our total subscriber base resides outside of the Moscow license area. According to AC&M-Consulting, approximately 36.4% of all mobile cellular subscribers in Russia reside in the Moscow license area, where penetration stood at approximately 53.3% as of June 30, 2003. In Russia generally, penetration was lower, at approximately 17.3% according to AC&M-Consulting. We had approximately 4.1 million subscribers in the Moscow license area as of June 30, 2003, representing approximately 45.6% of all mobile cellular subscribers in the area according to AC&M-Consulting. Our subscribers in Russia outside of the Moscow license area, in what we refer to as regional license areas, totaled approximately 5.2 million as of June 30, 2003. According to AC&M-Consulting, as of June 30, 2003, we had a 37.1% market share of total mobile cellular subscribers in Russia.

Both our subscriber base, which reflects only active subscribers, and our net revenues have increased significantly since 1996, as summarized below:

<u>Period</u>	<u>Subscribers⁽¹⁾⁽²⁾</u> <u>(in thousands)</u>	<u>Net revenues</u>
Twelve months ended December 31,		
1996	19	\$ 53,645
1997	60	\$ 208,408
1998	114	\$ 338,323
1999	306	\$ 358,327
2000	1,194	\$ 535,712
2001	2,650	\$ 893,247
2002	6,644	\$1,361,756
Six months ended June 30, 2002	4,370	\$ 563,092
Six months ended June 30, 2003	11,340	\$1,052,134

⁽¹⁾ For a description of our definition of "subscriber" see footnote 12 to "Summary Financial and Operating Data."

⁽²⁾ Subscribers in Russia as of the end of each period and, as of June 30, 2003, subscribers in Russia and Ukraine. We do not include our subscribers in Belarus in our operating information, because our joint venture in Belarus is accounted for as an equity investment and therefore is not consolidated in our financial statements.

To maintain and increase our market share, we use a combination of newspaper, magazine, radio, television, direct mail and outdoor advertising, focusing in particular on brand and image advertising and public relations, to position us as a leading cellular operator in Russia. Supporting these efforts, we had a sales and distribution network consisting of 27 integrated sales and customer service centers and over 4,500 independent dealer distribution outlets in the Moscow license area as of June 30, 2003. We had 200 sales and customer service centers in Russia as of June 30, 2003. In Ukraine and Belarus we had 32 and three sales and customer service centers, respectively, as of June 30, 2003.

We seek to minimize our exposure to the credit risk of our subscribers through our advance-payment billing system, which is used by over 97% of our subscribers in Russia and approximately 95% in Ukraine. Under this system, our subscribers prepay for their access, usage and value-added service fees.

In addition to standard voice services, we offer our subscribers enhanced services including voice mail, short message service, GPRS and data and fax transmission. We also offer our subscribers the ability to roam automatically throughout Europe, and in much of the rest of the world.

The following table summarizes our operating and financial performance for the last five years and for the six months ended June 30, 2002 and 2003.

	Years Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003
Subscribers ⁽¹⁾⁽²⁾ (in thousands)	114	306	1,194	2,650	6,644	4,370	11,340
Overall market share in the Moscow license area	34%	40%	55%	50%	43%	44%	46%
Overall market share in the Russian Federation ⁽¹⁾	16%	23%	35%	33%	38%	37%	37%
Overall market share in Ukraine	—	—	—	—	—	—	46%
Net revenues (in thousands)	\$338,323	\$358,327	\$535,712	\$893,247	\$1,361,756	\$563,902	\$1,052,134
Net operating income (in thousands)	\$164,069	\$115,612	\$139,047	\$324,109	\$464,371	\$194,844	\$375,036
Average monthly service revenues per Russian subscriber ⁽³⁾	\$302	\$124	\$54	\$36	\$23	\$25	\$19
Average monthly minutes of usage per Russian subscriber ⁽⁴⁾	384	224	151	157	159	167	162
Average monthly service revenues per Ukrainian subscriber ⁽⁵⁾	—	—	—	—	—	—	\$17
Average monthly minutes of usage per Ukrainian subscriber ⁽⁵⁾	—	—	—	—	—	—	94

Source: Sotovik, AC&M-Consulting, Ukrainian News, J'Son & Partners and our data.

⁽¹⁾ We define a “subscriber” as an individual or organization whose account does not have a negative balance for more than 61 days. For the “Jeans” tariffs only, introduced in November 2002, we define “subscriber” as an individual or organization whose account does not have a negative balance for more than 183 days.

⁽²⁾ Subscribers in Russia and, for the six months ended June 30, 2003, subscribers in Russia and Ukraine. We do not include our subscribers in Belarus in our operating information, because our joint venture in Belarus is accounted for as an equity investment and therefore is not consolidated in our financial statements.

⁽³⁾ We calculate our average monthly service revenue per subscriber by dividing our service revenues for a given period, including guest roaming fees, by the average number of our subscribers during that period and dividing by the number of months in that period.

⁽⁴⁾ Average monthly minutes of usage per subscriber is calculated by dividing the total number of minutes of usage during a given period by the average number of our subscribers during such period and dividing by the number of months in such period.

⁽⁵⁾ Average monthly service revenues and average monthly minutes of use per Ukrainian subscriber are presented for the months of March through June 2003.

Competitive Strengths

We believe that we have certain competitive strengths that facilitate implementation of our strategy.

Our experienced management enables us to expand effectively through organic growth and acquisitions.

Our experienced and motivated senior management team is currently led by Mr. Vassily V. Sidorov, Acting President; Dr. Yury Gromakov, First Vice President; Mr. Mikhail Susov, First Vice President; Mr. Nikolai V. Tsekhomsky, Vice President, Finance/Chief Financial Officer; Ms. Tatiana V. Evtushenkova, Vice President, Investments and Securities; Mr. Anatoly Tchekhvyan, Vice President, Operations; Mr. Valeriy A. Kozlov, Vice President, Administrative Affairs; and Mr. Valery I. Grashenkov, Vice President, Integration of Radio Systems. This group has significant experience in wireless communications. Their strategic vision for regional expansion has fostered our organic growth and strategic acquisitions, which, in turn, has led to further market consolidation and an increase in our subscriber base.

Our favorable nationwide brand recognition helps us to attract new customers and retain existing subscribers.

As penetration in the Russian mobile market increases competition, we expect competitive advantage to shift towards brand awareness and image, coupled with customer service. We believe that we are well positioned to compete effectively in this environment, focusing on customer service and relying on what we believe to be our well regarded “MTS” and “Jeans” brands.

Our established operations and customer base in Moscow provide us with a platform for expansion into the regions of the Russian Federation and for exploring the commercial viability of new technologies.

Our leading position and customer base in Moscow, as well as our extensive network, provide us with valuable market information and operational experience which we utilize in our expansion into the regions of the Russian Federation and in the development of new tariffs and products. In addition, we are able to use parts of our Moscow network to test the commercial viability of new technologies.

Our significant focus on and investment in our network has resulted in our high-quality, geographically expansive GSM network.

We have built an extensive GSM network with 8,089 base stations operational in Russia and Ukraine as of September 1, 2003. We were operational in 58 regions of Russia as of September 1, 2003.

In regions where we have frequency allocations in both the 900 and 1800 MHz bands, we intend to make use of the many network elements common to GSM 900 and GSM 1800 systems. This commonality allows us to reduce the capital expenditures needed to provide quality service to our subscribers and significantly lowers our attendant fixed- and variable-cost base.

Our commitment to employee training has resulted in a skilled workforce able to service our network and our subscribers.

Our rapid expansion has led to an increased need for skilled employees and the need for existing employees to develop additional skills. Thus, we have established internal and external training programs in order to maintain a properly trained, motivated workforce to service our network and subscribers and a consistent supply of employees with the requisite skills for company growth.

Support and advice from our principal shareholders, Sistema and T-Mobile, enables us to benefit from their business knowledge and experience.

Our major shareholders, T-Mobile and Sistema, have forged a strong working relationship and act in concert to provide us with support and advice, especially in relation to corporate management and regional and CIS expansion.

Business Strategy

Our primary goal is to maintain our position as a leading national mobile operator in Russia by integrating our regional networks into a single unified network, adopting a unified marketing approach and deploying integrated nationwide customer service and billing systems. In addition, we intend to take advantage of selected opportunities to expand our network coverage in the Russian Federation and other countries of the CIS, and offer our customers new products and services.

To accomplish this, we intend to maintain our leading position in the Moscow license area in terms of revenues by growing our subscriber base and focusing on the quality of our subscriber mix, service quality, cost control and the development of services and incentives aimed at encouraging subscriber loyalty. We have invested and intend to continue to invest in new customer service and billing systems to help maintain customer satisfaction, reduce costs and control churn.

We also plan to continue to develop our operations in the regional license areas in which we currently operate and, in particular, in St. Petersburg, which we consider to be the second-most important mobile market in Russia after Moscow.

In addition to further developing our coverage in areas in which we already offer services, we intend to selectively expand our network to parts of European and Asian Russia, primarily the Central and Volga regions and the Urals. Because per capita wealth and disposable income in these regions are generally well below those in the Moscow license area, we intend to focus our expansion initially on high density areas, such as regional capitals and along transportation routes, based on factors such as commercial return, strategic importance, market potential, license requirements and competition. In the event we expand by acquiring other GSM operators or license holders, we intend to consider the transparency of the business dealings of the operator or license holder in question and, in the case of an operator, the technical compatibility of its network with ours.

We also plan to further develop our operations in Ukraine and Belarus and expand our operations into other countries of the CIS as attractive opportunities arise through the acquisition of existing operators or new licenses. For example, in line with this strategy of expansion, in 2003 we acquired a 100% stake in Ukrainian Mobile Communications, or UMC. For a description of this transaction, see “—History and Development—Regional Expansion.”

In addition to expanding both within and outside of Russia’s borders, we intend to continue to provide new and varied tariff plans and value-added service options, including various SMS-based and data communications services, which appeal to the range of subscribers within our network. We also intend to continue to take advantage of the Moscow license area as a platform from which to test and launch new products and services. For example, in May 2003, we launched GPRS in the Moscow license area as a value-added service and have since launched GPRS as a value-added service in Ukraine and Novosibirsk. We also currently offer GPRS in test mode free of charge to our subscribers in certain regional license areas where we have installed GPRS equipment, and we intend to examine its commercial viability as a pay service in those regions in the future.

Our rapid expansion into the regions of Russia has lead us to reevaluate our management and organizational structure. We are currently working with McKinsey & Company to develop and implement a simplified and strengthened centrally-managed corporate function to enhance performance and efficiency at all levels of our operations and simultaneously integrate our operations in all territories where we are present.

Implementation of these strategies is subject to a number of risks, including our ability to manage our rapid growth and development, integrate new acquisitions successfully, and compete effectively against existing and new competitors. See “Risk Factors” for a description of these and other risks we face.

History

Mobile TeleSystems CJSC, our predecessor, was formed in 1993. The founding shareholders included the Moscow City Telephone Network, or MGTS, and three other Russian telecommunications organizations, which collectively held 53% of our original share capital, and two German companies, Siemens AG and T-Mobile Deutschland GmbH, an affiliate of Deutsche Telekom AG, which collectively held the remaining 47%. Our two principal shareholders are currently JSFC Sistema and T-Mobile International AG&Co KG (referred to herein as T-Mobile). Sistema, a Russian financial industrial group, owns 40.8% of our share capital directly, and owns 100% of Invest-Svyaz-Holding, which in turn owns 8.0% of our share capital. Sistema also owns 51% of VAST, which in turn owns 3% of our share capital. T-Mobile, a wholly-owned subsidiary of Deutsche Telekom, directly owns 25.1% of our share capital.

Mobile TeleSystems OJSC was created on March 1, 2000, through the merger of MTS CJSC and RTC CJSC, a wholly-owned subsidiary. In accordance with Russian merger law, MTS CJSC and RTC CJSC ceased to exist and MTS OJSC was created with the assets and obligations of the predecessor companies. Our charter was registered with the State Registration Chamber on March 1, 2000, and with the Moscow Registration Chamber on March 22, 2000. Our initial share issuance was registered by the Russian Federal Commission on the Securities Market on April 28, 2000.

We completed our initial public offering on July 6, 2000, and listed our shares of common stock, represented by ADSs, on the New York Stock Exchange under the symbol “MBT.” Each ADS represents 20 underlying shares of our common stock. T-Mobile also sold 5% of our shares in the form of Global Depositary Receipts in April 2003.

Our legal name is Mobile TeleSystems OJSC, and we are incorporated under the laws of the Russian Federation. We operate primarily in the Russian Federation under the commercial names “Mobile TeleSystems” and “MTS.” We also operate in Ukraine and in Belarus through our subsidiaries Ukrainian Mobile Communications and Mobile TeleSystems LLC, respectively. Our head office is located at 4 Marksistskaya Street, Moscow 109147, Russian Federation, and the telephone number of our investor relations department is +7 095 911 6553. We have appointed Puglisi & Associates, 850 Library Avenue, Suite 204, Newark, Delaware 19715 as our agent for service of process.

On June 9, 2003, our wholly-owned subsidiary Rosico merged into us pursuant to a shareholders’ resolution approving the merger and a merger agreement. In connection with this merger, the telecommunications licenses held by Rosico were reissued to us as the legal successor of this company and we assumed all of the rights and obligations of Rosico. The intent of this merger is to reduce financial, managerial and other expenses connected with providing communication services in the territories in which Rosico currently operates. Upon completion of the merger, Rosico shares were redeemed and there was no alteration in the amount of our authorized capital.

We also intend to merge our subsidiary ACC into us during 2004 pursuant to a shareholders’ resolution passed in April 2003 approving such merger.

MTS CJSC inaugurated service in the Moscow license area in 1994 and began expanding into nearby regions in 1997. Since that time, we have continued to grow by applying for GSM licenses in new regions, investing in new GSM licensees, increasing our ownership percentage in these licensees and acquiring existing GSM license holders and operators. As of June 30, 2003, we had licenses to operate in the 900 or 1800 MHz frequency bands in 58 regions and were operating in 49 of these

regions. Since June 30, 2003, we have launched operations in nine additional regions and have acquired licenses to operate in 15 additional regions.

We completed Eurobond offerings through Mobile TeleSystems Finance S.A., our 100% beneficially-owned subsidiary, on December 21, 2001 and March 20, 2002. The 10.95% notes, \$250 million of which were issued at 99.254% on December 21, 2001, and \$50 million of which were issued at 101.616% on March 20, 2002, were issued under an indenture dated December 21, 2001, are part of the same series and mature on December 21, 2004.

We completed a \$400 million Eurobond offering through Mobile TeleSystems Finance S.A. on January 30, 2003. The 9.75% notes were issued under an indenture dated January 30, 2003 and mature on January 30, 2008. Interest on the notes is payable in arrears on January 30 and July 30 of each year, commencing on July 30, 2003.

We completed a \$300 million Eurobond offering through Mobile TeleSystems Finance S.A. on August 5, 2003. The floating rate notes were issued under an indenture dated August 5, 2003 and mature on August 5, 2004. Interest on the notes is payable quarterly on November 5, 2003, February 5, 2004, May 5, 2004 and August 5, 2004.

The notes issued in connection with each offering are listed on the Luxembourg Stock Exchange and guaranteed by us.

Acquisitions

Since 1998, we have entered into the following transactions:

- In early 1998, MTS CJSC took a 24.8% founding stake in ReCom and acquired an additional 25.1% from Sistema later the same year. Our acquisition in 2001 of an additional 4% increased our ownership percentage to 53.9% and gave us operating control of ReCom;
- In 1998, MTS CJSC acquired 80% of Rosico from Sistema. In 2000, we acquired the remaining 20% of Rosico from Sistema's affiliates (9.5%), Siemens (10%) and T-Mobile (0.5%);
- In 1998, MTS CJSC acquired 100% of RTC CJSC, with which it subsequently merged in our formation;
- In 1999, MTS CJSC acquired 100% of ACC;
- In 1999, MTS CJSC acquired 51% of UDN-900;
- In 2000, we acquired 51% of MSS. Our acquisition in 2001 of an additional 32.5% increased our ownership of MSS to 83.5%;
- In May 2001, we acquired 100% of Telecom XXI, which holds dual-band licenses in 10 regions, including St. Petersburg;
- In August 2001 and November 2002, we acquired 81% and 19%, respectively, of Telecom-900, which owns a controlling stake in three regional operators, including FECS-900 (60%), Uraltel (53%) and SCS-900 (51%);
- In March 2002, we acquired a 51% controlling stake in Krasnodar-based CJSC Kuban GSM. Our acquisition in October 2002 and September 2003 of additional 1.7% and 47.3% stakes, respectively increased, our ownership of Kuban GSM to 100%;
- In May 2002, we acquired 100% of BM-Telecom, a telecommunications services provider in the Bashkortostan Republic;
- In July 2002, we acquired 100% of Mobicom-Barnaul, a GSM 900 mobile operator in the Altai region, which we renamed MTS-Barnaul in September 2002;

- In September and October 2002, we acquired 66.6% and 33.3%, respectively, of Dontelecom, a GSM 900/1800 mobile operator in the Rostov region;
- In October 2002, we acquired 100% of Bit LLC, which holds GSM 900 licenses for four regions of Russia;
- In March, June and July 2003, we acquired 57.7%, 26.0% and 16.3%, respectively, of Ukrainian Mobile Communications, a provider of GSM 900/1800 mobile services in Ukraine; and
- In April 2003, we acquired 51% of the common shares and 50% of the preferred shares in TAIF Telcom, which provides mobile services in the GSM 900/1800 standard in the Republic of Tartarstan and in the Volga region of Russia. We acquired an additional 1.7% of TAIF Telcom's common shares in May 2003.

For a description of our acquisitions after June 30, 2003, see “Operating and Financial Review and Prospects—Recent Developments.”

Regional Expansion

In furtherance of our goal to be a nationwide operator in Russia, we have extended our focus beyond Moscow and the Moscow region with a view towards developing our existing license areas in the regions, acquiring new regional licenses and acquiring regional operators. During 2002, we began operations in 12 Russian regions and acquired controlling stakes in five existing regional mobile operators. For a listing of our regional acquisitions see “—Acquisitions.”

St. Petersburg is among the key regions in Russia that we have focused on in developing and expanding our commercial operations. Telecom XXI, which we acquired in May 2001 for approximately \$50 million, has GSM 900 and 1800 licenses to operate in 10 regions of Russia: the city of St. Petersburg, Leningrad region, the Republic of Karelia, Nenetsky autonomous district, Arkhangelsk region, Vologda region, Kaliningrad region, Murmansk region, Novgorod region and Pskov region. The total population of Telecom XXI's license areas is 13.1 million people, and it had no subscribers at the time of our acquisition. We launched our network in St. Petersburg on December 11, 2001, and as of June 30, 2003, we had approximately 941,400 subscribers in St. Petersburg. Our network is also operational in each of the other nine regions covered by the Telecom XXI licenses.

We have also expanded into the Krasnodar region with our acquisition of a 51% stake in Krasnodar-based CJSC Kuban GSM in March 2002 for \$71.4 million and an additional 1.7% stake in October 2002 for \$5.0 million. The placement report for our acquisition of the additional 1.7% stake was registered in March 2003. In addition, in September 2003, we acquired 100% of Kubtelesot for \$107 million. Kubtelesot owns 47.3% of Kuban GSM, and our purchase of this stake increased our ownership interest in Kuban GSM to 100%.

Kuban GSM is currently Russia's largest mobile operator in the regions outside of Moscow and St. Petersburg in terms of subscribers. As of June 30, 2003, Kuban GSM had approximately 1,105,725 subscribers and operated in the most populous areas of the Krasnodar region, including Sochi, Krasnodar and Novorossiysk.

In April 2003, we acquired a controlling stake in TAIF Telcom, the largest cellular operator in Tartarstan, from the company's shareholders, for \$61 million. We also signed put and call option agreements with shareholders to acquire the remaining shares of the company, and we purchased an additional 1.7% stake in TAIF Telcom pursuant to this agreement in May 2003 for \$2.3 million. As of the date we acquired TAIF Telcom, the company had outstanding indebtedness of approximately \$16.6 million secured by telecom equipment.

We can exercise the call option for common shares during the 48 months following the date of our acquisition of a controlling stake in TAIF Telcom (the “initial acquisition date”) and the call option for

the preferred shares during the 48 months following the date falling 24 months after the initial acquisition date. The company's shareholders can exercise the put options for common shares during the 36 months following the date falling 18 months after the initial acquisition date and the call options for the preferred shares during the 24 months following the initial acquisition date. The minimum price of the put and call options is \$49 million for the common shares and \$10 million for the preferred shares, in each case plus 8% per annum starting from the initial acquisition date.

Pursuant to EITF Issue No. 00-4, "Majority Owner's Accounting for a Transaction in the Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in That Subsidiary," our call option agreements for the remaining 47.3% of common shares and 50.0% of preferred shares in TAIF Telecom are accounted for as financing derivatives, as the risks and rewards of the additional ownership are maintained by us for the duration of the derivatives, notwithstanding the legal ownership of the minority interest. We consolidated 100.0% of TAIF Telecom from the initial acquisition date and reflected the call option purchase price of \$49.0 million for the common shares and \$10.0 million for the preferred shares as current portion of long-term debt, as we intend to exercise the call options prior to June 30, 2004. We also recognized interest expense of approximately \$1.0 million related to these options for the six months ended June 30, 2003. We can give no assurance that this transaction will be completed on the terms described or at all.

TAIF Telecom provides mobile services in the GSM 900/1800 standard in the Republic of Tartarstan in the Volga region of Russia with a population of approximately 3.8 million. As of June 30, 2003, mobile penetration in Tartarstan was estimated at 13.3%, according to AC&M-Consulting, and TAIF Telecom had a subscriber base of approximately 237,636 people, or 41.2% of all mobile users in the region, according to AC&M-Consulting.

In addition to our regional expansion within Russia, we have also begun to expand our commercial operations outside of Russia. In particular, in September 2001, we won a tender held by the Telecommunications Ministry of the Belarus Republic for a GSM 900/1800 license to operate in Belarus. Belarus had a population of approximately 10 million and a nationwide mobile penetration rate of approximately 7.4% as of June 30, 2003, according to AC&M-Consulting. Pursuant to the tender conditions:

- we formed a joint venture in Belarus, Mobile TeleSystems LLC, and contributed approximately \$2.5 million for 49% of the share capital of the company, the other 51% of which is held by a state-owned enterprise;
- we paid a lump sum of \$10 million to the government of Belarus;
- the joint venture made a one-time payment of \$5 million (which was funded by a \$5 million loan from us to the joint venture) and will make annual payments of \$60,000 to the government of Belarus for the GSM 900/1800 license that is held by the joint venture; and
- we will pay \$6 million to the government of Belarus in five annual installments of \$1.2 million from 2003 through 2007.

On June 26, 2002, we received all of the governmental approvals and licenses required to commence operations in Belarus. We began operations in Belarus on June 27, 2002. We plan to pay \$6 million to the government of Belarus in annual installments of \$1.2 million from 2003 through 2007, as provided by the tender conditions. See Note 22 to our audited consolidated financial statements for further description of our investments in Mobile TeleSystems LLC.

Under the terms of the tender, the license will be valid for ten years, after which it may be prolonged for two additional five-year periods, as long as the joint venture fulfills the terms of the license. At the time we won the tender, Cellular Digital Network, or Velcom, already held a GSM 900 license to operate in Belarus. Velcom's license was issued in 1998 and is also valid for ten years and

may be renewed for two additional five-year periods. Velcom is a joint venture between two Belarussian state enterprises, Beltelecom and Beltechexport, which jointly own 51%, and SB Telecom, a Cypriot company owning 49%.

Our joint venture plans to spend up to \$75 million in 2003 for network development in Belarus. We initially plan to develop full GSM 900 and 1800 networks in Belarus' major cities, including Minsk and the Minsk region, Gomel, Mogilev and the Brest region, as well as to cover certain major highways, including the Moscow-Brest highway and train route. In addition, we expect to develop our network in certain areas near Belarus' border with Ukraine and Russia.

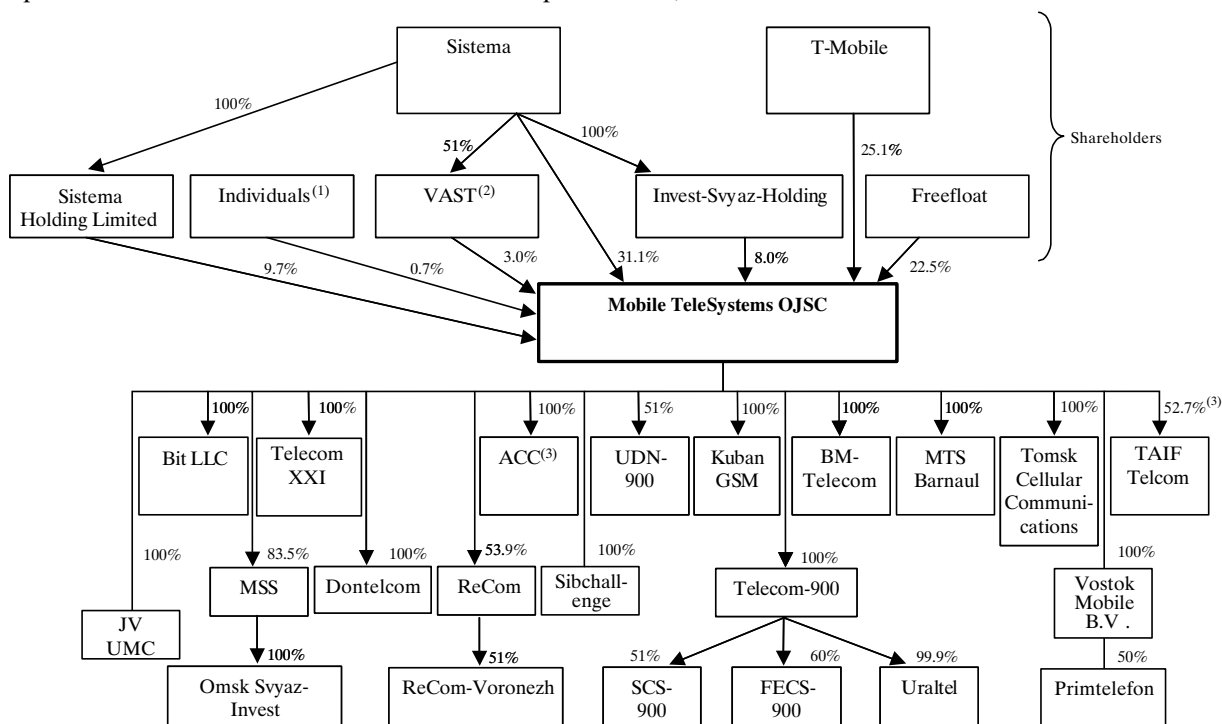
In March 2003, we purchased a 57.7% stake in Ukrainian Mobile Communications, or UMC, for \$194.2 million. We purchased a 16.33% stake from KPN, a 16.33% stake from Deutsche Telekom, and a 25.0% stake from Ukrtelecom. In June 2003, we purchased an additional 26.0% stake in UMC from Ukrtelecom for \$87.6 million pursuant to a call option agreement, which increased our ownership in UMC to 83.7%. We purchased the remaining 16.33% stake in UMC from TDC for \$91.7 million in August 2003 pursuant to a put and call option agreement. As of June 30, 2003, UMC had 2.0 million subscribers and, according to Ukrainian News, a 46% market share in Ukraine.

Prior to our entering into the agreements for the purchase of UMC, UMC did not make payments when due under certain loans from certain of its shareholders. In connection with our agreement to acquire UMC, UMC has agreed to restructure, and we have agreed to guarantee, such indebtedness, which totals \$58.1 million.

Under the participation interest purchase and option agreements, each of UMC's selling shareholders agreed to indemnify us from and against adverse consequences resulting from any breach of the warranties given by such seller in its respective participation purchase or option agreement for a period of two years from the date of our acquisition of a majority stake in UMC in March 2003. In some cases, the indemnification obligations are limited to 50% or 100% of the purchase price paid to the sellers, depending on the nature of the claim.

Ownership Structure

The following chart illustrates our ownership structure and ownership percentages of our operational subsidiaries and affiliates as of September 30, 2003:



(1) Upon completion of our initial public offering on July 6, 2000, selected directors, key advisors and executives of MTS received 3,587,987 shares of our common stock representing 0.18% of our issued and outstanding shares. See “Management—Management Stock Bonus and Stock Option Plans.” The terms of our stock option plan allow our directors and executives, together with management, to receive up to an additional 9,966,631 shares of our common stock, representing 0.5% of our issued and outstanding shares. These 9,966,631 shares, which were issued to Rosico in our initial public offering, were transferred to one of our wholly-owned subsidiaries, MTS CJSC, in connection with our merger with Rosico in June 2003. Please refer to Note 19 to our audited consolidated financial statements.

(2) VAST is a limited partnership formed under the laws of the Russian Federation. Sistema owns a 51% interest in VAST. ASVT OJSC, a Russian telecommunications company, owns the remaining 49% interest in VAST.

(3) Represents legal ownership. As discussed in Note 2 to our unaudited condensed consolidated financial statements, we included 100% of TAIF Telecom in our financial statements.

(4) At an extraordinary general meeting on April 17, 2003, our shareholders passed a resolution approving the merger of our wholly-owned subsidiaries Rosico and ACC into us. We completed the merger of Rosico into us on June 9, 2003 and intend to complete the merger of ACC into us during 2004. For a discussion of these mergers, see “Business—History.”

All of our subsidiaries, with the exception of Mobile TeleSystems LLC, Ukrainian Mobile Communications, Vostok Mobile BV, PTT Telecom Kiev and Mobile TeleSystems Finance S.A., are organized and operate under the laws of the Russian Federation. Our ownership interest and voting power in each subsidiary shown above are identical. Our strategic shareholder T-Mobile is a telecommunications company with significant telecommunication assets and experience, and our strategic shareholder Sistema is a Russian financial industrial group.

Current Operations

License Areas

The following table shows, as of September 1, 2003, information with respect to the license areas in which we provide or expect to provide GSM services:

License Region	GSM 900		GSM 1800	
	Licensee	Expiry date	Licensee	Expiry date
Moscow License Area				
Moscow	MTS OJSC	December 1, 2004	MTS OJSC	April 28, 2008
Moscow region	MTS OJSC	December 1, 2004	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
Regional License Areas				
European Russia				
Adygeya Republic	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	ReCom	May 15, 2008	MTS OJSC	April 28, 2008
Bryansk	ReCom	May 15, 2008	MTS OJSC	April 28, 2008
Ivanovo	—	—	MTS OJSC	April 28, 2008
Kaliningrad	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Kalmykia Republic ⁽¹⁾	Bit LLC	January 25, 2011	—	—
Kaluga	MTS OJSC	October 1, 2006	MTS OJSC	April 28, 2008
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	—	—	MTS OJSC	April 28, 2008
Kostroma	MTS OJSC	August 22, 2007	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	ReCom	May 15, 2008	MTS OJSC	April 28, 2008
Murmansk	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Nenetsk	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	ReCom	May 15, 2008	MTS OJSC	April 28, 2008
Orenburg	—	—	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	October 1, 2006	MTS OJSC	April 28, 2008
Samara region ⁽¹⁾	MTS OJSC	December 30, 2012	MTS OJSC	December 30, 2012
Saratov	MTS OJSC	July 11, 2012	—	—
Smolensk	MTS OJSC	October 1, 2006	MTS OJSC	April 28, 2008
Tambov	—	—	MTS OJSC	April 28, 2008
Tartarstan Republic	TAIF Telcom	April 4, 2007	TAIF Telcom	April 28, 2008
Tula	MTS OJSC	October 1, 2006	MTS OJSC	April 28, 2008
Tver	MTS OJSC	April 4, 2007	MTS OJSC	April 28, 2008
Udmurt Republic	UDN-900	February 21, 2007	MTS OJSC	April 28, 2008
Vladimir	MTS OJSC	October 1, 2006	MTS OJSC	April 28, 2008

License Region	GSM 900		GSM 1800	
	Licensee	Expiry date	Licensee	Expiry date
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
Asian Russia				
Aginski-Buryatski Autonomous District ⁽¹⁾	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Altai region	MTS-Barnaul	September 8, 2010	—	—
Altai Republic	SCS-900	July 19, 2011	—	—
Amursk	ACC	January 10, 2007	—	—
Amur region	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Buryatiya Republic ⁽¹⁾	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Chelyabinsk	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Chita region ⁽¹⁾	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Chukotka ⁽¹⁾	Bit LLC	July 19, 2011	—	—
Chukotski Autonomous District	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Jewish Autonomous District ⁽¹⁾ .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Irkutsk region ⁽¹⁾	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Khabarovsk	FECS-900	January 10, 2007	FECS-900	January 10, 2007
Khabarovsk Territory	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Khakassiya Republic	—	—	Sibchallenge	September 13, 2011
Kamchatka region ⁽¹⁾	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Koryakski Autonomous District ⁽¹⁾	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Krasnoyarsk Territory	Sibchallenge	December 21, 2010	Sibchallenge	September 13, 2011
Kurgan	—	—	MTS OJSC	April 28, 2008
Khanty-Mansyisk	—	—	MTS OJSC	April 28, 2008
Magadan region ⁽¹⁾	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Novosibirsk	SCS-900	February 21, 2007	SCS-900	February 21, 2007
Omsk	MSS	December 20, 2006	—	—
Primorsky Territory	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Sakhalin ⁽¹⁾	Bit LLC	July 19, 2011	—	—
Sakhalin region	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Sverdlovsk region	Uraltel	March 1, 2006	Uraltel	March 1, 2006
Sverdlovsk region	—	—	MTS OJSC	April 28, 2008
Taimyr Autonomous District . .	Sibchallenge	December 21, 2010	Sibchallenge	September 13, 2011
Tomsk region	TCC	June 5, 2008	TCC	June 5, 2008
Tyumen	—	—	MTS OJSC	April 28, 2008
Tuva Republic ⁽¹⁾	Bit LLC	July 19, 2011	—	—
Ust-Ordynski Autonomous District ⁽¹⁾	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Yakutiya Republic	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Yamalo-Nenetsk ⁽¹⁾	—	—	MTS OJSC	April 28, 2008
Ukraine				
Ukraine	UMC	December 3, 2013	UMC	December 3, 2013

⁽¹⁾ Our regional license areas in which the licensee has not commenced commercial operations.

Each of our licenses, except the licenses covering the Moscow license area, contains a requirement that service be commenced and that subscriber-number and territorial-coverage targets be achieved by a specified date. We have met these targets or received extensions to these dates in those regional license areas in which we have not commenced operations. Neither the Ministry of Communications nor other parties have taken or attempted to take legal actions to suspend, revoke or challenge the

legality of any of our licenses. We have not received any notice of violation of any of our licenses, and we believe that we are in compliance with all material terms of our licenses.

Services Offered

Network Access

We primarily offer mobile cellular voice, data and facsimile communication services to our subscribers on the basis of various tariff plans. In general, subscribers pay a monthly subscription fee and a per-minute charge for usage. However, we also offer tariff plans that do not require subscribers to pay a monthly subscription fee.

Automatic Roaming

Roaming allows our customers, both subscribers and guest roamers, to receive and make international, local and long-distance calls while traveling outside of their home network. Roaming is provided through individual agreements between us and other GSM operators. Unlike many non-GSM providers that require additional equipment or prior notification, our roaming service is instantaneous, automatic and requires no additional equipment.

As of June 30, 2003, we had bilateral roaming contracts with 266 GSM service providers in approximately 116 countries, including with regional operators in Russia. We continually seek to expand our roaming capability and are currently in negotiations with additional operators. In Russia, as of June 30, 2003, in addition to our network coverage area in 49 regions of Russia, GSM service is available to our subscribers in several regions of Russia where we do not currently operate through our roaming agreements with approximately 14 regional operators.

Roaming agreements regulate the relations and billing procedures between operators. The host operator sends the roamer's home operator a bill for the roaming services provided to the roamer. The roamer's home operator pays the host operator directly for the roaming services and then includes the amount due for the provision of roaming services in the roaming subscriber's monthly bill.

Value-Added Services

We offer the following value-added services to our customers in Moscow and in a number of the regions. These services may be included in the tariff plan selected by the subscriber or subscribers may pay additional monthly charges and, in some cases, usage charges for them:

- Call Divert/Forwarding;
- Call Barring;
- Caller ID Display;
- Call Waiting;
- Itemization of Monthly Bills;
- Voicemail;
- Information and Directory Service;
- International Access Service;
- Automatic Customer Care System;
- Customer Care System through the Internet;
- Short Message Service (SMS);

- General Packet Radio Service (GPRS);
- Wireless Application Protocol (WAP); and
- SIM-browser.

Other Services

In addition to cellular communication services, we offer corporate clients a number of telecommunication services such as design, construction and installation of local voice and data networks capable of interconnecting with fixed line operators, installation and maintenance of cellular payphones, lease of digital communication channels, access to open computer databases and data networks, including the Internet, and provision of fixed, local and long-distance telecommunication services, as well as video conferencing.

Sales and Marketing

Target Customers

Our target customers historically have included companies, professionals, high-income individuals, reporters, government organizations, businesspersons and diplomats. However, following the economic crisis in August 1998, we launched lower tariffs and widened our cellular services market, aggressively targeting new customer segments, such as family members of existing subscribers, students, retirees and other mass market customers. We also offer reduced tariffs and lower payments for certain value-added services. Although these newer customer segments have lower average monthly usage than our traditional customer base, they have begun to represent the bulk of new demand for cellular services. We believe that we will be able to provide the network capacity and expand our coverage area to serve these new customer segments.

Advertising and Marketing

Our advertising consists of:

- brand and image advertising and public relations to position us as a leading cellular operator in Russia;
- information advertising to inform potential customers of the advantages of GSM technology, the high quality and variety of our services and the extensive coverage we offer; and
- product- and tariff-related advertising to inform customers of specific promotions, new tariffs and pricing discounts.

We use a combination of newspaper, magazine, radio, television and outdoor advertising, including billboards and signs on buses and kiosks, and exhibitions to build brand awareness and stimulate demand. Our indirect advertising includes sponsorship of high-profile television programs, sporting events, concerts and other popular events. We combine our advertising campaigns with those of telecommunication equipment manufacturers such as Sony Ericsson, Siemens, Nokia and Panasonic. We are also coordinating the advertising policies of our dealers to capitalize on the increased volume of joint advertising and preserve the integrity and high-quality image of the MTS brand. As we expand our network, we intend to concentrate a greater part of our advertising and marketing effort on positioning us as a national brand. We plan to focus our advertising and marketing on the affordability and variety of our tariff plans, on the broad coverage of our network and the use and availability of national roaming.

Sales and Distribution

As of June 30, 2003, our distribution network in the Moscow license area consisted of 27 integrated sales and customer service centers and over 4,500 independent dealer distribution outlets. We had 200 sales and customer service centers in Russia, 32 in Ukraine and three in Belarus. In response to the demand shift to mass market subscribers, we have adjusted our distribution strategy and begun to open new dealer outlets in places of high consumer activity, such as supermarkets and malls.

In certain of our regional license areas, we intend to form joint ventures or enter into other cooperative arrangements, when prudent, to perform such tasks as marketing and sales and collection of subscriber payments. We expect that these joint ventures will have agreements with sub-dealers to better service the local markets. We also have formed three affiliates in which we have 26% stakes: MTS-RK in the Komi Republic, MTS-T in the Tver region and MTS-K in the Kostroma region. We have also formed a subsidiary in Nizhny Novgorod, MTS-NN, of which we own 65%, and acquired 51% of Novitel in Moscow. We have, consistent with our policy of ensuring MTS brand integrity, retained ownership of the local network elements, as well as responsibility for their construction, operation and maintenance. These joint ventures also collect subscriber payments, which they remit in full to us.

Some of our dealers purchase handsets directly from us and then sell them to the subscribers that they enroll. Whether a new subscriber connects to our network with equipment purchased from a dealer or directly from us, in most of the regions, we do not charge a connection fee. Under our current policy, dealers receive a commission per subscriber connected based on their monthly sales volume. The commission in Moscow license area, between \$27 and \$120 per subscriber as of September 1, increases with the number of new subscribers a dealer signs. As of September 1, 2003, the commission in St. Petersburg was between \$20 and \$55. Dealer commissions in the other regional license areas in Russia were between \$3.50 and \$23. Dealers generally receive a higher commission of approximately \$120 for enrolling subscribers in our “VIP” tariff plan.

We limit our credit exposure to dealers by controlling the cash flow from customers. If a new customer pays in cash, the dealer remits the full amount received to us within three days, and we then pay the commission to the dealer by the end of the month. If the customer chooses to pay by bank transfer or by credit card, the customer pays us directly, and we pay the dealer its commission after the end of the month.

After a dealer activates a subscriber’s contract, if such subscriber’s usage of our voice and non-voice services over the following six-month period amounts to less than the amount of the dealer’s commission, the dealer must reimburse the difference to us. We believe that this gives dealers an incentive to seek high-quality subscribers so as to avoid any loss of commission.

As of June 30, 2003, approximately 78% of our new subscribers enrolled through independent dealers, and we enrolled the remainder directly. We intend to continue expanding our internal distribution network, as well as our independent dealer distribution network. Independent dealers have also begun servicing some aspects of our subscribers’ accounts, such as the switching on and off of additional services and payment collection.

As the geographic range of our network expands, we expect to increase the number of distribution points, primarily through increasing the number of dealers under contract with us and creating joint ventures with local partners to act as our dealers.

Competition

We compete with at least one other mobile cellular operator in each of our markets. 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.

The following table illustrates the number of mobile cellular subscribers for each network operator in the Moscow license area at the year-end of 1998, 1999, 2000, 2001, 2002 and for the first six months of 2002 and 2003:

	Year Ended December 31,					Six Months Ended June 30,	
	1998	1999	2000	2001	2002	2002	2003
	(in thousands)						
MTS (GSM) ⁽¹⁾	112	298	1,106	2,035	3,082	2,351	4,140
VimpelCom (GSM, D-AMPS) ⁽²⁾⁽³⁾	124	351	780	1,911	3,743	2,845	4,437
Sonic Duo (part of the MegaFon group) (GSM) ⁽³⁾	0	0	0	26	313	440	440
MCC (NMT) ⁽¹⁾⁽³⁾	90	92	94	72	58	67	56
Sonet (CDMA) ⁽¹⁾⁽³⁾	2	12	15	56	75	66	85
Total	<u>328</u>	<u>753</u>	<u>1,995</u>	<u>4,100</u>	<u>7,271</u>	<u>5,769</u>	<u>9,158</u>

⁽¹⁾ Source: MTS data.

⁽²⁾ Source: VimpelCom press releases, dated March 26, 1999; April 14, 2000; April 26, 2001; August 27, 2002.

⁽³⁾ Source: AC&M-Consulting, J'Son & Partners.

VimpelCom

VimpelCom, which operates both D-AMPS and dual-band GSM networks, is one of our principal competitors in the Moscow license area and in several regions outside Moscow and the Moscow region.

In the Moscow license area, we believe that VimpelCom will continue to be our primary competitor for the foreseeable future. VimpelCom reported approximately 7.5 million subscribers at June 30, 2003, including 4.4 million in the Moscow license area. At June 30, 2003, according to AC&M-Consulting, VimpelCom had a 48.9% market share in Moscow, while we accounted for 45.6%. 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. At June 30, 2003, according to AC&M-Consulting, VimpelCom had a 29.6% market share of total wireless subscribers in Russia, while we accounted for 37.1%.

VimpelCom operators also compete with us in many regions outside of Moscow and the Moscow region, including in the North Caucasus region, Siberia and Central Russia. In addition, in 2002 and 2003 VimpelCom was awarded licenses to operate a GSM 900/1800 network for the North-West region, which includes St. Petersburg, and launched its network there in April 2003. According to press reports, VimpelCom invested \$50 million in connection with the roll out of its network in the North-West region. We expect that VimpelCom will compete with us in St. Petersburg, and that its entry into the North-West region generally will lead to an increase in competition in that area and may lead us to invest additional amounts in our operations in the region.

Since 1998, VimpelCom has been developing its dual-band GSM network, which offers its GSM subscribers international roaming capability comparable to ours. For a description of the risks we face from increasing competition, see “Risk Factors—Risks Relating to Our Industry—We face increasing competition from existing licensees that may result in reduced operating margins, loss of market share and diminished value in our services, as well as lead us to make different pricing, service or marketing decisions.”

MegaFon

In addition to VimpelCom, we also compete with MegaFon in Moscow, St. Petersburg and in several other regions.

The MegaFon group has a GSM 900/1800 license for the Moscow license area where its predecessor, Sonic Duo, launched commercial operations in November 2001. According to AC&M-Consulting, MegaFon had 440,290 subscribers in the Moscow license area as of June 30, 2003. MegaFon is our primary competitor in the North-West region, where St. Petersburg is located, and it was the first company to provide GSM services in that region. As of June 30, 2003, according to AC&M-Consulting, MegaFon had a 55% market share in the North-West region while we accounted for 35%.

According to AC&M-Consulting, MegaFon had a combined subscriber base of 4.3 million as of June 30, 2003, and has licenses to operate in all 89 regions of the Russian Federation. MegaFon has instituted a unified intra-network roaming tariff, and is expected to introduce unified tariffs in each of the regions in which it operates. For a description of the risks we may face in connection with the development and growth of MegaFon, see “Risk Factors—Risks Relating to Our Industry—The creation of MegaFon through the merger of Sonic Duo, North-West GSM and several other regional operators resulted in a new competitor that may receive preferential treatment from the federal government and benefit from the resources of its shareholders, potentially giving it a substantial competitive advantage over us.”

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 us, see “Risk Factors—Risks Relating to Our Industry—A merger between our two largest competitors would constrain our ability to effectively compete in the Russian mobile communications market and negatively impact our results of operations.”

Local Operators

In addition to our principal competitors, VimpelCom and MegaFon, which do not operate in all of the regions in which we operate, we compete with local operators using a variety of standards.

In the Moscow license area, we compete with MCC, which operates an analog network based on the NMT standard. MGTS, which is a subsidiary of Sistema, owns a minority stake in MCC, which commenced operations in December 1991. According to AC&M-Consulting, at June 30, 2003, MCC had approximately 56,000 subscribers in the Moscow license area. MCC has elected to pursue a license to operate a third-generation network based on the CDMA 2000 standard, which would operate on the same frequencies as the current network operated by MCC. In March 2000, the Ministry of Communication issued an approval to MCC to construct a trial network using the CDMA 400 standard. In addition, MCC, together with the Ministry of Communications and a Russian telecommunications company, Interregional Transit Telecom, established a unified NMT roaming network in Russia under the commercial name “Sotel,” allowing automatic roaming in certain regions of Russia using the NMT standard. As of June 30, 2003, NMT roaming was available in most regions of Russia, as well as in countries of the former Soviet Union.

In addition, we may face future competition from JSC Personal Communications, a CDMA network operator in the Moscow license area which began operations under the brand name “Sonet” in August 1998. JSC Personal Communications is a subsidiary of MTU-Inform, which is indirectly controlled by Sistema. Sonet’s license was recently extended by the Ministry of Communications until the end of 2004 with an obligation to reach a minimum of 100,000 subscribers. CDMA licenses in other regions have been issued primarily to the regional public switched telephone network operators, which are subsidiaries of Svyazinvest.

In St. Petersburg, we compete with regional operators Fora Communications, operating on the D-AMPS standard, and Delta Telecom, operating on the NMT-450i standard. In Nizhny Novgorod, our primary competitor is Nizhny Novgorod Cellular Communications, which had approximately 248,025

subscribers as of June 30, 2003. In Ekaterinburg, we compete with Ekaterinburg Cellular Communications, a D-AMPS operator with over 143,500 subscribers as of June 30, 2003. In Ukraine, we compete primarily with Kyivstar, a GSM operator with over 2.2 million subscribers as of June 30, 2003. In Tartarsan, we compete primarily with Tatinkom, a D-AMPS operator with over 121,931 subscribers as of June 30, 2003. In the Samara region, where in March 2003 we received a license to provide mobile cellular services but do not currently operate, we expect to compete with SMARTS, a GSM operator with 227,500 subscribers as of June 30, 2003. The preceding subscriber numbers, in each case, are according to AC&M-Consulting.

Tariffs

We customize our marketing efforts and pricing policies in each region in consideration of such factors as the average income levels, competitive environment and subscriber needs in a particular region, all of which vary from region to region. Consistent with our marketing strategy, we have developed new tariff plans to appeal to a broader market.

All of our tariff plans combine different monthly network access fees (with the exceptions of the “Jeans” tariff plans discussed below), per minute usage charges and value-added services in packages designed to appeal to different market segments.

In February 2003, we launched a new unified system of tariff plans across our nationwide network in Russia. The new tariff plans are divided into four categories—“MTS Corporation,” “MTS Optima,” “MTS Business” and “MTS VIP”—with each category designed to target a specific group of subscribers as follows:

- **MTS Corporation:** MTS Corporation tariff plans are available to corporate clients nationwide. They feature substantial discounts on calls within the contract group, international roaming and voice traffic depending on the quantity of calls, as well as a variety of free value-added services.
- **MTS VIP:** MTS VIP tariff plans are geared toward heavy users who spend over \$100 per month on mobile communications.
- **MTS Business:** MTS Business tariff plans are designed for active users who spend \$40 or more per month on mobile communications.
- **MTS Optima:** MTS Optima tariff plans are designed for mass-market users who spend up to \$40 per month on mobile communications.

While categories of tariff plans offered in the regions generally match the categories of tariff plans offered in the Moscow license area, the prices of these plans will continue to differ from region to region and are expected to generally remain higher in the Moscow license area. Our intent in introducing a unified system of tariff plans is to achieve such benefits as tariff plan transparency for prospective subscribers throughout Russia, as well as savings on our advertising expenses through unified advertising campaigns in Moscow and the regions.

We set prices with reference to the market and believe that our pricing is competitive vis-à-vis other providers of mobile communications services. While we have traditionally designed our tariff plans to appeal to high- and medium-usage subscribers, we have also begun to target the mass-market subscriber segment with a new, prepaid tariff plan launched in November 2002. We market this new tariff under the distinct brand name “Jeans” rather than “MTS” in order to maintain our core image as a premium mobile services provider. We expect that, as the mass market is penetrated and subscriber numbers increase, competition will place downward pressure on the prices we charge for our services.

Our tariff plans offer a variety of pricing schemes. The following description of tariffs and charges are, in each case, exclusive of VAT and sales tax. As of June 30, 2003, the per-minute tariff for calls to Moscow from Moscow varied from \$0.06 per minute to \$0.18 per minute during peak periods and from

\$0.06 per minute to \$0.18 per minute during off-peak periods, with some plans offering discounted rates at night, sometimes as low as \$0.04 per minute. The Jeans tariffs varied from \$0.01 per minute to \$0.34 per minute in Moscow. The per minute prices in the regions outside of the Moscow license area ranged from \$0.01 per minute to \$0.27 per minute during peak periods, and from \$0.01 per minute to \$0.11 per minute during off-peak periods, with some plans offering discounted rates at night, sometimes as low as \$0.01 per minute; in St. Petersburg tariffs varied from \$0.035 per minute to \$0.17 per minute. The Jeans tariffs varied from \$0.01 per minute to \$0.32 per minute in the regions outside of Moscow. Higher rates apply to domestic long distance calls and we assessed a surcharge for all international calls that ranged from \$1.11 per minute for calls to Europe to \$2.31 per minute for calls to Africa. Our value-added services, such as Caller ID and Call Waiting, are sometimes included in the plan at no additional charge and sometimes carry a charge between \$1.00 and \$3.00 per month, depending on the plan. We also offer special tariffs for intranet calls that are considerably lower than normal roaming tariffs.

As of June 30, 2003, the per minute prices in Ukraine varied from \$0.15 per minute to \$0.47 per minute during peak periods and from \$0.05 per minute to \$0.15 per minute during off-peak and night periods. Certain UMC plans also had special tariffs for intranet calls that ranged from \$0.04 per minute to \$0.10 per minute. Higher rates applied to international calls ranging from \$0.37 per minute to \$2.29 per minute.

In addition, in the Moscow license area, calls from one cellular telephone to another within the same network connected to the same mobile switching center are charged at no cost to the subscriber receiving the call, and at a discount of 20% to 50% to the subscriber placing the call. Similar discounts are also available to subscribers in other regions. In comparison, some of our competitors do not charge their subscribers for specific categories of incoming calls under certain of their tariff plans.

We launched a set of tariff plans geared at mass-market subscribers, which we market under the “Jeans” brand, on November 15, 2002 in Moscow and in 37 other regions in Russia. “Jeans” tariffs were launched in Ukraine in August 2003. The “Jeans” brand is comprised of a set of prepaid tariffs that generally include features such as no monthly subscription fee, per-second billing, free incoming calls from MTS subscribers and, for certain tariff plans, advance payment credit expiration dates. In December 2002, we introduced a promotion whereby our “Jeans” tariff subscribers in the Moscow license area will receive all incoming calls free of charge from other MTS subscribers and VimpelCom subscribers through December 31, 2003. For the “Jeans” tariff only, we define “subscriber” as an individual or organization whose account does not have a negative balance for more than one hundred and eighty-three days, in contrast to sixty-one days for our other tariff plans.

Customer Payments and Billing

Before 1997, subscribers were enrolled in a credit payment system under which they were billed monthly for their access, usage and value-added service fees. Since November 1997, we have enrolled new subscribers, except for certain corporate clients, in an advance payment program under which the customer prepay a specific amount to cover these fees.

We believe that customer acceptance of the advance-payment option is due to the high degree of automation of our customer care and billing system, which telephonically transmits reminders to add funds before service is discontinued, helping subscribers to monitor and control their mobile telephone expenses. Our advance payment system monitors each subscriber account and sends a ten-day advance warning on the customer’s mobile telephone when the advance payment amount decreases below a certain threshold, which is approximately the average consumption by the subscriber for a ten-day period. Then the system sends a daily telephonic reminder or SMS of the decreasing account balance, including the current level of the subscriber’s remaining deposit and a recommendation as to the sum that should be advanced to us based on the subscriber’s historical usage.

Under the credit payment system, customers are billed monthly in arrears for their network access and usage. If the invoice is not paid within 25 days, the customer may face an up to \$20 late payment charge. We limit the amount of credit extended to customers based on the customer's payment history, type of account and past usage. As of June 30, 2003, subscribers using the credit system of payment had a maximum credit limit of \$1,000. When the limit is reached, the subscriber receives an invoice, which must be paid within five days. If the subscriber fails to do so, we block the telephone until the invoice is settled. We actively manage our subscriber base to migrate existing credit payment customers over to the advance-payment system. However, existing credit payment customers may continue on their old tariff plan as long as their accounts remain in good standing. As of June 30, 2003, approximately 3.0% of our customers used the credit system, while 97.0% used the advance-payment system.

We upgraded our billing system in October 2001. Prior to this upgrade, we had experienced some negative reaction from subscribers in the Moscow license area due to the sometimes substantial time gap between the time of use and the date on which the use was actually charged to the subscriber. This time gap problem intensified as our subscriber base increased. In order to remedy this problem, we upgraded our billing system software to decrease the delay between usage and billing for subscribers in the Moscow license area. As a result of this upgrade, the time gap between usage and billing has rarely exceeded two hours, making it easier for our subscribers to keep track of their balance. However, during the first quarter of 2003, certain dealers and subscribers together fraudulently exploited these billing time lags by placing a sizable amount of long distance calls using subscriber accounts registered under false names. See "Risk Factors—Risks Relating to Our Business—Our failure to implement the necessary infrastructure to manage our growth could have a material negative effect on our profits and results of operations" for further description of this fraud.

Our tariffs are quoted in currency units equivalent to U.S. dollars. Invoices specify the amount owed in U.S. dollar-equivalent units and require translation into rubles in order to make payments. We offer our subscribers various ways to pay for our services, including by cash or credit card, wire transfer, on account, prepaid cards and express-payment cards. Customer Service We believe that to attract and retain customers, we must provide a high level of service in the key areas of customer assistance, care and billing. In most of the regions in which we operate, we have a call center that provides customer service 24 hours a day, seven days a week. Customer service representatives answer inquiries regarding disconnection due to lack of payment, handset operation, roaming capabilities, service coverage and billing. A special group of customer service representatives handles customer claims and assists customers who wish to change their services. In addition, customer service staff follow up with customers who have discontinued service to determine the reasons for disconnection and to help us improve our services or tariff plans to accommodate subscriber needs. We also have customer service and financial control department representatives at our walk-in centers located in several of the regions where we operate to assist customers and address their questions.

Our customers are able to automatically access their account balance information, activate certain value-added features and receive information regarding us and our services by calling, at no charge to the customer, our Automatic Customer Care System at "0880" or "767-0880." In December 1999, we also introduced a new, Internet-based service, "Customer Care System Through the Internet." This service allows subscribers to access their accounts via our Internet site and carry out, on-line, all major account activities such as payments by credit cards, viewing and delivery of itemized statements by fax or via e-mail and changes in the selection of value-added services.

Network Technology

We believe that geographic coverage, capacity and reliability of the network are key competitive factors in the sale of mobile cellular telecommunication services. Our network is based primarily on GSM 900 infrastructure, augmented by GSM 1800 equipment. We use GSM 1800 equipment in

high-use areas, because 1800 MHz base stations are more efficient in relieving capacity constraints in high traffic areas. Although there is no difference in quality between GSM 900 and GSM 1800 services, the higher-frequency 1800 MHz signals do not propagate as far as 900 MHz signals. As a result, more 1800 MHz base stations are typically required to achieve the same geographic coverage. Accordingly, in regions where geographic coverage, rather than capacity, is a limiting factor, networks based on GSM 900 infrastructure are typically superior to those based on GSM 1800, because they require fewer base stations to achieve coverage and, therefore, cost less. In most markets, including in Russia, the most efficient application of GSM technology is to combine GSM 900 and GSM 1800 infrastructure in a unified network, which is commonly referred to as a dual-band GSM network.

Network Infrastructure

We use switching and other network equipment supplied by Motorola, Siemens, Ericsson and other major network equipment manufacturers. The radio frequencies allocated to us for the operation of GSM 900 span 11.4 MHz of spectrum in the city of Moscow and 10.2 MHz of spectrum in the Moscow region. The frequencies allocated to us in the city of Moscow include 1.2 MHz of limited capacity spectrum with restricted emanation that we may only use in the Moscow underground or in a microcell to enhance coverage and capacity within buildings. During 2001, we returned 3.2 MHz of limited capacity spectrum with restricted emanation to the Ministry of Communications to allow research into the joint use of frequency spectrum by cellular operators. In addition, we have frequencies spanning 24.6 MHz of spectrum in the Moscow license area for operation of GSM 1800 base stations. We believe that these allocations in the Moscow license area are adequate and that we have also been allocated adequate spectrum in our regional license areas.

The radio frequencies allocated to us for the operation of GSM 900 span 8 MHz of spectrum in the city of St. Petersburg. We also have frequencies spanning 18.2 MHz of spectrum in the St. Petersburg license area for operation of GSM 1800 base stations.

In September 2000, we began installing GPRS equipment in the Moscow license area, and we currently have enough GPRS software to support a majority of our base stations in the Moscow license area. In May 2003, we launched GPRS in the Moscow license area as a value-added service. We have also installed GPRS technology in several of our regional license areas, and we currently offer GPRS in test mode free of charge to our subscribers in those regions. We intend to examine its commercial viability as a pay service in those regions in the future.

Property and Equipment

We occupy premises in Moscow at 4 Marksistskaya Street and 10 Teterinsky Pereulok, which we use for administration as well as operation of mobile switching centers. The rights to use the premises were contributed to our charter capital by a founding shareholder.

We also own nine buildings in Moscow for use by our sales and customer service departments, as well as our billing, financial control and technical services departments. We also lease 18 buildings in Moscow for similar purposes, including marketing and sales and other service centers. We intend to build new technical and administrative offices over the course of the next two years. We also own office buildings in some of our regional license areas, including Barnaul, Vladimir, Ivanovo, Izevsk, Kostroma, Kurgan, Perm, Pskov, Ryazan, St. Petersburg, Syktyvkar, Smolensk, Tambov, Kaluga, Tula, Chelyabinsk and Kirov, and we own three office buildings in Belarus. In addition, we lease office space on an as-needed basis. We plan to acquire additional buildings in Moscow, St. Petersburg, and in some of the other Russian regions where we operate, as well as in Ukraine and Belarus.

The primary elements of our network are base stations, base station controllers, transcoders and mobile switching centers. GSM technology is based on an "open architecture," which means that equipment from one supplier can be combined with that of another supplier to expand the network.

Thus, there are no technical limitations to using equipment from other suppliers. Several major suppliers currently offer GSM 900/1800 mobile cellular equipment and the market for suppliers is competitive.

Of the 7,352 base stations comprising our network as of June 30, 2003, 5,131 operated in the 900 MHz band and 2,221 operated in the 1800 MHz band. We also operated 127 base station controllers and approximately 70 switches as of June 30, 2003.

We do not lease a significant amount of property or equipment, except in Ukraine, where most of our property is leased. In addition, certain of our subsidiaries entered into lease agreements for network equipment and a billing system with our shareholder, Invest-Svyaz-Holding. See “Certain Transactions with Related Parties.”

Third-Generation Technology

Third-generation networks, using UMTS technology, will allow subscribers to send video images and access the Internet using their handsets at transmission speeds of up to 2,000 Kb per second. We currently operate one of four experimental third-generation networks existing in the Russian Federation utilizing rented network equipment. The 3G Association, an industry group charged with advising the Ministry of Communications of the Russian Federation on the procedure for allocating third-generation licenses and regulating third-generation operations, has proposed that we, VimpelCom and MegaFon each be issued a third-generation license, and that a fourth license be issued to a fourth operator. Though the Ministry of Communications 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. We estimate that the initial buildout of our third-generation network in the Moscow license area will require an investment of \$60 million to \$100 million.

Base Station Site Procurement and Maintenance

The process of obtaining appropriate sites requires that our personnel coordinate, among other things, site-specific requirements for engineering and design, leasing of the required space, obtaining all necessary governmental permits, construction of the facility and equipment installation. We use site development software supplied by Lucent Technologies to assess new sites so that the network design and site development are coordinated. Our own software can create digital cellular coverage maps of our license areas, taking into account the peculiarities of the urban landscape, including the reflection of radio waves from buildings and moving automobiles. Used together, these software tools enable us to plan base station sites without the need for numerous field trips and on-site testing, saving us considerable time and money in our network buildout.

Base station site contracts are essentially cooperation agreements that allow us to use space for our base stations and other network equipment. The terms of these agreements range from one to 49 years, with the term of a majority of agreements being three to five years. Under these agreements, we have the right to use premises located in attics or on top floors of buildings for base stations and space on roofs for antennas. We pay the lessor in cash or with telephones that provide a specified amount of free usage or a combination of both, which is accounted for on the basis of standard rates. In areas where a suitable base station site is unavailable, we construct towers to accommodate base station antennae. We anticipate that we will be able to continue to use our existing GSM 900 base station sites and to co-locate GSM 1800 base stations at some of the same sites.

To provide quality service to subscribers, our maintenance department, staffed 24 hours per day, performs daily network integrity checks and responds to reported problems. Our technicians inspect base stations and carry out preventative maintenance at least once every six months.

Interconnect Arrangements and Telephone Numbering Capacity

Cellular operators must interconnect with local, inter-city and international telephony operators to obtain access to their networks and, via these operators, to the networks of other operators around the world. We have local interconnection agreements, including agreements for the provision of telephone numbering capacity, with several telecommunications operators in Moscow and in the other regions, including the public switched telephone network operator in the city of Moscow, MGTS, as well as MTU-Inform, majority owned by MGTS, and Telmos, a joint venture of MGTS with Sistema and Rostelecom. See “Certain Transactions with Related Parties” for additional information regarding these operators. For use of 11-digit telephone numbering capacity and the associated interconnection, we have agreements with Rostelecom. Local interconnection typically entails payment of a one-time connection fee, a monthly fee per subscriber connected and a usage charge based on minutes of traffic, or some combination thereof.

To provide our subscribers with domestic long-distance services, we have interconnection agreements with Rostelecom and Interregional Transit Telecom and, to provide international services, with Rostelecom and Sovintel, a joint venture of Rostelecom and Golden Telecom, Inc. MTU-Inform and Telmos also provide domestic long-distance and international services through interconnection with the Rostelecom network. Most interconnection fees are based on usage by minute and vary depending on the destination called.

Russian legislation requires that public switched telephone networks may not refuse to provide interconnection or discriminate against one operator in comparison to another; in practice, however, it has been our experience that some regional network operators do discriminate among mobile operators by offering different interconnection rates to different mobile operators. See “Risk Factors—Risks Relating to Our Business—If we cannot interconnect cost-effectively with other telecommunications operators, we may be unable to provide services at competitive prices and therefore lose market share and revenues.” Certain interconnection fees are subject to government regulation, such as those set by Rostelecom.

A combination of regulatory, technological and financial factors has led to the limited availability of local telephone numbering capacity in Moscow and the Moscow region. Moscow’s “095” code and the Moscow region’s “096” code have already reached numbering capacity limits, and additional codes are expected to be introduced in 2003. See “Risk Factors—Risks Relating to Our Industry—The public switched telephone networks have reached capacity limits and need modernization, which may inconvenience our subscribers and will require us to make additional capital expenditures.” To meet subscriber demand and provide for an adequate inventory of numbering capacity, we have purchased numbering capacity from various vendors for cash. Our right to use this numbering capacity ranges from five years to an unlimited period of time. As of June 30, 2003, we had numbering capacity for over 4.5 million subscribers in the Moscow license area. For a description of how we amortize the acquisition costs of numbering capacity, see Note 3 to our audited consolidated financial statements.

To foster the growth of telecommunications in Russia and to increase the telephone numbers available to GSM operators in Russia, the Russian government has devised a plan to link all GSM operators in Russia by means of a national network. As envisioned, this network would be based around eight hubs to be linked together through fiber-optic cable connections. In accordance with a Ministry of Communications decree, we were appointed a coordinating operator in the Central region of Russia. We expect that we and other GSM operators in Russia will, if and when this national network is implemented, be able to decrease reliance on current interconnection arrangements.

Network Monitoring Equipment

Through our operation and maintenance center in Moscow, we control and monitor the performance of our network and our call completion rate. We use our monitoring systems to optimize our network and to locate and identify the cause of failures or problems, and also to analyze our

network performance and obtain network statistics. We have agreements with our suppliers for technical support services that allow us to obtain their assistance in trouble shooting and correcting problems with our network within the warranty period.

Handsets

To receive service from us, subscribers must have a handset that can be used on our network. New subscribers who do not own a GSM handset must buy one, either directly from us or from an independent dealer. We and our dealers also offer an array of mobile telephone accessories, with the average new subscriber spending between \$29 to \$49 on such accessories in addition to the cost of the handset.

Since July 1998, we have offered subscribers dual-band GSM 900/GSM 1800 handsets. These dual-band handsets are currently in widespread use on networks in Western Europe and, because they send and receive communications on both GSM 900 and GSM 1800 frequencies, they can relieve possible congestion on our network and increase the ability of our customers to roam. The share of dual-band handsets has increased from approximately 1% of our total handset sales in 1998 to approximately 100% in 2002. We also offer our subscribers tri-band handsets. These handsets, which function in the GSM 900, GSM 1800 and PCS-1900 standards, provide users with greater automatic roaming possibilities in Russia, Europe, the United States and Canada. During 2001, we responded to competitive pressure by introducing limited handset subsidies. As of June 30, 2003, the amount of these subsidies, which we only offer in our own integrated sales and customer care offices, are up to \$20 per handset on the less expensive models. However, in view of the experience and practice of mobile services providers in more mature markets, increased competition may compel us to more heavily subsidize handsets in the future.

We have entered into arrangements with Sony Ericsson, Nokia, Motorola, Philips, Panasonic, Samsung, Siemens, Benefon and Alcatel to purchase handsets. We offer approximately 60 GSM 900/GSM 1800 handset models, the majority of which are manufactured by Sony Ericsson, Nokia, Siemens and Motorola. We are not dependent on any particular supplier for handsets. The handset manufacturers provide training to our sales force, customer service personnel, dealers and engineering staff and cooperate with us on marketing and promotion. To ensure quality control and to maintain the MTS brand image, we encourage our dealers to purchase handsets for use on our network directly from us. Typical dual-band handsets range in cost from approximately \$40 to \$800.

Seasonality

Our results of operations are impacted by certain seasonal trends. Generally, revenue is higher during the second and third quarter due to increased mobile phone use by subscribers who travel in summer from urban areas to country homes where fixed line penetration is relatively low. In the fourth quarter, operating income and average revenue per user tend to be low as the increase in new subscribers tends to outpace the increase in phone usage. However, quarterly trends can be influenced by a number of factors, including promotions, and may not be consistent from year to year.

REGULATION

In the Russian Federation, the federal government controls the regulation of telecommunication services. The principal legal act regulating telecommunications in the Russian Federation is the Federal Law on Communications, dated February 16, 1995, as amended. The Federal Law on Communications provides for, among other elements, the following:

- licensing of telecommunication services;
- requirements for obtaining a radio frequency allocation;
- equipment certification;
- equal rights for individuals and legal entities, including foreign, to offer telecommunication services;
- fair competition; and
- liability for violations of Russian legislation on telecommunications.

The Federal Law on Communications is a framework law which refers to regulations to be enacted by government bodies. Although a number of these regulations have been promulgated, regulations enacted under the legislative framework in place prior to the Federal Law on Communications continue to be applied to the extent that they do not contradict the Federal Law on Communications.

On July 7, 2003, President Putin signed the Federal Law on Communications, which will become effective and replace the current Federal Law on Communications as of January 1, 2004. The new law, which confers broad powers to the state to regulate the communications industry, including the allocation of frequencies, 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 current law the Ministry of Communications issues licenses for the provision of mobile communications services at its own discretion, under the new law, licenses to provide communications services in territories where frequency and numbering capacity are limited will be issued only on the basis of a tender. The new law also provides for the re-issuance of licenses to merged or otherwise reorganized companies and to companies that change their official names or other identification data. By contrast, under the current law, companies are required to apply for the issuance of new licenses in such instances and the re-issuance is generally subject to the discretion of the Ministry of Communications. 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—Risks Relating to the Russian Legal System and Russian Legislation—The implementation of the new Federal Law On Communications will impose an additional financial burden on us which may adversely affect our financial results” for a description of the potential impact of this new levy on our financial results.

Regulatory Authorities

The Ministry of Communications and Informatization, or the Ministry of Communications, regulates the telecommunications industry, largely through the issuance of all licenses for the provision of mobile telephone services in Russia, regardless of the standard or technology, and the issuance of instructions. The Ministry of Communications also allocates federal funding for the telecommunications industry and oversees the technical condition and development of telecommunications, including the licensing and supervision of the GSM, AMPS, NMT and CDMA networks.

Regulatory agencies under the Ministry of Communications include the State Radio Frequencies Commission, the State Radio Frequencies Service and the Department for Supervision over

Communications and Informatization. The State Radio Frequencies Service issues frequency permits. As part of the issuance process, the State Radio Frequencies Service obtains consents from other federal authorities for a particular frequency allocation, including consents from the Ministry of Defense and civil aviation authorities. The Department for Supervision over Communications and Informatization is responsible for the technical supervision of networks and equipment throughout Russia, including the monitoring of the compliance of network operators with applicable regulations, terms of their licenses and terms of the use of frequencies allocated to them. The Department for Supervision over Communications and Informatization is also responsible for the enforcement of the equipment certification requirements. The State Radio Frequencies Commission is primarily responsible for the development and implementation of a long-term policy for frequency allocation.

The Ministry of Antimonopoly Policy of the Russian Federation supervises competition and pricing regulations. The Federal Agency on Government Communications and Information, an executive agency whose role in telecommunications regulation is not clearly defined by the Federal Law on Communications and whose functions are currently being transferred to the Federal Security Service, is primarily responsible for the development and maintenance of networks for the government of Russia. Additionally, the Ministry of Health Protection has some authority over the location of telecommunications equipment.

Licensing of Telecommunications Services and Radio Frequency Allocation

The Ministry of Communications issues telecommunications licenses based on the Regulations on Licensing in the Field of Telecommunications in the Russian Federation, enacted by Decree No. 642 of the Russian government on June 5, 1994, as amended, and Decree No. 578 of June 10, 1998, on Approval of Regulations for Holding a Competitive Tender for Receipt of Licenses Associated with the Provision of Cellular Radiotelephone Services. Under these regulations, licenses for telecommunication services may be issued and renewed for periods ranging from three to ten years. Our licenses expire in various years beginning in 2004 and may be renewed upon application to the Ministry of Communications. For example, the GSM license with frequency allocation in the 900 MHz band covering the Moscow license area expires in 2004. Officials of the Ministry of Communications have fairly broad discretion with respect to both issuance and renewal procedures.

A company must complete a three-stage process before commercial launch of a communications network:

- receipt of a license from the Ministry of Communications to provide mobile telephony services using a specific standard and band of radio frequency spectrum;
- approval to use specific frequencies within the specified band from the State Radio Frequencies Service; and
- issuance by the Department for Supervision over Communications and Informatization of a permission for network operations. To receive this permission, a licensee must develop a frequency allocation and site plan, which is then reviewed and certified by the Department for Supervision over Communications and Informatization for electromagnetic compatibility of the proposed cellular network with other radio equipment operating in the license area. The Department for Supervision over Communications and Informatization has discretion to modify this plan, if necessary.

Both the Federal Law on Communications and related licensing regulations prohibit the transfer of a license, including assignment or pledge of a license as collateral, except for licenses awarded through a competitive tender, which may be transferred throughout their term. Additionally, Letter No. 1805 of March 25, 1999, of the Ministry of Communications stipulates that agreements on the provision of telecommunications services must be concluded and performed exclusively by the actual licensee.

If the terms of a license are not fulfilled or the service provider violates legislation, the license may be suspended or terminated. Licenses may be suspended for various reasons, including:

- failure to comply with the terms and conditions of the license;
- failure to provide services within three months from the start-of-service date set forth in the license;
- provision of inaccurate information about the communication services rendered to consumers; and
- refusal to provide documents requested by the Ministry of Communications.

Licenses may be terminated for various reasons, including:

- failure to remedy in a timely manner the circumstances which resulted in a suspension of the license;
- unfair competition by the license holder in providing the licensed services; and
- other grounds set forth by Russian legislation or international treaties.

Decisions of the Ministry of Communications on suspension or termination of licenses may be appealed in court. To date, there have been no legal actions seeking to suspend or terminate any of our licenses nor have we received any notice of violation with respect to any of our licenses.

Licensing fees are calculated as multiples of the monthly minimum wage, which for these purposes, as of June 30, 2003, was 100 rubles, or approximately \$3.20, and are 30 times the monthly minimum wage, or approximately \$100, for mobile radio-communication services and 40 times the monthly minimum wage, or approximately \$130, for mobile radiotelephone and cellular communication services.

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 which must be achieved by specified dates. We have commenced service by the applicable deadline in accordance with our licenses. In the areas in which we have not yet commenced operations, we have received an extension of the deadlines.

In addition to the licensing fees and contributions, Decree No. 552 of the Russian government of June 2, 1998, requires a payment of fees for use of radio frequency for cellular telephone services. Decree of the Russian government No. 895, dated August 6, 1998, further requires that all operators pay an annual fee set by the State Radio Frequencies Commission and approved by the Ministry of Antimonopoly Policy, for the use of their frequency spectrums. According to Government Decree No. 380, dated April 28, 2000, communications operators must also make monthly payments to fund the operations of the Department for Supervision of Communications and Informatization. These fees are fixed by the Ministry of Communications and approved by the Ministry of Economic Development and Trade and the Ministry of Antimonopoly Policy in the amount of 0.3% of revenues generated by rendering communications services. Prior to January 1, 2003 we did not pay these fees, as we believed that under Russian law taxes may only be established by law and not by government decree. See also “Risk Factors—Risks Relating to the Russian Federation—Risks Relating to the Russian Legal System and Russian Legislation—Changes in the Russian tax system could materially adversely affect an investment in the notes.” However, a recent Russian Supreme Court decision upheld the validity and enforceability of this levy, and a number of Russian telecom companies have elected to begin paying these fees. We began paying this levy for the periods commencing January 1, 2003, and we do not expect that our obligation for amounts that may become due for past periods or that will become due in the future will have a significant impact on our cash flows, financial position or results of operations.

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 mobile networks open to the public. The Ministry of Communications issues certificates of compliance with technical requirements to equipment suppliers based on a review by the Department of Certification. In addition, a Presidential Decree requires a license and equipment certification from Federal Agency on Government Communications and Information 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 Agency on Government Communications and Information.

Further, all high-frequency equipment, defined as involving frequencies in excess of 9 kHz, manufactured or used in the Russian Federation requires special permission from the Department for Supervision over Communications and Informatization. These permissions are specific to the entity that receives them, and do not allow the use of the equipment by other parties.

The Ministry of Communications Decree No. 8 of January 14, 1997, also directs public switched telephone network operators to give preference to Russian producers when purchasing switching equipment. Public switched telephone networks must receive the Ministry of Communications permission in order to purchase foreign-produced equipment. Also, Decree No. 903 of the Russian government on Regulation of Use of Equipment in the Interconnected Telecommunications Network, dated August 5, 1999, gives the Ministry of Communications and the Ministry of Antimonopoly Policy the right to restrict the use of certain equipment, including the equipment manufactured outside Russia.

Competition 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 if necessary. Presidential Decree No. 221, dated February 28, 1995, on Measures for Streamlining State Regulation of Prices (Tariffs) and Decree No. 715 of the Russian government, dated October 11, 2001, allow for regulation of tariffs and other commercial activities of telecommunications companies which are “natural monopolies.” In accordance with the Order of the Ministry of Antimonopoly Policy No. 1184, dated November 15, 2001, the Ministry of Antimonopoly Policy of the Russian Federation maintains a Register of Natural Monopolies in the Sphere of Communication. A telecommunications operator may be included in this register if (i) there is no other operator providing similar services and (ii) the operator is properly licensed. At present, neither we nor any of our subsidiaries are included in the Register of Natural Monopolies in the Sphere of Communication and, therefore, neither we nor our subsidiaries are subject to these regulations.

The Ministry of Antimonopoly Policy is authorized by law to maintain a register of companies holding a market share in excess of 35%. Companies entered in this register may become subject to certain restrictions in conducting their business, including limitations in decisions relating to price formation, geographical expansion, associations and agreements with competitors. Acquisitions of assets or shares in or by other entities involving such companies are subject to particular scrutiny by the Ministry of Antimonopoly Policy. As of July 25, 2003, the Russian Ministry of Antimonopoly Policy has categorized us and our subsidiaries Tomsk Cellular Communications, CJSC Kuban GSM and UDN 900 as companies with a market share exceeding 35%. See also “Risk Factors—Risks Relating to Our Business—Risks Relating to Our Industry—If we were categorized as a monopoly, our tariffs could be reduced and our commercial activities restricted, significantly affecting our results of operations.”

Interconnection and Pricing

Mobile operators are free to set their own tariffs, in contrast to certain fixed line telephony tariffs, which have to be approved by the Ministry of Antimonopoly Policy. The Ministry of Antimonopoly Policy also has certain oversight authority with regard to rates between certain regional telephone operators, long-distance provider Rostelecom and mobile operators. In addition, Russian legislation requires that operators of public switched telephone networks may not refuse to provide connections or discriminate against one operator in comparison to another. However, a regional fixed-line operator may charge different interconnection rates to different mobile operators.

MANAGEMENT

Key Biographies

Our directors, executive officers and key employees, and their dates of birth and positions as of September 1, 2003, were as follows:

Name	Year of Birth	Position
Directors and Executive Officers:		
Alexander U. Goncharuk	1956	Chairman
Vassily V. Sidorov	1971	Director and Acting President
Alexei N. Buyanov	1968	Director
Michael Guenther	1944	Director
Paul A. Kusubov	1966	Director
Mikhail A. Smirnov	1950	Director
Gernot Taufmann	1957	Director
Dr. Yury A. Gromakov	1946	First Vice President
Mikhail V. Susov	1967	First Vice President
Nikolai V. Tsekhomsky	1974	Vice President—Finance/Chief Financial Officer
Tatiana V. Evtushenkova	1976	Vice President—Investments and Securities
Valeriy A. Kozlov	1956	Vice President—Administrative Affairs
Anatoly V. Tchekhvan	1948	Vice President—Operations
Valery I. Grashenkov	1946	Vice President—Integration of Radio Systems

Alexander U. Goncharuk has served as Chairman of our Board of Directors since June 2002. His current term expires on the date of our next shareholders' meeting, which will take place on October 25, 2003. He also acted as our Deputy Chairman during 1997 and from January 1999 through June 1999, and as our Chairman in 1998. Mr. Goncharuk served as President of Sistema Telecom from 1998 until 2003. Since 2003, he has served as General Director of Sistema-affiliated OJSC Scientific Center and, since 1996, Vice President of JSFC Sistema. He also serves on the board of directors of four other companies affiliated with Sistema.

Vassily V. Sidorov has served as our Acting President since September 1, 2003 and as one of our Directors since 2002. He has also been nominated to serve as our President, which will be voted upon at a shareholders' meeting on October 25, 2003. His current term as Director expires on the date of our next shareholders' meeting, which will take place on October 25, 2003. From 2000 until August 2003, he served as First Vice President for Finance and Investments at Sistema Telecom. He also serves on the board of directors of Comstar CJSC, MTU-Inform Company CJSC, MTT CJSC, MGTS, Kosmos-TV CJSC and our competitors Personal Communications CJSC and Moscow Cellular Communications OJSC.

Alexei N. Buyanov has served as one of our Directors since June 2003. His current term expires on the date of our next shareholders' meeting, which will take place on October 25, 2003. Mr. Buyanov has served as First Vice President of JSFC Sistema since September 2002. From 1998 to 2002, he served as our Vice President for Finance and Investments. He also serves on the board of directors of nine other companies affiliated with Sistema.

Michael Guenther has served as one of our Directors since October 2000. His current term expires on the date of our next shareholders' meeting, which will take place on October 25, 2003. Mr. Guenther is a member of the Board of Management of T-Mobile International AG. He is also a member of the board of directors or supervisory board of each of the following companies affiliated with T-Mobile: T-Mobile Deutschland GmbH, T-Mobile Worldwide Holding GmbH, T-Mobile Czech Republic a.s., Zeta GmbH, Matav, HT Mobilne Komunikacije, Polska Telefonica Cyfrowa Sp., C-Mobil B.V., WESTEL Mobil Tavkozlesi Rt., Eurotel Bratislava a.s and Hrvatski Telekom (HT).

Paul A. Kusubov has served as one of our Directors since June 2003. His term as a Director expires on the date of our next shareholders' meeting, which will take place on October 25, 2003. Mr. Kusubov has served as Head of T-Mobile International AG in Russia since January 2003. From 2001 to 2002, he was the Director of International Joint Venture Management RF/CIS at T-Mobile International AG in Bonn, Germany. From 1997 to 2000 he served as Deputy General Director of BaikalWestCom mobile company.

Mikhail A. Smirnov has served as one of our Directors since 1995. His term as a Director expires on the date of our next shareholders' meeting, which will take place on October 25, 2003. Mr. Smirnov served as our President from 1995 to August 2003 and has served as General Director of Moscow City Telephone Network (MGTS), a fixed-line operator majority owned by Sistema since August 2003. He has also served as Chairman of the Board of Directors of our subsidiary ReCom since 1998 and as chairman of the Association of GSM Operators of Russia since 1995. He is also Chairman of the Board of Directors of our subsidiaries UDN-900, ReCom OJSC, and member of the Board of Directors of Kuban GSM, MTS JLLC, MTS in the Komi Republic LLC, MSS, Novitel CJSC, MTS-P, SCS-900, TAIF Telcom and MTS-NN.

Gernot Taufmann has served as one of our Directors since 1998. His current term expires on the date of our next shareholders' meeting, which will take place on October 25, 2003. He is president of the Moscow Office of Deutsche Telekom AG and has overseen Deutsche Telekom's responsibilities in the Commonwealth of Independent States since 1995. Mr. Taufmann is Chairman of Board of Directors of Ukrainian Mobile Communications. He has also served as an executive director of ZETA Telekommunikationsdienste GmbH since 2000.

Dr. Yury A. Gromakov has served as our First Vice President since March 2002, and served as our Vice President of Technology and Network Development from 1994 until February 2002. He has been involved in mobile communications for 30 years and holds a degree of Doctor of Technical Sciences, the highest scientific degree in Russia, and has been awarded a degree as Honorable Radio Operator of Russia. Dr. Gromakov is also a member of the International Academy of the Science of Information and Information Processes and Technologies. He has published more than 100 scientific works, including two monographs in the area of mobile communications.

Mikhail V. Susov has served as our First Vice President in charge of commercial operations since February 2002. From December 2001 until February 2002, Mr. Susov served as the General Director of Comstar Telecommunications. From 1996 until December 2001, he served as the General Director of CJSC Personal Communications.

Nikolai V. Tsekhomsky has served as our Vice President of Finance/Chief Financial Officer since July 2003. From September 2002 through June 2003, he served as our Finance Director. Prior to joining us, 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. He also worked as a senior auditor at Ernst & Young in London and St. Petersburg from March 1995 to August 1998. Mr. Tsekhomsky also serves on the Board of Directors of our subsidiary TAIF Telcom.

Tatiana V. Evtushenkova has served as our Vice President of Investments and Securities since October, 2002. From December 1999 to October 2002, Ms. Evtushenkova served as the Director of the Investment Department at Sistema Telecom. Prior to joining Sistema Telecom she worked in the investment banking division of Salomon Smith Barney. Ms. Evtushenkova is the daughter of Vladimir P. Evtushenkov, the controlling shareholder and Chairman of the Board of Directors of Sistema. Ms. Evtushenkova also serves on the Board of Directors of the Moscow Bank for Reconstruction and Development.

Valeriy A. Kozlov has served as our Vice President of Administrative Affairs since 1993. Before joining us, Mr. Kozlov served as an administrative director for VAST, a joint Russian-Canadian venture formerly called M-Bell.

Anatoly V. Tchekhvian has served as our Vice President of Operations since March 2001. From April 1999 through March 2001, Mr. Tchekhvian served as the chief of our operational department. Before joining us in 1996, Mr. Tchekhvian served as chief engineer of Rostelecom.

Valery I. Grashenkov has served as our Vice President of Integration of Radio Systems since March 2002. From 1995 through March 2002, Mr. Grashenkov served as the head of our network planning department. Before joining us, he held various posts at the Moscow Radio-Technical Scientific and Research Institute.

Executive Compensation

Our officers and directors were paid during 2002 an aggregate amount of approximately \$4.3 million for services in all capacities provided to us; this amount was comprised of \$0.46 million in base salary, and a \$3.84 million bonus paid pursuant to a bonus plan for the management and directors whereby bonuses are awarded annually based on our financial performance.

Management Stock Bonus and Stock Option Plans

On April 27, 2000, contingent on the closing of our initial public offering, we established a stock bonus plan and stock option plan for selected officers, key employees and key advisors. Under the plans, directors, key employees and key advisors received 3,587,987 of our common shares and will participate in a stock option plan under which they may receive options to purchase up to an additional 9,966,631 of our common shares. At the time of the initial public offering, we issued 13,554,618 shares of common stock to our subsidiary Rosico pursuant to these plans at a price of \$1.024 per share for the total amount of \$13.9 million. Following the merger of Rosico into us in June 2003, these shares were transferred to our wholly-owned subsidiary, MTS CJSC.

Under the stock bonus plan, during the period from September 12, 2000, through September 22, 2000, 3,587,987 common shares were purchased from Rosico at nominal price of 0.1 rubles per share as follows:

	<u>Number of shares purchased</u>	<u>Percentage of total shares outstanding</u>
Employees and Directors	3,049,786	0.153%
Key Advisors	538,201	0.027%
Total	<u>3,587,987</u>	<u>0.180%</u>

On the date the shares were granted, we recognized aggregate expenses under this plan as compensation and consulting expenses amounting to \$4.5 million and \$0.8 million, respectively, based on the fair value of the shares on the date they were granted.

Under the stock option plan, board members and key employees, upon being granted stock options, will have the right to purchase up to 9,966,631 of our common shares 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 our common stock on the date of exercise.

On August 14, 2001, pursuant to option agreements, we granted options in respect of 1,020,682 common shares to our board members and 808,529 common shares to our key employees. These options provided that, on July 15, 2003, board members and key employees could purchase our common shares at \$1.31 per share, which represented the 100-day average sales price of the shares at

August 14, 2001. The stock option agreement for a board member terminated if the board member was terminated as a board member prior to our 2002 annual general shareholder meeting. The stock option agreement for a key employee terminated if the employee left us before July 15, 2003.

In July 2003, board members and key employees purchased a total of 37,557 shares pursuant to the August 2001 option agreements. Sixty-two of the option holders elected cash awards in lieu of shares, and cash awards were granted in respect of 1,746,310 shares in the amount of \$1.633 per share (the difference between \$1.31, the price per share fixed in each agreement, and \$2.943, the market price per share on July 15, 2003). In addition, options relating to 45,344 shares were cancelled pursuant to the termination provisions described above.

On October 24, 2002, pursuant to option agreements, we granted options in respect of 1,739,640 common shares to our board members and 1,107,041 common shares to our key employees. These options have an exercise price of \$1.49 per share, which represents the 100-day average market price of the shares at the date of grant and will vest 21 months from the date of the grant. The stock option agreement for a board member would have terminated if the board member was terminated as a board member before our 2003 annual general shareholder meeting. The stock option agreement for a key employee will terminate if the employee leaves us before July 15, 2004. We expect to recognize a compensation expense of approximately \$0.2 million based on the intrinsic value of these options over the 21-month period.

On June 30, 2003, options relating to 1,778,694 common shares were approved at our annual shareholders' meeting.

We are accounting for the management stock option plan in accordance with APB No. 25, under which expense is generally only recognized for a difference between the exercise price and the fair market value measured as of the date the option was granted. At August 14, 2001, however, the fair market price of our common shares was \$1.17, which is less than the exercise price of \$1.31. Accordingly, no compensation expense has been recorded for the year ended December 31, 2001.

In accordance with Russian legislation, our board members and key employees may be considered insiders with respect to us, and thus may be restricted from selling their shares.

Board of Directors

Members of our Board of Directors are elected by a majority vote of shareholders at the annual General Meeting using a cumulative voting system. Directors are elected for one year terms and may be re-elected an unlimited number of times. Our Board of Directors currently consists of seven members, although it may be increased to nine members by shareholder resolution. The Board of Directors has the authority to make overall management decisions for us, except those matters reserved to the shareholders. The members of our Board of Directors do not serve pursuant to a contract.

President

The General Meeting of Shareholders, at the recommendation of the Board of Directors, appoints our President for a term of three years. The rights, obligations and the times and amounts of payment for the President's services are determined by a contract concluded with him by MTS OJSC, which is represented by the Chairman of the Board of Directors or by a person authorized by the Board of Directors. This contract may be terminated without cause with two months' prior written notice, following which the President is entitled to five months' salary. The President is responsible for day-to-day management of our activities, except for matters reserved to our shareholders or the Board of Directors.

Review Commission

Our Review Commission supervises our financial and operational activities. Members of the Review Commission are nominated and elected by our shareholders for a term of one year. A Director may not simultaneously be a member of the Review Commission. As of June 30, 2003, our Review Commission had three members:

- Elena V. Bekian holds the position of Head of Internal Audit Department within Sistema Telecom JSC. Her current term expires at the next annual shareholders' meeting, which will take place in June 2004.
- Vassily V. Platoshin holds the position of Chief Accountant at JSFC Sistema. His current term expires at the next annual shareholders' meeting, which will take place in June 2004.
- Bernd Willmann holds the position of Head of International Auditing at Deutsche Telekom AG. His current term expires at the next annual shareholders' meeting, which will take place in June 2004.

The members of our Review Commission do not serve pursuant to a contract.

Audit and Disclosure Committee Plans

We are currently in the process of establishing a Disclosure Committee and an Audit Committee and expect both committees to be established by the end of 2004. We expect that the establishment of our Disclosure Committee will enhance our existing internal disclosure controls and procedures. The committee will oversee the collection, review and reporting of information relating to our disclosure obligations. It will also be tasked with periodically evaluating our system of disclosure controls and procedures and generally responsible for all aspects of information disclosure in connection with the preparation of our annual reports and other disclosure documents in accordance applicable law.

We also intend to establish an Audit Committee comprised of members of our Board of Directors for the purpose of overseeing our accounting and financial reporting process and audits of our financial statements and handling other responsibilities delegated to it in its charter and under U.S law.

Employees

At June 30, 2003, we had 14,592 employees, representing growth of approximately 164% from June 30, 2002. Over 25.2% of these employees, or 3,686, worked in Moscow. Of the Moscow employees, 18 were executives; 868 were technical and maintenance employees; 1,925 were sales, marketing and customer service staff; and 875 were administration and finance staff. As of June 30, 2003, of our employees worked in the regions outside of the Moscow license area. Of these employees, we estimate that 225 were executives; 2,634 were technical and maintenance employees; 5,404 were sales, marketing and customer service staff; and 2,643 were administration and finance staff.

The substantial growth in the number of our employees is attributable primarily to the continued expansion of our network in Russia and the CIS and our increased focus on customer care. The

following chart sets forth the number of our employees at December 31, 2000, 2001 and 2002, and at June 30, 2002 and 2003:

	At December 31,			At June 30,	
	2000	2001	2002	2002	2003
Moscow license area	1,782	2,633	3,388	3,030	3,686
Other regions (including Ukraine)	558	2,357	7,654	5,857	10,906
Total	<u>2,340</u>	<u>4,990</u>	<u>11,042</u>	<u>8,887</u>	<u>14,592</u>
Percent increase of total employees over prior period		113%	121%		164%

Our future success will depend in significant part on the continued service of our key technical, sales and senior management personnel. To date, we have experienced a low level of departures, voluntary or otherwise. Our employees are not unionized, we have not experienced any work stoppages and we consider our relations with employees to be strong.

Share Ownership

Of our directors, senior management and employees that own our shares, each individually beneficially owns less than one percent of our common stock.

The aggregate beneficial interest of our directors, senior management and employees as of September 1, 2003, was 767,564 shares of common stock, equaling less than 1% of our outstanding common stock.

PRINCIPAL SHAREHOLDERS

The following table sets forth, as of September 1, 2003, information regarding the beneficial ownership of our common stock by each person known by us to own beneficially any of our voting securities and all our directors and executive officers as a group. All shares of common stock have the same voting rights.

In April 2003, Sistema exercised its rights under a call option agreement entered into with T-Mobile dated March 12, 2003 to acquire directly and indirectly from T-Mobile 199,322,614 shares of common stock amounting, in aggregate, to an additional 10% of our outstanding common stock. This included 120,811,184 shares of common stock acquired directly from T-Mobile and the acquisition of all the shares in Invest-Svyaz-Holding previously held by T-Mobile, representing a beneficial interest in a further 78,521,430 shares of common stock. The acquisition was completed in April 2003. See “Risk Factors—Risks Relating to Our Business—Our controlling shareholders have the ability to exert significant influence over us and their interests may conflict with those of holders of the notes as they may make decisions that materially adversely affect your investment. In addition, because one of our controlling shareholders is also our competitor, it may have interests that conflict with those of holders of the notes.” T-Mobile also sold an additional 5.0% of our common stock. See Note 26 to our audited consolidated financial statements for a description of this transaction.

Subject to the above, since the date of our creation on March 1, 2000, as a result of a merger of MTS CJSC and RTC CJSC, a wholly-owned subsidiary, there have not been any significant changes in the percentage ownership held by any major shareholders, other than the dilution each such shareholder experienced during our initial public offering, completed on July 6, 2000.

Name	Beneficial ownership as of September 1, 2003	
	Number	Percentage
Sistema ⁽¹⁾	619,860,752	31.1%
Sistema Holding Limited ⁽¹⁾	193,473,900	9.7%
T-Mobile ⁽²⁾	501,325,554	25.1%
Invest-Svyaz-Holding ⁽³⁾	160,247,802	8.0%
Deutsche Bank AG (London Branch)	500,000	*
VAST ⁽⁴⁾	60,219,432	3.0%
MTS CJSC	9,929,074	*
Holders of American Depositary Shares	347,602,060	17.4%
Holders of Global Depositary Shares	99,400,000	5.0%
All executive officers and directors, and shares issued for ESOP as a group	*	*
Total	<u>1,993,326,138</u>	<u>100.0%</u>

* Less than 1%

⁽¹⁾ In connection with its April 2003 Eurobond offering, Sistema has pledged 193,473,900 shares of common stock held by Sistema Holding Limited to Deutsche Trustee Company Limited. The total number of shares pledged by Sistema to Deutsche Trustee Company Limited represents approximately 9.7% of our issued and outstanding shares. Vladimir P. Evtushenkov has a controlling interest in Sistema, and would be considered under U.S. securities laws as the beneficial owner of our shares held by Sistema, Sistema Holding Limited, VAST and Invest-Svyaz-Holding, as further discussed in Note 4 below. Mr. Evtushenkov is also chairman of the board of directors of Sistema.

⁽²⁾ T-Mobile is a wholly-owned subsidiary of Deutsche Telekom AG, the largest telecommunications provider in Germany.

⁽³⁾ Invest-Svyaz-Holding is a Russian closed joint stock company wholly owned by Sistema. Invest-Svyaz-Holding has pledged 81,728,372 shares of our common stock to Zeta Telekommunikationsdienste GmbH, a company 51% owned by T-Mobile and 49% owned by Disantis S.A., an entity affiliated with Sistema. The total number of shares pledged by Invest-Svyaz-Holding to Zeta constitute 4.1% of our issued and outstanding shares.

⁽⁴⁾ VAST is a limited partnership formed under the laws of Russia. Sistema owns a 51% interest in VAST. ASVT OJSC, a Russian company engaged in telecommunications, owns the remaining 49% interest in VAST.

As of September 1, 2003, we had 1,993,326,138 shares of common stock outstanding, including 9,929,074 shares of common stock held by our wholly-owned subsidiary MTS CJSC that we issued at the time of our initial public offering pursuant to our stock bonus plan and stock option plan for selected officers, key employees and key advisors. The total number of ADSs outstanding was 17,380,103 representing underlying ownership of 347,602,060 shares, approximately 17.4% of our outstanding share capital. The shares underlying the ADSs are deposited with Morgan Guaranty Trust Company of New York and the local custodian is ING Eurasia. T-Mobile also placed GDSs representing underlying ownership of 99,400,000 shares, approximately 5.0% of our outstanding share capital.

CERTAIN TRANSACTIONS WITH RELATED PARTIES

Rosico Purchase

In August 1998, MTS CJSC purchased from Sistema 13,680 shares of common stock of Rosico, our former subsidiary that merged into us in June 2003, representing 80% of the issued and outstanding capital stock of Rosico, in exchange for 408,631,860 newly issued shares of MTS CJSC's common stock, which represented approximately 25% of its issued and outstanding capital stock immediately after that exchange. MTS CJSC recorded the purchase price at \$118 million, based on the estimated fair value of the Rosico businesses acquired. Under this purchase agreement, Sistema agreed to fund all payment and other obligations arising under the Ericsson loan and to indemnify us and Rosico for any costs we or Rosico incur in connection with the repayment of the Ericsson loan. In 2000, we acquired the remaining 20% of Rosico's common stock for \$16.1 million from Sistema's affiliates (9.5%), Siemens (10%) and T-Mobile (0.5%).

Rosno OJSC

In 2000, 2001, 2002 and 2003, we arranged medical insurance for all employees and insured our property for approximately \$274 million in 2000, \$612 million in 2001, \$781 million in 2002 and \$nil for the six months ended June 30, 2003, respectively, with Rosno OJSC. Sistema is a significant shareholder of Rosno. Expenses relating to insurance premiums to Rosno amounted to \$6.5 million in 2000, \$8.0 million in 2001, \$4.9 million for 2002 and \$4.8 million for the six months ended June 30, 2003, including premiums for medical insurance of approximately \$1.6 million in 2000, \$2.5 million in 2001, \$3.6 million for 2002 and \$1.8 million for the six months ended June 30, 2003. We believe that all of the insurance contracts with Rosno have been entered on market terms. Rosno has entered into reinsurance contracts with leading global reinsurers, with the exception of medical risks.

Dontelecom Purchase

In September 2002, we acquired 33.3% of Dontelecom from a company affiliated with Sistema, for \$7.5 million.

Telecom-900 Purchase

During 2001 and 2002, we acquired 81% and 19% of the outstanding common stock of Telecom-900, for \$26.8 million and \$6.9 million, respectively, from Sistema and Invest-Svyaz-Holding, respectively.

Maxima Advertising Agency

In 2000, 2001, 2002 and 2003, we entered into contracts for advertising services with Maxima Advertising Agency. Maxima is majority-owned by a Sistema affiliate, and certain members of our board of directors are also members of Maxima's board of directors. Advertising fees paid to Maxima amounted to \$6.4 million in 2000, \$8.7 million in 2001, \$13.1 million in 2002 and \$13.4 million for the six months ended June 30, 2003. We believe all contracts with Maxima have been entered into on market terms.

Moscow City Telephone Network (MGTS)

In 2000, 2001, 2002 and 2003, we had line rental agreements with MGTS and rented a cable plant from MGTS for installation of optic-fiber cable. We also rented buildings for administrative offices, sales and marketing offices as well as premises for switching and base station equipment. The amounts paid under these agreements for the years ended December 31, 2000, 2001 and 2002 and for the six months ended June 30, 2003 were approximately \$1.0 million, \$1.5 million, \$4.4 million and

\$2.3 million, respectively. We also purchased buildings from MGTS for the amounts of approximately \$2.9 million in 2000, \$2.6 million in 2001 and \$2.0 million in 2002. We did not make any building purchases from MGTS for the six months ended June 30, 2003. We believe that these purchases were, and all other agreements are, on market terms. MGTS is majority-owned by Sistema and its affiliates, and certain members of our board of directors are also members of MGTS' board of directors.

Moscow Bank of Reconstruction and Development (MBRD)

Beginning in August 2000, we have maintained bank and deposit accounts with the Moscow Bank of Reconstruction and Development, or MBRD, whose major shareholder is Sistema. As of June 30, 2003, our cash position at MBRD amounted to \$109.1 million, including \$105.6 million in time deposits and \$3.5 million in current accounts. During 2000, 2001 and 2002 and the six months ended June 30, 2003, the related interest accrued and collected on the deposits amounted to approximately \$1.0 million, \$3.0 million, \$5.1 million and \$1.6 million, respectively, which is reflected in our financial statements as a component of interest income. In addition, in January 2003, we entered into an agreement with MBRD whereby the bank acted as our financial advisor in connection with our Eurobond offering in exchange for total compensation of \$20,000. In June 2003, we also entered into a loan agreement with MBRD for \$6.2 million. For a description of this loan see "Description of Existing Indebtedness."

MTU-Inform

We have interconnection arrangements with, and receive domestic and international long-distance services from, MTU-Inform. We paid interconnection and line rental fees to MTU-Inform for the years ended December 31, 2000, 2001 and 2002 and the six months ended June 30, 2003 of approximately \$17.4 million, \$29.0 million, \$24.1 million and \$14.5 million, respectively. In 2000, 2001 and 2002 and the six months ended June 30, 2003 we also purchased telephone numbering capacity from MTU-Inform. Payments under these agreements for the years ended December 31, 2000, 2001 and 2002 and the six months ended June 30, 2003 amounted to \$11.7 million, \$4.7 million, \$1.6 million and \$13.8 million, respectively. We believe that these arrangements are on market terms. MTU-Inform is owned 51% by MGTS, which is majority-owned by Sistema and its affiliates, and 48% by Sistema.

Telmos

We have interconnection arrangements with, and receive domestic and international long-distance services from, Telmos. Interconnection and line rental fees paid to Telmos for the years ended December 31, 2000, 2001 and 2002 and the six months ended June 30, 2003 were \$4.3 million, \$4.0 million, \$1.3 million and \$0.8 million, respectively. We believe that these arrangements are on market terms. Telmos is 40% owned by MGTS, which is majority-owned by Sistema and its affiliates, which in turn also own 40% of Telmos.

Key Advisors for Initial Public Offering

Officers of two of our shareholders, Sistema and T-Mobile, advised us in connection with our initial public offering. In return for their assistance, these key advisors purchased a total of 538,201 of our shares from Rosico during the period from September 12, 2000 through September 22, 2000, at the nominal price of 0.1 rubles per share, for total compensation of approximately \$797,000.

Invest-Svyaz-Holding

In 2001 and 2002, subsidiaries of Telecom-900, Uraltel, FECS-900 and SCS-900 entered into agreements with our shareholder, Invest-Svyaz-Holding, for the leasing of network equipment and a billing system. The interest rate implicit in these leases varies from 13% to 44%, which our

management believes are market terms. As of June 30, 2003, the total minimum lease payments due through December 31, 2006, including interest, was approximately \$16.8 million.

In addition to the above lease transactions, during 2001, 2002 and 2003 we also guaranteed debt of Invest-Svyaz-Holding in the amount of \$14.6 million to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to our subsidiaries. For the six months ended June 30, 2003, leases to our subsidiaries amounted to approximately 99% of the revenues of Invest-Svyaz-Holding.

Principal and interest paid to Invest-Svyaz-Holding for the period from the date of our acquisition of Telecom-900 on August 10, 2001 through December 31, 2001, were approximately \$0.5 million and \$0.1 million, respectively. For the year ended December 31, 2002, principal and interest paid to Invest-Svyaz-Holding were \$2.9 million and \$1.4 million, respectively. For the six months ended June 30, 2003, principal and interest paid to Invest-Svyaz-Holding were \$2.0 million and \$1.5 million, respectively.

T-Mobile

In 2000, 2001, 2002 and 2003, we had non-exclusive roaming agreements with T-Mobile that were comparable to roaming agreements between us and other cellular mobile operators. We made payments under these roaming agreements of approximately \$0.7 million, \$0.7 million, \$1.0 million and \$0.7 million for the years ended December 31, 2000, 2001 and 2002 and the six months ended June 30, 2003, respectively. In addition, during 2000 T-Mobile provided consulting services to us for \$2.7 million.

Ukrainian Mobile Communications

On November 5, 2002, we signed agreements with all the existing shareholders of Ukrainian Mobile Communications, or UMC, providing for our acquisition of a 57.7% stake in UMC for \$194.2 million, including an agreement for our purchase of a 16.3% participation interest in UMC from Deutsche Telekom AG. This transaction was completed in March 2003. In addition, as part of the transaction, we have guaranteed shareholder loans from Deutsche Telekom AG to UMC of \$21.3 million. See “Business—History” and “—Regional Expansion.” Our shareholder T-Mobile is a wholly-owned subsidiary of Deutsche Telekom AG.

STROM Telecom

During the first half of 2003, we entered into agreements with STROM Telecom, a company affiliated with our major shareholder Sistema, for the purchase of a billing system and a communications software support system. The total purchase price under these contracts was approximately \$24.4 million, which we believe to be the market price.

DESCRIPTION OF EXISTING INDEBTEDNESS

Ericsson Loan

In December 1996, Rosico, our subsidiary that merged into us in June 2003, entered into a credit agreement with Ericsson Project Finance AB for a five-year credit facility, with an original principal amount of \$60 million. In July 2001, the credit agreement was amended to extend the repayment date to February 2006. The credit agreement contains covenants restricting Rosico's ability to encumber its present and future assets and revenues without the lender's express consent. The amounts advanced under the agreement bear interest of LIBOR + 4%. If the borrower fails to pay any amount payable under the credit facility, the overdue amount bears interest at a rate of an additional 6% per annum. During 2003, Ericsson assigned this loan to Salomon Brothers Holding Company on the same terms and conditions. In addition, upon Rosico's merger into us in June 2003, we assumed all liabilities of Rosico, including under the Ericsson loan. For a description of Rosico's merger with us, see "Business—History."

As of June 30, 2003, the principal amount outstanding on this credit was \$27 million. In connection with our acquisition of Rosico in 1998, Sistema agreed to indemnify Rosico for this loan and all related obligations. Under the indemnification agreement, a significant portion of payments we receive from Sistema is in exchange for the issuance by us of long-term, ruble-denominated promissory notes with 0% interest and maturities from 2049 to 2052. The carrying amount of these notes is negligible for our financial statements. For additional information regarding the Ericsson Loan, see "Risk Factors—Risks Relating to Our Financial Condition—Sistema may not fulfill its obligation to make payments to us in connection with our loan from Ericsson, which would have an adverse effect on the anticipated increase in our shareholders' equity and our cash position."

Motorola Debt

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. These 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 2.5%. MSS' total payments under this agreement have not changed by greater than 10% due to this restructuring. As of June 30, 2003, the amounts of these promissory notes payable was \$3.5 million which represented the principal and accrued interest.

Sberbank Credit Facilities

In 2001 and 2002 Kuban GSM entered into a number of credit facility agreements with Sberbank of the Russian Federation (Sberbank). The amounts borrowed under these credit facilities bear interest at rates varying from 17% to 23% and are to be repaid in regular installments on various dates ending June 2005. Borrowings in the amount of \$20.5 million are secured by a pledge of equipment. Borrowings in the amount of \$1.9 million are secured by a guarantee of Kubtelesot, the minority shareholder of Kuban GSM. At June 30, 2003, the total amount payable under these facilities including accrued interest was \$nil.

Dresdner Bank Loans

In October 2002, MSS entered into a credit agreement with Dresdner Bank CJSC (Dresdner) to borrow up to \$10 million. As of June 30, 2003, \$10 million was outstanding under this agreement. Borrowings under this agreement bear interest of LIBOR + 3.35% (4.49% at June 30, 2003) per annum and mature in October 2004.

In July 2002, we entered into a one-year credit agreement with Dresdner permitting us to borrow up to \$12.0 million at an interest rate of LIBOR + 1.95% (3.09% at June 30, 2003) per annum. As of June 30, 2003, \$11.1 million was outstanding under this agreement. This loan matured and was repaid in July 2003.

In December 2001 and in April 2002, UDN-900 entered into credit agreements with Dresdner Bank CJSC (Dresdner) to borrow up to \$20 million in the aggregate. As of June 30, 2003, \$2.1 million was outstanding under these agreements. Borrowings under these agreements bear interest of LIBOR + 3.2% (4.34% at June 30, 2003) per annum.

In December 2001, Telecom XXI entered into a rollover credit facility with Dresdner. Amounts borrowed under this \$20 million credit facility are repayable within one to six months from the disbursement date, have a final repayment date of November 2003 and bear interest of LIBOR + 3.2% (4.34% at June 30, 2003) per annum. As of June 30, 2003, Telecom XXI had \$20 million outstanding under this facility.

MBRD Loans

In June 2003, we entered into a credit agreement with Moscow Bank for Reconstruction and Development for \$6.2 million with an interest rate of 6.0% per annum. As of June 30, 2003, \$6.2 million was outstanding under this agreement. This loan matured and was repaid in August 2003.

Raiffeisenbank Loan

In May 2003, we entered into a credit agreement with ZAO Raiffeisenbank Austria for \$20 million with an interest rate of LIBOR + 2.85% per annum (3.99% at June 30, 2003). This loan matures in May 2004. As of June 30, 2003, \$20 million was outstanding under this agreement.

Yugbank Loans

Kuban GSM has a number of credit facility agreements with Yugbank denominated in rubles. The amounts borrowed under these credit facilities bear interest at rates varying from 20% to 21% and are secured by a pledge of equipment. As of June 30, 2003, the total amount payable under these facilities including accrued interest was \$0.2 million.

Eurobonds Issued December 21, 2001 and March 20, 2002

On December 21, 2001, MTS Finance S.A. issued an aggregate principal amount of \$250,000,000 10.95% notes due 2004 at a price of 99.254%. Proceeds received from the notes, net of discount, were \$248 million. Related debt issuance costs in the amount of \$3.9 million were capitalized. On March 20, 2002, in a follow-on offering to the December 2001 offering, we issued an aggregate principal amount of \$50,000,000 10.95% notes due 2004 at a price of 101.616%. Proceeds received from the notes, net of discount, were \$50.8 million. Related debt issuance costs in the amount of \$649,000 were capitalized. The notes are guaranteed by MTS OJSC and listed on the Luxembourg Stock Exchange. See “Risk Factors—Risks Relating to Our Financial Condition—Our debt facilities and our controlling shareholder Sistema’s debt facilities contain restrictive covenants, which may limit our ability to engage in various activities” for a description of the nature of the covenants in our debt agreements.

Eurobonds Issued January 30, 2003

On January 30, 2003, MTS Finance S.A. issued an aggregate principal amount of \$400,000,000 9.75% notes due 2008 at a price of 100.00%. Proceeds received from the notes, net of discount, were \$396.1 million. Related debt issuance costs in the amount of \$3.9 million were capitalized. The notes are guaranteed by MTS OJSC and listed on the Luxembourg Stock Exchange.

Eurobonds Issued August 5, 2003

On August 5, 2003, MTS Finance S.A. issued an aggregate principal amount of \$300,000,000 floating rate notes due 2004 at a price of 99%. Proceeds received from the notes, net of discount, were \$297 million. Related debt issuance costs in the amount of approximately \$1 million were capitalized. The notes are guaranteed by MTS OJSC and listed on the Luxembourg Stock Exchange.

WestLB International Loan

In July 2002, MTS-P entered into a credit facility agreement with WestLB International S.A. As of June 30, 2003, the amount of borrowings under this agreement was \$4.7 million. Amounts outstanding under this agreement bear interest of EURIBOR + 2% (4.15% at June 30, 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.

Kuban GSM Loans

In February and March 2003, Kuban GSM entered into a ruble-denominated credit facilities with Rosbank permitting borrowings of up to approximately 245 million rubles (approximately \$7.8 million). As of June 30, 2003, approximately \$17.8 million was outstanding under this agreement. 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, respectively.

On June 9, 2003, Kuban GSM entered into a 350 million ruble (approximately \$11.5 million) credit facility with the Moscow International Bank. 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 June 30, 2003, approximately \$9.4 million was outstanding under this facility.

On June 27, 2003, Kuban GSM entered into a 295 million ruble (approximately \$9.7 million) credit facility with Rosbank. Amounts borrowed under this facility have an interest rate of 15% and mature in June 2005. As of June 30, 2003, approximately \$9.7 million was outstanding under this facility.

UMC Loans

UMC entered into a total of six credit facilities with three of its former shareholders, including two unsecured U.S. dollar-denominated credit agreements with Deutsche Telekom AG for \$12 million and \$15 million respectively; two unsecured U.S. dollar-denominated credit agreements with a subsidiary of KPN Telecom for \$12 million and \$15 million, respectively; and two unsecured U.S. dollar-denominated credit agreements with a subsidiary of TDC for \$12 million and \$15 million respectively. These credit agreements were amended in connection with our purchase of a majority stake in UMC to provide for UMC's repayment of the outstanding amounts under these facilities, which together totaled \$58.1 million. The amounts outstanding under the agreements bear interest of LIBOR + 5% to 7% (6.1–8.1% at June 30, 2003) The amount payable to the KPN subsidiary matured and was repaid in May 2003. The amounts payable to Deutsche Telekom AG and the TDC subsidiary are payable in equal quarterly installments and have a final repayment date in April 2004. We have guaranteed each of these loans, as described in "Business—Regional Expansion."

UMC also has entered into two loan agreements for up to approximately €12 million with bank KfW. The loans bear interest of LIBOR + 4% (5.14% at June 30, 2003) and LIBOR + 0.95% (2.09% at June 30, 2003) and mature in March 2004 and February 2005, respectively. As of June 30, 2003, approximately €5.4 million of debt was outstanding under these agreements.

TAIF Telecom Loans

In April 2003, we entered into call option agreements simultaneously with our acquisition of TAIF Telecom for the remaining 47.3% of common shares and 50.0% of preferred shares in TAIF Telecom for \$49.0 million and \$10.0 million, respectively. These call options are accounted for as financing derivatives (see Note 2 to our unaudited condensed consolidated financial statements) and have been reflected as current portion of long-term debt as of June 30, 2003 as we intend to exercise the call options prior to June 30, 2004. These call option agreements accrue interest at 8% per annum.

In November 2002, TAIF Telecom entered into loan agreements for up to 45 million rubles with Sberbank. The loans bear interest of 19–20% per annum and mature in November 2003. As of June 30, 2003, approximately \$1.5 million was outstanding under these agreements.

On January 28, 2002, TAIF Telecom entered into a \$2.2 million credit facility with Guta Bank. Amounts borrowed under this facility mature in February 2007 and have an interest rate varying from 7% to 15% per annum until February 2007. As of June 30, 2003, approximately \$1.7 million was outstanding under this facility.

In July 2001, TAIF Telecom entered into a loan agreement with Tatsotsbank in the amount of \$6 million. This loan bore interest at 8.0% and matured in September 2003. As of October 7, 2003 this loan has been repaid.

In October 2001, TAIF Telecom entered into loan agreements for up to 180 million rubles (approximately \$5.9 million) with Bank AkBars. The loans bore interest of 18%-20% and matured in October 2003. As of October 7, 2003 this loan has been repaid.

Guarantee of Mobile TeleSystems LLC Loan

In April 2003, Mobile TeleSystems LLC entered into a \$10 million credit facility with ABN AMRO BANK A.O. Amounts borrowed under this facility are guaranteed by us. As of June 30, 2003 approximately \$10 million was outstanding under this facility.

Additional Indebtedness

For a summary of outstanding indebtedness as of June 30, 2003 and a description of credit facilities entered into after June 30, 2003 see “Operating and Financial Review and Prospects—Recent Developments.”

DESCRIPTION OF THE NOTES

The notes will be issued and guaranteed under a document called the “indenture.” The indenture, to be dated October 14, 2003, is a contract among the issuer, us and JPMorgan Chase Bank, as trustee.

Because this section is a summary, it does not describe every aspect of the notes. This summary is subject to and qualified in its entirety by reference to all of the provisions of the indenture, including the definitions of some terms that are used in the indenture and which we use in this section. We describe the meaning for only the more important terms, and wherever we refer to particular defined terms, those defined terms as they are used in the indenture are incorporated by reference here. In this section, references to “MTS,” “we,” “us” or “our” refer solely to Mobile TeleSystems OJSC and not our subsidiaries, and references to the “issuer” refer solely to Mobile TeleSystems Finance S.A.

General

The notes will be senior unsecured obligations of the issuer. The notes will be unsubordinated, which means that they will rank equally among themselves and with all of the issuer’s other present and future senior, unsecured and unsubordinated indebtedness, except as required by mandatory provisions of law. The notes will rank senior to all of the issuer’s unsecured subordinated debt and will be effectively subordinated to any of its secured debt to the extent of the value of the assets securing such debt. As of the date hereof, the issuer had no secured indebtedness. However, the issuer may incur debt in the future, subject to the restrictions imposed by the indenture as discussed under “—Principal Covenants—Limitation on Incurrence of Debt” and “—Limitations on Liens.”

The notes will be issued in an initial aggregate principal amount of \$400,000,000. The issue date will be October 14, 2003. Payment of the full principal amount of the notes at par will be due on October 14, 2010, to the extent the notes are not redeemed or repurchased prior to that date.

The notes will bear interest at the annual rate shown on the front cover of this offering memorandum. The issuer will pay interest semi-annually on April 14 and October 14 of each year, beginning April 14, 2004, until the principal is paid or made available for payment or the notes are redeemed in accordance with their terms. Interest will be paid to the holders of record of the notes indicated in the register at the close of business on the 15th day preceding the relevant interest payment date. Interest payable in respect of any period which is not a full interest period will be calculated on the basis of a 360 day year consisting of 12 months of 30 days each and, in the case of an incomplete month, the number of days elapsed.

The issuer may, from time to time without notice to or consent from the holders, issue additional notes of the same tenor, coupon and other terms as the notes (including our guarantee), so that such notes and the notes offered hereby shall form a single series.

The notes will be represented by one or more global notes in registered form without interest coupons. Notes sold in transactions outside the United States in compliance with Regulation S under the U.S. Securities Act will be represented by interests in the Regulation S global note. We refer to these notes as “Regulation S notes.” Notes which are sold pursuant to Rule 144A under the U.S. Securities Act will be represented by interests in the Rule 144A global note. We refer to these notes as the “Rule 144A notes.” We refer to the Regulation S global note and the Rule 144A global note together as the “global notes.” Interests in, and transfers of interests in, the global notes will be shown on and effected only through the book-entry systems operated by The Depository Trust Company (“DTC”), Euroclear Bank S.A./N.V. (“Euroclear”) or Clearstream Banking, société anonyme (“Clearstream”) and their respective participants.

The issuer will pay you any cash amounts to which you may be entitled under the terms of the notes in respect of the principal of and any accrued interest on the notes at maturity (or upon the redemption of the notes) in U.S. dollars.

The principal corporate trust office of the trustee in the City of New York is designated as the principal paying agent. We may at any time designate additional paying agents or rescind the designation of any paying agents or approve a change in the office through which any paying agent acts. For so long as any of the notes are listed on the Luxembourg Stock Exchange, we will maintain a paying agent in Luxembourg. We will, if the laws implementing the June 3, 2003 European Council Directive become effective, ensure that we maintain a paying agent in a jurisdiction that will not be obliged to withhold or deduct tax pursuant to any European Union Directive implementing those conclusions or any law implementing or complying with, or introduced in order to conform to, such Directive.

So long as the notes are represented by global notes, payment of interest on and, if applicable, principal of the notes will be made in immediately available funds. For a more detailed discussion of payments on definitive notes, if any, see “—Payment and Paying Agents” below.

The Guarantee

MTS, which beneficially owns 100% of the issued shares of the issuer, will fully and unconditionally guarantee all payments of principal and interest payable under the notes by the issuer, including any Additional Amounts in respect of Taxes as described below under “—Taxation and Additional Amounts.”

We will guarantee the payment of these amounts when they become due and payable. You do not need to proceed against the issuer before you can proceed against us under the indenture. The guarantee will be our senior, unsubordinated and unsecured obligation, which means that it will rank on a par with all of our other present and future senior, unsubordinated indebtedness, except as required by mandatory provisions of law, senior to all of our unsecured subordinated indebtedness. The guarantee will be effectively subordinated to any of our secured debt to the extent of the lesser of the amount of such debt or the value of the assets securing such debt, as well as any debt and other liabilities of our subsidiaries, whether secured or unsecured. As of June 30, 2003, we had no secured indebtedness and our subsidiaries had \$157.7 million of indebtedness and \$154.2 million of other liabilities. We and our subsidiaries may incur other debt subject to the limitations discussed under “—Principal Covenants—Limitation on Incurrence of Debt” and “—Limitations on Liens.”

We are required to obtain permission from the Central Bank of Russia (the “CBR Permission”) to make payments in U.S. dollars under the Guarantee. We will undertake in the indenture to use our best efforts to obtain the CBR Permission as soon as practicable. You may exercise an optional early redemption right in the event we fail to obtain the CBR Permission within 60 days after the closing date until we have obtained the CBR Permission, as described under “—Redemption at Option of Holders upon a Failure by MTS to Obtain a Permission from the Central Bank of Russia to make Payments in U.S. Dollars under the Guarantee.” If you exercise this right, you will not have full recourse to us under the guarantee, as a permission of the Central Bank of Russia would not then have been obtained, and you will have to rely for payment on the issuer of the notes, which could seek to enforce the agreement pursuant to which the issuer loaned the offering proceeds to us. See “Risk Factors—If we are unable to obtain permission from the Central Bank of Russia for purposes of making payments pursuant to the guarantee, we will not be able to make payments in U.S. dollars pursuant to the guarantee and the guarantee may not be enforceable.”

Obligations to Direct Holders

The issuer’s obligations under the notes and our obligations under the guarantee, as well as the obligations of the trustee and those of any third parties employed by the issuer, us or the trustee, only apply to persons who are registered as holders of notes. Neither we nor the issuer have obligations to you if you hold in street name or other indirect means, either because you choose to hold notes in that manner or because the notes are issued in the form of global notes as described below. For example,

once payment is made to the person with whom the global note is deposited, neither we nor the issuer have any further responsibility for the payment even if that holder is legally required to pass the payment along to you as a street name customer but does not do so.

In the remainder of this description “you” means direct holders and not street name or other indirect holders of notes.

Form, Exchange and Transfer

The Rule 144A notes and the Regulation S notes will each be represented by one or more global notes in registered form, without coupons. The global notes will be issued in denominations that in the aggregate equal the outstanding principal amount of notes represented thereby. The notes will have denominations of \$1,000 or even multiples of \$1,000. The Rule 144A global note will be deposited with a custodian for and registered in the name of Cede & Co., as nominee of DTC. The Regulation S global note will be deposited with, and registered in the name of a common depositary for Euroclear and Clearstream or a nominee thereof.

For so long as the notes are in global form, holders may transfer or exchange notes in accordance with the indenture and rules of the relevant clearing system. If definitive notes are issued in the special situations described under “—Special Situations in Which a Global Note Will Be Terminated” below, you may exchange or transfer your notes at the office of the trustee or any transfer agent (including the transfer agent in Luxembourg), upon presentation of the notes in definitive form and the forms of transfer at the office of the transfer agent in Luxembourg. Forms of transfer are available at the office of any transfer agent (including the transfer agent in Luxembourg). The trustee acts as the issuer’s agent for registering notes in the names of holders and transferring notes. The issuer may change this appointment to another entity other than itself, us or any of our Affiliates. The entity performing the role of maintaining the list of registered holders is called the “security registrar.” It will also register transfers of the notes.

You will not be required to pay a service charge to transfer or exchange notes, but you may be required to pay any tax or other governmental charge associated with the exchange or transfer. The transfer or exchange of notes will only be made if the security registrar is satisfied with your proof of ownership.

For so long as any of the notes are listed on the Luxembourg Stock Exchange, we will maintain a paying and transfer agent in Luxembourg. We may designate additional transfer agents. We may cancel the designation of any particular transfer agent. We may also approve a change in the office through which any transfer agent acts. Notice regarding any such changes will be provided as described in “—Notices.”

Situations in Which a Global Note Will Be Terminated

In the situations described below, a global note will terminate and interests in it will be exchanged for physical certificates representing definitive notes. After that exchange, the choice of whether to hold notes directly or in street name will be up to the investor. Investors must consult their own bank or brokers to find out how to have their interests in notes transferred to their own name so that they will be direct holders.

The circumstances in which a global note will be terminated are:

- In the case of the Rule 144A global note, when DTC notifies the trustee that it is unwilling, unable or no longer qualified to continue holding the global note, and we do not appoint a successor to DTC within 90 days.

- In the case of the Regulation S global note, when either Euroclear or Clearstream is closed for business for a continuous period of 14 days, other than public holidays, or permanently ceases business or announces an intention to do so.
- When the issuer elects to exchange the global note representing such notes in whole but not in part for physical certificates representing such notes.
- When an event of default on the notes has occurred and has not been cured, if requested by the holder of a book-entry interest in the notes. Defaults on notes are discussed below under “—Events of Default.”

In addition, if instructions have been given to transfer a beneficial interest in one global note to a person who would otherwise take delivery in the form of an interest in another global note, and such other global note has previously been exchanged for definitive notes, then the transferee will receive its interest in the form of definitive notes.

Definitive notes issued in exchange for book-entry securities will be issued in registered form only, without coupons. They will be registered in the name or names instructed by the registrar based on the instructions of DTC, Euroclear or Clearstream, as applicable.

Payment and Paying Agents

The issuer will pay interest to you if you are a direct holder listed in the trustee’s records at the close of business on the 15th day prior to each interest payment date, even if you no longer own the security on the interest payment date. That particular day is called the “regular record date.” Payments on definitive notes, if any, will be made at the corporate trust office of the trustee in New York City located at JPMorgan Chase Bank, 4 New York Plaza, Floor 15, New York, NY 10004, or at the office of the paying agent in Luxembourg located at J.P. Morgan Bank Luxembourg S.A., 5 Rue Plaetis, L-2338 Luxembourg. You must make arrangements to have your payments picked up at or wired from any of these offices. The issuer may also choose to pay interest on definitive notes by mailing checks. For so long as any of the notes are listed on the Luxembourg Stock Exchange, we will maintain a paying agent in Luxembourg. The payment of principal on definitive notes will be made upon presentation and surrender of definitive notes at the office of the paying agent in Luxembourg.

When an interest payment date or a redemption date falls on a Saturday, Sunday, legal holiday, or a day when banks are authorized or obligated to close in Moscow, Luxembourg or New York, payment may be made on the next business day in Moscow, Luxembourg or New York.

The issuer will pay interest, principal and any other money due on global notes to the registered holder thereof by wire transfer of same-day funds. For a discussion of payments with respect to book-entry securities issued in respect of global notes, see “—Arrangements Relating to Notes in Global Form—Payments” below.

Street name and other indirect holders should consult their banks or brokers for information on how they will receive payments.

We may also arrange for additional payment offices, and may cancel or change these offices, including our use of the trustee’s corporate trust office as a payment office. These offices are called “paying agents.” We must notify you of changes in the paying agents for the notes that you hold.

Redemption at Option of Holders upon a Change in Control

If a change in control (as defined below) occurs, you will have the right, at your option, to require the issuer to redeem all of your notes not previously called for redemption. The price the issuer is required to pay will be 101% of the principal amount of the notes, plus accrued interest to the redemption date.

Within 30 days after the occurrence of a change in control, the issuer is obligated to give you notice of the change in control and of the redemption right arising as a result of the change. Notice will be provided as described in “—Notices.” The issuer must also deliver a copy of this notice to the trustee and paying agent in Luxembourg. To exercise your redemption right, you must deliver to the trustee or the paying agent in Luxembourg, on or before the 30th day after the date of the notice to you, irrevocable written notice of your exercise of your redemption right, together with the notes, in the case of definitive notes, with respect to which that right is being exercised. The issuer is required to effect the redemption no earlier than 30 and no later than 60 days after the date of the issuer’s notice to you. You may not, however, exercise your early redemption right in the event the issuer has already exercised its option to redeem for tax reasons as described under “—Redemption at the Option of the Issuer for Tax Reasons” below.

A “change in control” will be deemed to have occurred at any time after the notes are originally issued in any of the following circumstances:

- (1) Any person, including any syndicate or group deemed to be a “person” under Section 13(d)(3) of the Securities Exchange Act of 1934, as amended, acquires beneficial ownership, directly or indirectly, through a purchase, merger or other acquisition, transaction or series of transactions, of shares of our common stock entitling that person to exercise 50% or more of the total voting power of all shares of our common stock; however, any acquisition by (a) Sistema, T-Mobile and/or any of their respective subsidiaries that results in the 50% threshold being exceeded will not trigger this provision or (b) us, any subsidiary of ours or any employee benefit plan of ours will not trigger this provision.
- (2) We consolidate with or merge with or into any other person, another person merges into us, or we convey, transfer, sell, lease or otherwise dispose of all or substantially all of our assets to another person, other than a transaction where immediately after the transaction Sistema and T-Mobile (together with their respective subsidiaries) beneficially own, in the aggregate, more than 50% of the total voting power of all shares of common stock of the continuing or surviving corporation or the person who has received our assets.
- (3) We no longer beneficially own more than 50% of the issuer’s share capital.

The definition of change in control includes a phrase relating to the conveyance, transfer, sale, lease or disposition of “all or substantially all” of our assets. There is no precise, established definition of the phrase “substantially all” under applicable law. Accordingly, your ability to require the issuer to redeem your notes as a result of conveyance, transfer, sale, lease or other disposition of less than all of our assets may be uncertain.

The foregoing provisions would not necessarily provide you with protection if we are involved in a highly leveraged or other transaction that may adversely affect you.

Street name and other indirect holders should consult their banks or brokers for information on how to direct the exercise of the option to require the issuer to redeem the notes upon a change in control.

Redemption at Option of Holders upon a Failure by MTS to Obtain a Permission from the Central Bank of Russia to make Payments in U.S. Dollars under the Guarantee

If we have not, within 60 days after the closing date, obtained a permission from the Central Bank of Russia to make payments in U.S. dollars under the guarantee, you will have the right, until we have obtained the permission, to require the issuer to redeem all of your notes as described below at a price (the “CBR Permission Redemption Price”) in cash equal to 101% of the principal amount of the notes, plus accrued interest to the redemption date.

If we have not, within 60 days after the closing date, obtained a permission from the Central Bank of Russia to make payments in U.S. dollars under the guarantee, the issuer is obligated to give you

notice that we have not obtained the permission. Until we have obtained such permission, you may exercise your right requiring us to redeem your notes on the date described below, following tender of such notes, at the CBR Permission Redemption Price, plus accrued interest to the redemption date. Notice shall be provided as described in “—Notices” and shall state the procedures that you must follow in order to tender your notes for payment.

To exercise your redemption right, you must deliver to the trustee or the paying agent in Luxembourg, on or prior to any interest payment date (each interest payment date on the date of, or next following, the tender of a note being a “CBR Permission Tender Date”) but prior to the date of receipt of the CBR permission, irrevocable written notice of your exercise of your redemption right, together, in the case of a definitive note, with the notes with respect to which that right is being exercised. The issuer is required to effect the redemption no later than seven business days after the relevant CBR Permission Tender Date. You may not, however, exercise your early redemption right in the event the issuer has already exercised its option to redeem as described under “—Redemption for Tax Reasons.”

Redemption at the Option of the Issuer for Tax Reasons

The issuer may redeem the notes at its option, at any time, on giving not less than 30 nor more than 60 days’ notice to the holders, at a redemption price equal to 100% of the principal amount thereof, together with any Additional Amounts (as defined below) and interest accrued to the date fixed for redemption, if on the occasion of the next payment of interest due under the notes,

- we have or the issuer has or we or the issuer will become obliged to pay Additional Amounts as a result of any change in, or amendment to, the laws, treaties, rulings or regulations of any Taxing Jurisdiction (as defined below), or any change in, or amendment to the application or official interpretation of these laws, treaties, rulings or regulations, including a holding by a court of competent jurisdiction, which change or amendment becomes effective on or after the date upon which the notes are issued (or in the case of Additional Amounts paid by a successor to us or the issuer, the date on which the successor became such pursuant to the applicable provisions of the indenture); provided, that, in the case of Additional Amounts payable by us arising from an imposition or levy of Taxes by the Russian Federation or any political subdivision or taxing authority thereof on amounts paid under the guarantee, the Taxes are imposed or levied at a rate in excess of 30% on the gross amount payable under the guarantee; and
- we or the issuer cannot avoid this obligation by taking reasonable measures, including, in our case, by making payments through the issuer, provided that no notice of a tax redemption shall be given earlier than 60 days prior to the earliest date on which we or the issuer would be obliged to pay such Additional Amounts were a payment in respect of the notes then due.

Any notice of a tax redemption will be provided as described in “—Notices.”

Principal Covenants

The following covenants apply to the notes. The capitalized terms in these covenants are defined below under “—Definitions.”

Payment of Principal and Interest

The issuer will pay the principal amount of the global notes on October 14, 2010. The issuer will pay interest due on the global notes to the registered holder at a rate of 8.375% per annum on each interest payment date, until the principal amount of the global notes is paid or made available for payment. For further description of the procedures for payment, see “—Payments and Paying Agents” above and “—Arrangements Relating to Notes in Global Form—Payments” below.

Limitation on Incurrence of Debt

We will not, and will not permit any of our Subsidiaries to, create, issue, incur, assume, guarantee or in any manner become directly or indirectly liable with respect to, or otherwise become responsible for (collectively, “incur”) any Debt, including any Acquired Debt, unless the ratio of our total outstanding Debt to annualized Consolidated Cash Flows (as determined by multiplying our Consolidated Cash Flows for the two most recent fiscal quarters by two) would be no greater than 4.0 to 1.0, determined on a pro forma basis after giving pro forma effect to such incurrence and the incurrence of any other Debt and any other changes in our Debt since the date of our most recently available quarterly or annual consolidated balance sheet and the application of the net proceeds therefrom as if it had occurred on the first date of such quarterly or annual period.

For the purposes of calculating this ratio, any acquisitions that have been made by us or a Subsidiary of ours, including through mergers or consolidations and including any related financing transactions, during or subsequent to the relevant fiscal quarter or year and on or prior to the date of the calculation of the ratio shall be deemed to have occurred on the first day of the relevant fiscal quarter or year, with the pro forma determinations of Consolidated Cash Flows resulting from any such transactions as determined in good faith by us.

The accrual of interest, the accretion or amortization of original issue discount and the payment of interest on any Debt in the form of additional Debt with the same terms will not be deemed to be an incurrence of Debt for purposes of this covenant.

Limitations on Liens

None of the issuer, us or any of our Subsidiaries may create, assume or permit to exist any Debt secured by a Lien (other than a Permitted Lien) upon or in respect of any of its property or assets, now owned or hereafter acquired, without effectively providing that the notes and the guarantee will be directly secured equally and ratably with such Debt.

This restriction will not apply to a Lien created to secure Attributable Debt in connection with a Sale and Lease-Back Transaction permitted under “—Limitations on Sale and Lease-Back Transactions” below.

Limitations on Sale and Lease-Back Transactions

None of the issuer, we or any of our Subsidiaries may enter into any Sale and Lease-Back Transaction with respect to any of its property or assets, now owned or hereafter acquired, unless, after giving effect to the Sale and Lease-Back Transaction, the aggregate amount of all Attributable Debt relating to all Sale and Lease-Back Transactions plus all outstanding secured Debt created, incurred or assumed by us and our Subsidiaries does not exceed 10% of the book value of our total assets, as determined by reference to our most recent quarterly or annual consolidated balance sheet on a pro forma basis after giving effect to the incurrence of any Debt and any other changes in our Debt since the date of such balance sheet. For the purposes of this determination, the amount of Debt under any secured credit facility will be the total amount available under the facility, regardless of the amount at any one time outstanding.

This restriction will not apply to transactions between us and one of our Subsidiaries or between our Subsidiaries or to a Sale and Lease-Back Transaction where the issuer, we or such Subsidiary would be entitled pursuant to “—Limitations on Liens” above to incur Debt secured by a Lien on the property or assets subject to the Sale and Lease-Back Transaction without equally and ratably securing the notes.

Mergers and Sales of Assets

- (1) Neither we nor the issuer may consolidate with or merge into any other person or convey, transfer, sell or lease our properties and assets substantially as an entirety to any person, or permit any person to consolidate with or merge into us, unless each of the following requirements is met:
 - (a) the successor or transferee, if other than us or the issuer, respectively, (i) is a corporation organized and existing under the laws of the Russian Federation or Luxembourg, respectively, and (ii) assumes, expressly or by operation of law, the due and punctual payment of all our or the issuer's obligations and the performance of all of our or the issuer's other covenants under the notes and the indenture; provided, that in the case of any such consolidation or merger involving the issuer, or conveyance, transfer, sale or lease of assets by the issuer, the issuer's successor or transferee will be a wholly-owned Subsidiary of ours (or our successor);
 - (b) immediately after giving effect to that transaction, no event of default, and no event which, after notice or lapse of time or both, would become an event of default, shall have occurred and be continuing;
 - (c) on the date of that transaction, after giving pro forma effect to (i) the transaction; (ii) any related financing transactions; and (iii) the pro forma Consolidated Cash Flows resulting from such transaction, as determined in good faith by the Guarantor, in each case as if they had occurred at the beginning of the relevant quarterly or annual period, the ratio of Debt to the pro forma Consolidated Cash Flows, calculated as provided in the covenant entitled "Limitation on Incurrence of Debt," would be no greater than the greater of (x) such ratio immediately prior to the date of such transaction and (y) 4.0 to 1.0; provided, however, that this clause (c) shall not apply in the case of a consolidation or merger by one of our Subsidiaries with or into us or another of our Subsidiaries; and
 - (d) we or the issuer, as applicable, deliver to the trustee an officer's certificate relating to conditions (a) through (c) above and a legal opinion relating to conditions (a) and, with respect to the absence of an event of default being caused by such transaction, (b) above.
- (2) We have agreed that (a) each conveyance, transfer, sale or lease of assets (other than the payment of dividends) by us or a Subsidiary to or from an Affiliate (other than a Subsidiary or us) will be for Fair Market Value, and (b) if we or any of our Subsidiaries engage in a transaction or series of related transactions that will result in the conveyance, transfer, sale or lease of assets to or from one or more of our Affiliates (other than to or from a Subsidiary or us) with a Fair Market Value of more than \$70 million (or the equivalent in other currencies) since the issue date of the notes, we will deliver to the trustee a board resolution confirming that the transaction or series of related transactions was for Fair Market Value.
- (3) Regardless of whether we, Telecom XXI, or Kuban GSM are permitted to do so by law, (a) we may not transfer, sell or lease our GSM 900 or 1800 license for the Moscow license area, (b) Telecom XXI may not transfer, sell or lease its GSM 900 or 1800 license for the St. Petersburg license area, (c) Kuban GSM may not transfer, sell or lease its GSM 900 or 1800 license for the Krasnodar license area and (d) UMC may not transfer, sell or lease its GSM 900 or 1800 licenses, in either case except in a transaction that would be permitted under paragraph (1) above or would not have a material adverse effect on the business, financial condition or results of operations of us and our subsidiaries as a whole.

Transactions with Affiliates

None of the issuer, us or any of our Subsidiaries shall, directly or indirectly, enter into or permit to exist any intercompany loan with, or for the benefit of, any Affiliate, unless (a) the terms of such intercompany loan are no less favorable to the issuer, us or such Subsidiary, as the case may be, than those that could be obtained in a comparable arm's-length transaction or series of related transactions

with a person that is not an Affiliate of the issuer, us or such Subsidiary or (b) such intercompany loan is made pursuant to a contract or contracts existing on the issue date of the notes (excluding any amendments or modifications thereto after the issue date of the notes).

This covenant shall not apply to (a) compensation or employee benefit arrangements with any officer or director of the issuer, us or such Subsidiary arising out of any employment contract entered into in the ordinary course of business or (b) transactions between the issuer, us or any of our Subsidiaries or between any such Subsidiaries.

Maintenance of Rating

We and the issuer have agreed to take all commercially reasonable steps necessary to maintain a rating on the notes from Moody's or Standard & Poor's.

Reports

We have agreed that, during any period in which we are not subject to and in compliance with Section 13 or 15(d) of the Exchange Act or are not exempt from such reporting requirements pursuant to and in compliance with Rule 12g3-2(b) under the Exchange Act, we will provide to each holder of the notes and to each prospective purchaser of the notes, upon the request of such holder or prospective purchaser, any information required to be provided by Rule 144A(d)(4) under the U.S. Securities Act.

We have also agreed

- to submit to the U.S. Securities and Exchange Commission, or the Commission, or otherwise make public and deliver to the trustee, within 60 days after the end of each of the first three fiscal quarters of each fiscal year, quarterly reports on Form 6-K (or any successor form) containing our consolidated balance sheet, statement of operations and cash flow statement prepared in accordance with U.S. GAAP (but excluding footnotes) and a discussion by management highlighting critical financial developments during the period;
- to make public and deliver to the trustee, within 120 days after the end of each fiscal year, reports with respect to the fourth quarter containing our consolidated balance sheet, statement of operations and cash flow statement prepared in accordance with U.S. GAAP (but excluding footnotes) and a discussion by management highlighting critical financial developments during the fourth quarter; and
- to file with the Commission or otherwise make public and deliver to the trustee, within 180 days after the end of each fiscal year, annual reports on Form 20-F (or any successor form) containing the information required to be contained therein (or required in such successor form), regardless of whether we are then required to file a Form 20-F under the rules promulgated by the Commission.

The above reports that will be delivered to the trustee will also be made available to the public at the office of the paying agent in Luxembourg.

Definitions

For the purposes hereof:

“Acquired Debt” means any Debt of an entity existing at the time such entity is merged into us or a Subsidiary or becomes one of our Subsidiaries, and any Debt secured by a Lien on an asset acquired by us or one of our Subsidiaries.

“Affiliate” means, with respect to any person at any time, any entity directly or indirectly controlling, controlled by or under common control with that person at that time. For purposes of this

definition, “control” means the power to direct the management and policies of an entity, directly or indirectly, whether through the ownership of voting securities, by contract or otherwise.

“*Attributable Debt*” means, in respect of a Sale and Lease-Back Transaction, at the time of determination, the lesser of (x) the Fair Market Value of the property subject to such arrangement and (y) the present value (discounted at the weighted average annual interest rate on all notes then issued and outstanding under the indenture, compounded semi-annually) of the total obligations of the lessee for rental payments during the remaining term of the lease included in such arrangement after excluding all amounts required to be paid on account of maintenance and repairs, insurance, taxes and similar charges.

“*Consolidated Cash Flows*” for any period means our consolidated net income for such period, excluding any cumulative effect of a change in accounting principles since the beginning of the relevant period, plus the following items (i)-(iv), in each case to the extent such items were deducted when calculating our consolidated net income for such period:

- (i) any non-recurring loss, including any loss realized in connection with any asset sale or disposition of securities;
- (ii) provision for income taxes;
- (iii) interest expense; and
- (iv) depreciation and amortization (including amortization of goodwill and other intangibles but excluding amortization of prepaid cash expenses that were paid in a prior period) and other non-cash expenses, including currency exchange and translation losses (excluding bad debt expense and any such non-cash expense to the extent that it represents an accrual of or reserve for cash expenses in any future period or amortization of a prepaid cash expense that was paid in a prior period);

minus the following items, in each case to the extent such items increased our consolidated net income for such period:

- (v) any non-recurring gain, including any gain realized in connection with any asset sale or disposition of securities; and
- (vi) any non-cash items, including currency exchange and translation gains, other than items in the ordinary course of business,

all as determined on a consolidated basis in accordance with U.S. GAAP.

“*Debt*” means, with respect to any person, without duplication:

- (i) all obligations of such person for borrowed money;
- (ii) all reimbursement obligations of such person in respect of letters of credit, banker’s acceptances or other similar instruments or credit transactions;
- (iii) all obligations of such person evidenced by bonds, debentures, notes or other similar instruments;
- (iv) all obligations of such person to the extent that they defer the purchase price of property or services for more than 180 days, except trade accounts payable arising in the ordinary course of business;
- (v) all obligations of such person as lessee under leases that would be capitalized on a balance sheet of the lessee prepared in accordance with U.S. GAAP;
- (vi) all guarantees and indemnities of such person in respect of the Debt of any other person or persons, without duplication of any Debt otherwise included in this definition; and

- (vii) all Debt of other persons secured by a Lien on any property, income and assets of such person, whether or not such Debt is assumed by such person; provided that if such Debt is not assumed by such person, the amount of such Debt shall be the lesser of (a) the Fair Market Value of such property, income or assets at such date of determination and (b) the amount of such Debt of such other person.

“Fair Market Value” means, with respect to any property or assets, the sale price for such property or assets as could be negotiated in a free market transaction for cash conducted at arm’s length between a willing seller and a willing and able buyer as determined by our board of directors in cases of property or assets with a Fair Market Value in excess of \$70 million, or as determined by our chief financial officer or our chief executive officer in cases of property or assets with a Fair Market Value equal to or below \$70 million.

“Lien” means any mortgage, lien, pledge, charge, security interest, right of set off or other encumbrance or preferential arrangement, whether or not filed, recorded or otherwise perfected under applicable law (including any conditional sale or other title retention agreement, any lease in the nature thereof, any option or other agreement to sell or give a security interest in and any filing of or agreement to give any financing statement under the Uniform Commercial Code (or equivalent statutes) of any jurisdiction).

“Permitted Lien” means:

- (i) any Lien existing on the date of the indenture, including any Lien created in respect of an obligation arising out of a credit agreement between Ericsson and Rosico dated December 20, 1996, assumed by us as a result of the merger of Rosico into us on June 9, 2003, as amended;
- (ii) any Lien on any property or assets of any corporation existing at the time such corporation is merged or consolidated with or into us or any of our Subsidiaries or becomes a subsidiary of ours and not created in contemplation of such event, provided that no such Lien shall extend to any other property or assets;
- (iii) any Lien existing on any property or assets prior to the acquisition thereof by us or any of our Subsidiaries and not created in contemplation of such acquisition, provided that no such Lien shall extend to any other property or assets;
- (iv) any Lien on any property or assets securing our Debt or Debt of any of our Subsidiaries incurred or assumed for the purpose of financing all or part of the cost of acquiring, repairing or refurbishing such property or assets, provided that (a) no such Lien shall extend to any other property or assets, (b) the aggregate principal amount of all Debt secured by Liens under this clause (iv) on such property or assets shall not exceed the lower of (x) the purchase price of such property or assets and (y) the Fair Market Value of such property or assets at the time of acquisition, repair or refurbishing and (c) such Lien attaches to such property or assets concurrently with the repair or refurbishing thereof or within 90 days after the acquisition thereof, as the case may be;
- (v) any Lien arising by operation of law, including any Liens (a) arising in the ordinary course of business with respect to amounts not yet delinquent or being contested by us, the issuer or a Subsidiary of ours in good faith in appropriate proceedings or (b) for taxes, assessments, government charges or claims, including without limitation those in favor of Russian governmental fiscal authorities;
- (vi) any Lien on the property or assets of any of our Subsidiaries securing intercompany Debt of such Subsidiary owing to the issuer, us or another of our Subsidiaries;
- (vii) easements, rights-of-way, restrictions and any other similar charges or encumbrances incurred in the ordinary course of business and not interfering in any material respect with our business

or the business of any of our Subsidiaries, including any encumbrance or restriction with respect to an equity interest of any joint venture pursuant to a joint venture agreement;

- (viii) any extension, renewal or replacement of any Lien described in clauses (i)-(vii) above, provided that (a) such extension, renewal or replacement shall be no more restrictive in any material respect than the original Lien, (b) the amount of Debt secured by such Lien is not increased and (c) if the property, income or assets securing the Debt subject to such Lien are changed in connection with such refinancing, extension or replacement, the Fair Market Value of the property or assets is not increased; and
- (ix) any other Lien; provided, that, immediately after giving effect to such Lien, all our secured Debt and Attributable Debt in the aggregate do not exceed 10% of the book value of our total assets as determined by reference to our most recent quarterly or annual consolidated balance sheet on a pro forma basis after giving effect to the incurrence of any Debt and any other changes in our Debt since the date of such balance sheet;

provided, that no Lien on the property, income or assets of the issuer shall be a Permitted Lien, other than a Lien arising by operation of law.

“Sale and Lease-Back Transaction” means any arrangement providing for the leasing for a period, including renewals, in excess of 18 months, of any property or asset that has been owned by us or any Subsidiary for more than 180 days and has been or is to be sold or transferred by us or such Subsidiary in such transaction.

“Subsidiary” means, with respect to any person, (i) any corporation, association or other business entity of which more than 50% of the total voting power of shares of capital stock entitled (without regard to the occurrence of any contingency) to vote in the election of directors, managers or trustees thereof is at the time owned or controlled, directly or indirectly, by such person or one or more of the other Subsidiaries of such person (or a combination thereof) and (ii) any partnership (a) the sole general partner or the managing general partner of which is such person or a Subsidiary of such person or (b) the only general partners of which are such person or of one or more Subsidiaries of such person (or any combination thereof).

Taxation and Additional Amounts

All payments by the issuer and us in respect of the notes and the guarantee will be made free and clear of and without deduction or withholding for or on account of any present or future taxes, duties, assessments, fees or other governmental charges (“Taxes”) imposed or levied by or on behalf of Luxembourg, the Russian Federation, any jurisdiction from or through which a payment is made, or any political subdivision or taxing authority thereof or therein each of the preceding jurisdictions (each, a “Taxing Jurisdiction”), unless such withholding or deduction is required by law. If the issuer is required to make any withholding or deduction for or on account of any Taxes from any payment made under or with respect to the notes, or if we are required to make any withholding or deduction for or on account of any Taxes imposed by a Taxing Jurisdiction from any payment made under or with respect to the guarantee, the issuer (or, in respect of the guarantee, we) will pay as additional interest to any holder of the notes such additional amounts (the “Additional Amount”) as may be necessary in order that every net payment made by the issuer on such note (or by us on the guarantee) after deduction or withholding for or on account of any Taxes will not be less than the amount then due and payable. The foregoing obligation to pay Additional Amounts, however, will not apply to any (i) Taxes that would not have been imposed but for the existence of any present or former connection between such holder of the notes and any Taxing Jurisdiction other than the mere receipt of such payment or the ownership or holding of such note, (ii) Taxes that would not have been imposed but for the presentation by the holder of such note for payment on a date more than 30 days after the date on which such payment became due and payable or the date on which payment thereof is duly provided for, whichever occurs later, (iii) Taxes required to be deducted or withheld by any paying agent from a

payment on a note or the guarantee, if such payment can be made without deduction or withholding by any other paying agent, (iv) Taxes that would not have been imposed but for the failure of the holder to comply with the issuer's written request addressed to the holder at least 60 days prior to the relevant payment to provide information with respect to any reasonable certification, documentation, information or other reporting requirement concerning the nationality, residence, identity or connection with the Taxing Jurisdiction of the holder of such note, (v) Taxes imposed on a payment to an individual that are required to be made pursuant to any European Union Directive on the taxation of savings implementing the conclusion of the ECOFIN Council meeting of 26–27 November 2000 (including the Directive adopted on June 3, 2003) or any law implementing or complying with, or introduced in order to conform to, the Directive, and (vi) estate, inheritance, gift, sale or excise tax.

The issuer or we, as applicable, will make any withholding or deduction for or on account of Taxes and remit the full amount deducted or withheld to the relevant authority in accordance with the applicable law. The issuer or we, as applicable, will furnish to the holders of the notes outstanding on the date of the required payment within 30 days after the date the payment of any Taxes is due, certified copies of tax receipts evidencing that such payment has been made and will indemnify and hold harmless each holder on the date of the required payment of any Taxes and, upon written request, reimburse such holder for the amount of (i) any Taxes (other than net income taxes) levied on and paid by the holder as a result of payments made under or with respect to the outstanding notes or the guarantee; (ii) any liability (other than any liability relating to any net income taxes) (including penalties, interest and expense) arising from or with respect to the notes or the guarantee; and (iii) any Taxes imposed with respect to any reimbursement under (i) or (ii) above.

Purchase of Notes

We and any of our subsidiaries, including the issuer, may, to the extent permitted by applicable law, at any time purchase notes in the open market at any price by tender or by any private arrangement pursuant to the terms and conditions of such tender or private arrangement and, to the extent permitted by, and pursuant to, the requirements of the Luxembourg Stock Exchange. Any note that we or any of our subsidiaries purchases may, at our option, be surrendered to the trustee for cancellation. None of the notes we or any of our subsidiaries purchase may be reissued or resold, except to any of our subsidiaries or to us.

Events of Default

The following will be events of default under the indenture:

- failure to pay principal of any note when due;
- failure for 15 days to pay the full amount of interest or Additional Amounts on any note when due;
- failure to comply with the obligations described under “Redemption at Option of Holders Upon a Change in Control”;
- failure to perform any other covenant in the indenture and that failure continues for 30 days after receipt by us and the issuer of a written notice of such failure from the trustee or the holders of at least 25% in aggregate principal amount of outstanding notes;
- default under Debt of the issuer, us or any of our Subsidiaries or under any indenture or other instrument under which such Debt has been issued or is governed where the aggregate amount of the Debt is in excess of \$5,000,000 (or the equivalent in other currencies), which default (i) results in the acceleration of the payment of such Debt or (ii) has not been cured or waived and constitutes the failure to make any payment of principal or interest on such Debt when due, after the expiration of any applicable grace period;

- a final action resulting in suspension for more than 30 days or loss of any of (i) our GSM 900 or 1800 license for the Moscow license area; (ii) Telecom XXI's GSM 900 or 1800 license for the St. Petersburg license area; (iii) Kuban GSM's GSM 900 or 1800 license for the Krasnodar license area; or (iv) UMC's GSM 900 or 1800 licenses, in each case other than, in the event of our, Telecom XXI's, Kuban GSM's or UMC's merger or consolidation or the sale of our, Telecom XXI's, Kuban GSM's or UMC's assets and properties substantially as a whole in a transaction permitted under paragraph (1) of "—Mergers and Sales of Assets," a loss where the license is issued within 30 days to us, the successor or transferee corporation, or any of our or such successor's or transferee's Subsidiaries;
- reassignment to other users (other than one of our Subsidiaries), cancellation or other loss of any of our, Telecom XXI's, Kuban GSM's or UMC's assigned spectrum allocations, except as would not have a material adverse effect on the business, financial condition or results of operations of us and our Subsidiaries as a whole;
- express transfer, sale or lease of any of (i) our GSM 900 or 1800 license for the Moscow license area; (ii) Telecom XXI's GSM 900 or 1800 license for the St. Petersburg license area; (iii) Kuban GSM's GSM 900 or 1800 license for the Krasnodar license area; or (iv) UMC's GSM 900 or 1800 licenses, regardless of whether such transfer, sale or lease is permitted by law, other than in a merger, consolidation, transfer, sale or lease permitted under paragraph (1) of "—Mergers and Sales of Assets" above or that would not have a material adverse effect on the business, financial condition or results of operations of us and our Subsidiaries as a whole;
- our guarantee ceases to be in full force and effect;
- the American Depositary Shares representing our common stock are no longer listed on the New York Stock Exchange or such listing is suspended for more than 15 days, where such de-listing or suspension is due to our failure to satisfy our obligations under our listing agreement with the New York Stock Exchange;
- rendering against the issuer, us or any of our Subsidiaries of a judgment, decree or order for the payment of money in excess of \$10,000,000 and the continuance of such judgment, decree or order unsatisfied and in effect for any period of 60 consecutive days without a stay of execution; and
- bankruptcy, insolvency or bankruptcy-related reorganization of the issuer, us or any of our Significant Subsidiaries, each as specified in the indenture.

Subject to the provisions of the indenture relating to the duties of the trustee, in case an event of default shall occur and be continuing, the trustee will be under no obligation to exercise any of its rights or powers under the indenture at the request or direction of any of the holders, unless such holders shall have offered to the trustee reasonable indemnity. Subject to the provisions for the indemnification of the trustee, the holders of a majority in aggregate principal amount of the outstanding notes will have the right to direct the time, method and place of conducting any proceeding for any remedy available to the trustee or exercising any trust or power conferred on the trustee.

If an event of default, other than an event of default arising from events of bankruptcy, insolvency or bankruptcy-related reorganization, occurs and is continuing, either the trustee or the holders of at least 25% in principal amount of the outstanding notes may accelerate the maturity of all of the notes. After acceleration, but before a judgment or decree based on acceleration, the holders of a majority in aggregate principal amount of the outstanding notes may, in the circumstances set forth in the indenture, rescind the acceleration if all events of default, other than the nonpayment of principal of the notes which have become due solely because of the acceleration, have been cured or waived as provided in the indenture. If an event of default arising from events of our bankruptcy, insolvency or bankruptcy-related reorganization occurs and is continuing, then the principal of, and accrued interest

on, all of the notes will automatically become immediately due and payable without any declaration or other act on the part of the holders of notes or the trustee.

Before you may take any action to institute any proceeding relating to the indenture, or to appoint a receiver or a trustee, or for any other remedy, each of the following must occur:

- you must have given the trustee written notice of a continuing event of default;
- the holders of at least 25% of the aggregate principal amount of all outstanding notes must make a written request of the trustee to take action because of the default and must have offered reasonable indemnification to the trustee against the cost, liabilities and expenses of taking such action; and
- the trustee must not have taken action for 60 days after receipt of such notice and offer of indemnification.

These limitations do not apply to a suit for the enforcement of payment of the principal of or any premium or interest on a note, or the redemption amount of a note, on or after the due dates for such payments.

We and the issuer will furnish to the trustee annually a statement as to our performance of our respective obligations under the indenture and as to any default in our performance.

Street name and other indirect holders should consult their banks or brokers for information on how to give notice or direction to or make a request of the trustee and to make or annul a declaration of acceleration.

Modification and Waiver

The consent of the holders of a majority in principal amount of the outstanding notes affected is required to make a modification or amendment to the indenture. However, a modification or amendment requires the consent of the holder of each outstanding note affected if it would:

- change the stated maturity of the principal of a note or the interest payment dates of a note;
- reduce the principal amount or interest on any note;
- reduce the amount payable upon a redemption of a note or alter any provision with respect to redemption of any note (other than provisions relating to the covenants described under “—Redemption at Option of Holders upon a Change in Control”);
- modify any payment obligation pursuant to the guarantee;
- change the place (other than changes to or additions or removals of paying agents in accordance with the indenture) or currency of payment on a note;
- impair the right to institute suit for the enforcement of any payment on any note;
- reduce the percentage of holders whose consent is needed to modify or amend the indenture;
- change the obligation of the issuer or us to pay Additional Amounts on the notes;
- reduce the percentage of holders whose consent is needed to waive compliance with certain provisions of the indenture; or
- modify the provisions dealing with modification and waiver of the indenture.

The holders of a majority in principal amount of the outstanding notes must provide written consent to waive compliance by the issuer or us with certain restrictive provisions of the indenture. The holders of a majority in principal amount of the outstanding notes may waive any past default, except a default in the payment of principal, any premium, interest or redemption amounts.

Noteholder consent will not be required in connection with the following amendments:

- to cure any inconsistency, omission, defect or ambiguity in the indenture;
- to add any additional events of default;
- to secure the notes;
- to provide for the issuance of additional notes in accordance with the indenture;
- to add to the issuer's or our covenants and agreements or to surrender any of our or the issuer's rights or powers;
- to assign the trustee's rights and duties to a qualified successor;
- to evidence the succession of another person to the issuer or to us and the assumption by the successor to the issuer's or our obligations and our covenants, where the parties are amending the indenture in a similar way;
- to comply with the U.S. Securities Act, the Exchange Act, the Investment Company Act of 1940 or the Trust Indenture Act of 1939, each as amended; or
- to modify, alter, amend or supplement the indenture in any other manner that is not adverse to the holders of the notes.

No amendment to the indenture or the notes or the book-entry securities that affects DTC, Euroclear, Clearstream or the holders of book-entry securities in an adverse way will be allowed without the consent of DTC, Euroclear or Clearstream, as the case may be.

Street name and other indirect holders should consult their banks or brokers for information on how approval may be granted or denied if we or the issuer seek to modify or amend the indenture or the notes or request a waiver.

Defeasance

We and the issuer may be discharged from all obligations in respect of the notes under the indenture (except for, among other things, certain obligations to register the transfer or exchange of notes, to replace stolen, lost or mutilated notes, to maintain paying agents and to hold moneys or payments in trust) if we or the issuer have deposited with the trustee, in trust for the benefit of the holders of the notes, cash in U.S. dollars, non-callable U.S. governmental securities, or a combination thereof, in such amounts as will be sufficient, in the opinion of an internationally recognized firm of independent public accountants, to pay the principal of and interest and additional interest, if any, on the outstanding notes on the stated maturity date or any redemption date. This discharge is known as "legal defeasance." We and the issuer may also be discharged from certain of our obligations under the indenture, including those described under "—Principal Covenants—Limitation on Incurrence of Debt," "—Limitations on Liens," "—Limitations on Sale and Lease-Back Transactions," clause (c) under "—Mergers and Sales of Assets," "—Transactions with Affiliates" and "—Reports" and "—Redemption at Option of Holders upon a Change in Control," if we or the issuer have deposited cash, securities or a combination thereof as described above. This discharge is known as "covenant defeasance."

Defeasance will become effective after the issuer, among other things, has delivered to the trustee an opinion of counsel confirming that the deposit and related defeasance will not cause the holders of the notes to recognize income, gain or loss for U.S. federal income tax purposes, and, in the case of legal defeasance, that either the issuer has received a ruling or other formal statement or action to such effect from or published by the U.S. Internal Revenue Service or there has been a change in U.S. federal income tax law to such effect. After legal defeasance, you will only be able to look to the trust fund for payments on the notes.

Meetings of Noteholders

The indenture contains provisions for convening meetings of the holders of notes to approve a modification or amendment to, or obtain a waiver of, any provision of the indenture or the notes or to consider any other matter of common interest to the holders.

Notice of at least 30 days must be given of any meeting. A meeting must be called if requested in writing by the holders of at least one-tenth of the aggregate principal amount of the outstanding notes or by a resolution of the board of directors of the issuer. The indenture provides that any meeting of the holders will be held in London. The quorum for any meeting, other than an adjourned meeting, shall be, the holders of at least two-thirds of the aggregate principal amount of the notes then outstanding, and at an adjourned meeting shall be the holders of at least a majority of the aggregate principal amount of the notes then outstanding. For the purpose of such meetings, notes held by the issuer, us, any of our subsidiaries or any related party of any of the foregoing persons or by the trustee, in its individual capacity, will not be counted.

No action at a meeting of holders will be effective unless approved by persons holding or representing notes in the aggregate principal amount required by the applicable provision of the indenture. At any meeting of holders, each holder or proxy will be entitled to one vote for each \$1,000 principal amount of outstanding notes held or represented. A proxy need not be a holder of the notes.

Listing

Application for the notes to be listed on the Luxembourg Stock Exchange has been made but is not expected to be approved prior to closing. We have agreed in the purchase agreement with the initial purchasers to obtain the listing of the notes on the Luxembourg Stock Exchange within 28 days from the date of this offering memorandum.

Notices

Any notice to holders of notes shall be given:

- By first-class mail to the addresses of the holders as they appear in the security register, in which case notices will be deemed to have been given on the date of mailing. The issuer will give holders of notes irrevocable notice that it is exercising its option to redeem the notes not less than 30 nor more than 60 days before the redemption date.
- As long as the notes are listed on the Luxembourg Stock Exchange and the rules of that stock exchange so require, by publication in a leading newspaper having general circulation in Luxembourg, which is expected to be the Luxembourg Wort. This notice will be deemed to have been given on the date of publication or, if published more than once on different dates, on the first date on which publication is made.

In addition, notice of any meeting of noteholders will be given by publication in leading newspapers having general circulation in New York City, in Europe and in Luxembourg.

As long as the notes are listed on the Luxembourg Stock Exchange and the rules of that stock exchange so require, reports filed by us with the Commission or required to be provided to the holders of the notes under the indenture may be obtained at the office of the paying agent in Luxembourg.

Replacement of Notes

The issuer will replace, at the expense of the holders, notes that become mutilated, destroyed, stolen or lost upon delivery to the trustee or the paying agent in Luxembourg of the mutilated notes or evidence of the loss, theft or destruction of the notes satisfactory to the issuer and the trustee. In the case of a lost, stolen or destroyed note, indemnity satisfactory to the trustee or the paying agent in

Luxembourg and the issuer may be required at the expense of the holder of the note before a replacement note will be issued.

The Trustee

If an event of default occurs and is not cured, the trustee will be required to use the degree of care of a prudent person in the conduct of his own affairs in the exercise of its powers. Subject to these provisions, the trustee will be under no obligation to exercise any of its rights or powers under the indenture at the request of any holders of notes, unless they shall have offered to the trustee reasonable security or indemnity.

Governing Law, Consent to Jurisdiction and Service and Arbitration

The indenture and the notes are governed by New York law. The application of articles 86-94-8 of the Luxembourg law on commercial companies of 10th August 1915 (as amended) has been excluded in respect of the notes. We and the issuer have submitted to the jurisdiction of the federal and state courts located in the Borough of Manhattan, City and State of New York, for purposes of all legal actions and proceedings instituted in connection with the notes, the guarantee and the indenture and have appointed Puglisi & Associates as our authorized agent upon which process may be served in any such action. We and the issuer also have consented to arbitration in accordance with the Rules of the London Court of International Arbitration in the event of any controversy, claim or cause of action arising out of or relating to the notes and the indenture. This means that an action brought against us or the issuer by or on behalf of the holders of the notes may be brought in these New York courts or may be submitted to arbitration.

Arrangements Relating to Notes in Global Form

The Rule 144A global note will be deposited with a custodian for, and registered in the name of, Cede & Co., as nominee of DTC. The Regulation S global note will be deposited with, and registered in the name of a common depositary for Euroclear and Clearstream or a nominee thereof.

You can hold a beneficial interest in the Rule 144A global note only directly through DTC or indirectly through participants or indirect participants in DTC. You can hold a beneficial interest in the Regulation S global note only directly through Euroclear or Clearstream or indirectly through participants or indirect participants in Euroclear or Clearstream. These beneficial interests may be held in such denominations as are permitted by DTC, Euroclear or Clearstream, as applicable. Indirect participants are banks, brokers, dealers, trust companies and other parties that clear through or maintain a custodial relationship with a participant. Beneficial interests in the global notes are called book-entry securities. Ownership of beneficial interests in the global notes will be in the form of book-entry securities.

The ultimate beneficial owners of the global notes can only be indirect holders. We do not recognize this type of investor as a holder of notes and instead only deal with the registered holders of the global notes. As an indirect holder, an investor's rights and obligations relating to a global note will be governed by the account rules of DTC, Euroclear or Clearstream and the investor's financial institution. We, the trustee, any paying agent, the registrar and any of our or their agents will not be responsible for the obligations under the rules and procedures of DTC, Euroclear or Clearstream, any of their respective participants or an investor's financial institution.

We have no responsibility for any aspect of the actions of any participant in DTC, Euroclear or Clearstream or for payments related to, or for its records of, ownership interests in the global notes. We also do not supervise the participants in DTC, Euroclear or Clearstream in any way, nor will we govern payments, transfers, exchange and other matters relating to the investor's interest in the global notes.

Payments

Payments related to the notes will be made through the facilities of JPMorgan Chase Bank, as principal paying agent, to the nominee of DTC as the registered holder of the Rule 144A note and to the nominee of the common depositary as the registered holder of the Regulation S note. Payments to DTC's nominee and to the nominee of the common depositary will discharge our payment obligations in respect of the notes. DTC, Euroclear and Clearstream have informed us that they will credit their participants' accounts the date they receive payment from the paying agent with payments in amounts proportionate to their respective ownership interests as shown on their respective records. Payments by participants in DTC, Euroclear or Clearstream to the owners of book-entry securities will be the participants' responsibility. We expect that payment by participants in DTC, Euroclear or Clearstream to the owners of interests in book-entry securities will be governed by standard customary practices.

All payments will be made through the facilities of the paying agent or agents. Redemption If and when the global notes are redeemed, at maturity or otherwise, all amounts in respect of the redemption will be paid through the facilities of the paying agent or agents to the nominee of DTC or the nominee of the common depositary for Euroclear or Clearstream, as the case may be. The redemption price that will be paid for the book-entry securities will be equal to the amount paid to the depositary systems for the applicable global notes.

Transfers and Transfer Restrictions

Transfers of global notes may be made only through the book-entry register. Until the book-entry securities are exchanged for definitive notes, the global notes may only be transferred as a whole by:

- DTC to a nominee of DTC;
- the common depositary to a nominee of the common depositary;
- a nominee of DTC to DTC or another nominee of DTC;
- a nominee of the common depositary to the common depositary or another nominee of the common depositary;
- DTC or any such nominee to a successor of DTC or a nominee of such successor; or
- the common depositary or any such nominee to a successor of the common depositary or a nominee of such successor.

DTC, Euroclear and Clearstream, as the case may be, will record all transfers of the interests in book-entry securities using their respective book-entry systems following their customary procedures.

Beneficial interests in a Rule 144A global note may be transferred only in accordance with the restrictions set out under "Transfer Restrictions."

Clearance and Settlement

General

The book-entry systems operated by DTC, Euroclear and Clearstream have established electronic securities and payment transfer, processing, depositary and custodial links among themselves and others, either directly or through custodians and depositaries. These links allow notes to be issued, held and transferred among these clearing systems without the physical transfer of certificates.

The policies of DTC, Euroclear and Clearstream will govern payments, transfers, exchange and other matters relating to the investors' interest in notes held by them.

We have no responsibility for any aspect of the actions of DTC, Clearstream or Euroclear or any of their direct or indirect participants. We have no responsibility for any aspect of the records kept by

DTC, Clearstream or Euroclear or any of their direct or indirect participants. We also do not supervise these systems in any way.

DTC, Euroclear and Clearstream and their participants perform these clearance and settlement functions under agreements they have made with one another or with their customers. You should be aware that they are not obligated to perform these procedures and may modify them or discontinue them at any time.

The description of the clearing systems in this section reflects our understanding of the rules and procedures of DTC, Euroclear and Clearstream as they are currently in effect. These systems could change their rules and procedures at any time.

Transfers of Beneficial Interests in the Global Notes

Trading between DTC participants

A beneficial owner of an interest in the Rule 144A global note may hold its interest directly through DTC if such person is a participant in DTC, or indirectly through organizations which are direct DTC participants if such person is not a participant in DTC. Beneficial owners may also own interests in the global note held by DTC through banks, brokers, dealers, trust companies and other parties that clear through or maintain a custodial relationship, either directly or indirectly, with a direct DTC participant.

Transfers between direct DTC participants will be effected in accordance with DTC's rules and will be settled using the procedures applicable to U.S. corporate debt obligations in DTC's SDFS system in same-day funds.

Trading between participants in Euroclear and Clearstream

Transfers between participants in Euroclear or Clearstream will be effected in accordance with the normal rules and operating procedures of Euroclear and Clearstream and will be settled using the procedures applicable to conventional eurobonds. Euroclear and Clearstream will hold interests in the Regulation S global note on behalf of their participants through customers' securities accounts in their respective names on the books of their common depository. Euroclear and Clearstream have established an electronic bridge between their two systems across which their respective participants may settle trades with each other.

Trading between a DTC seller and a Euroclear or Clearstream purchaser

When an interest in a global note held by DTC is 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 instructions for delivery to the relevant Euroclear or Clearstream accountholder by 12 noon, New York time, on the settlement date. DTC will in turn transmit this 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. In addition, on the settlement date, DTC will instruct the paying and transfer agent and the registrar to (1) decrease the amount of book-entry interests in the name of Cede & Co. representing interests in the global note held by DTC and (2) increase the amount of book-entry interests registered in the name of the common depository for the accounts of Euroclear and Clearstream and representing interests in the Regulation S global note. Book-entry interests will be delivered free of payment to Euroclear or Clearstream, as the case may be, for credit to the relevant accountholder on the first business day following the settlement date.

Trading between a Euroclear or Clearstream seller and a DTC purchaser

When interests in the Regulation S global note 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 delivery free of payment instructions by 7:45 p.m., Brussels or Luxembourg time, one business day prior to the settlement date. Euroclear or Clearstream, as the case may be, will in turn transmit appropriate instructions to the common depositary and the registrar to arrange delivery to the DTC participant on 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, the common depositary will transmit appropriate instructions to DTC who will in turn deliver such interests in the Regulation S global note, 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 paying and transfer agent and the registrar to (1) decrease the amount of the book-entry interests registered in the name of the common depositary for the account of Euroclear or Clearstream and representing interests in the Regulation S global note, and (2) increase the amount of the book-entry interests registered in the name of Cede & Co. and representing interests in the applicable global note held by DTC.

Special Timing Considerations

You should be aware that investors will only be able to make and receive deliveries, payments and other communications involving notes through Euroclear and Clearstream on days when those systems are open for business. Those systems may not be open for business on days when banks, brokers and other institutions are open for business in the United States.

In addition, because of time-zone differences, there may be problems with completing transactions involving Euroclear and Clearstream on the same business day as in the United States. U.S. investors who wish to transfer their interests in the notes, or to receive or make a payment or delivery of notes, on a particular day, may find that the transactions will not be performed until the next business day in Brussels or Luxembourg, depending on whether Euroclear or Clearstream is involved.

Security Codes

The Common Code for the Rule 144A notes is 017842331, the ISIN for the Rule 144A notes is US60741AAE55 and the CUSIP number for the Rule 144A notes is 60741AAE5. The Common Code for the Regulation S notes is 017841904, the ISIN for the Regulation S notes is XS0178419049 and the CUSIP number for the Regulation S notes is L64395AG8.

PLAN OF DISTRIBUTION

We, the issuer and the initial purchasers have entered into a purchase agreement relating to the notes. In the purchase agreement the initial purchasers have agreed to purchase from the issuer, and the issuer has agreed to sell to each initial purchaser, the principal amount of notes set forth opposite its name below.

	Principal Amount of Notes
Credit Suisse First Boston (Europe) Limited	\$247,001,000
ING Bank N.V., London Branch	133,001,000
ABN AMRO Bank N.V.	3,333,000
Commerzbank Aktiengesellschaft	3,333,000
J.P. Morgan Securities Ltd.	3,333,000
Merrill Lynch International	3,333,000
Raiffeisen Zentralbank Österreich AG	3,333,000
Renaissance Advisory Services Limited	3,333,000
	<u>\$400,000,000</u>

The issuer has agreed to pay to the initial purchasers commission of 0.75% of the aggregate principal amount of the notes and has agreed to reimburse the initial purchasers for certain of their expenses in connection with the offering of the notes. The initial purchasers will purchase the notes at the offering price indicated on the cover page less commissions paid to them by the issuer, and offer to resell the notes at the price to investors indicated on the cover page. After the initial offering of the notes, the initial purchasers may from time to time vary the offering price and other selling terms.

The obligations of the initial purchasers under the purchase agreement to purchase the notes are subject to the approval by their counsel of certain legal matters and to certain other conditions being satisfied. The initial purchasers must purchase all of the notes if they purchase any of them.

No action has been or will be taken in any jurisdiction by the issuer, us or the initial purchasers that would permit a public offering of the notes or the possession, circulation or distribution of this offering memorandum or any other material relating to the issuer, us or the notes in any jurisdiction where action for the purpose is required. Accordingly, the notes may not be offered or sold, directly or indirectly, and neither this offering memorandum nor any other offering material or advertisements in connection with the notes may be distributed or published, in or from any country or jurisdiction, except in compliance with any applicable rules and regulations of any such country or jurisdiction. Persons into whose possession this offering memorandum comes are advised to inform themselves about and to observe any restrictions relating to the offering of the notes and distribution of this offering memorandum. This offering memorandum does not constitute an offer to purchase or a solicitation of an offer to sell in any jurisdiction.

General

All applicable laws and regulations must be observed in any jurisdiction in which notes may be offered, sold or delivered. No person may directly or indirectly offer, sell, resell, reoffer or deliver notes or distribute any document, circular, advertisement or other offering material in any country or jurisdiction except under circumstances that will result, to the best of its knowledge and belief after due inquiry, in compliance with all applicable laws and regulations.

The United States

The issuer has been advised by each of the initial purchasers that the initial purchasers propose to offer and sell the notes:

- within the United States, to persons they reasonably believe to be “qualified institutional buyers” as defined in Rule 144A under the U.S. Securities Act, in reliance on Rule 144A under the U.S. Securities Act; and
- outside the United States, to persons other than U.S. persons, within the meaning of Regulation S under the U.S. Securities Act, in reliance on Regulation S under the U.S. Securities Act and in accordance with applicable law. See “Transfer Restrictions.”

The price at which the notes are being sold may be changed at any time without notice. Any offer or sale of the notes in reliance on Rule 144A under the U.S. Securities Act will be made by broker-dealers who are registered as such under the U.S. Exchange Act. Terms used above have the meanings assigned to them in Rule 144A or Regulation S under the U.S. Securities Act.

Each initial purchaser has acknowledged and agreed that in connection with the sale of the notes made in reliance on Regulation S, except as permitted by the purchase agreement, it will not offer, sell or deliver the notes within the United States or to, or for the account or benefit of, U.S. persons:

- as part of its distribution at any time; or
- otherwise, until 40 days after the later of the date of the commencement of the offering and the closing of the offering of the notes, and that it will send to each distributor, dealer or other person receiving a selling concession, fee or other remuneration to which it sells notes in reliance on Regulation S during the 40-day distribution compliance period, a confirmation or other notice setting out the restrictions on offers and sales of the notes within the United States or to, or for the account or benefit of, U.S. persons.

In addition, until the expiration of the 40-day period referred to above, an offer or sale of the notes within the United States or to, or for the account or benefit of, a U.S. person by a dealer (whether or not participating in the offering) may violate the registration requirements of the U.S. Securities Act if such offer or sale is made otherwise than in accordance with Rule 144A under the U.S. Securities Act or pursuant to another exemption from registration under the U.S. Securities Act.

The notes have not been and will not be registered under the U.S. Securities Act and may not be offered or sold in the United States or to, or for the account or benefit of, U.S. persons, except pursuant to an exemption from, or in a transaction not subject to the requirements of, the U.S. Securities Act. See “Transfer Restrictions.”

The United Kingdom

Each initial purchaser has represented, warranted and agreed in the purchase agreement that:

- (i) it has not offered or sold and, prior to the expiry of a period of six months from the closing date, will not offer or sell any notes to persons in the United Kingdom 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;
- (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 Financial Services and Markets Act 2000 (the “FSMA”) received

by it in connection with the issue or sale of any notes in circumstances in which section 21(1) of the FSMA does not apply to the issuer or us; 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 notes in, from or otherwise involving the United Kingdom.

The Russian Federation

Each initial purchaser has represented and agreed in the purchase agreement that it has not offered or sold or otherwise transferred and will not offer or sell or otherwise transfer as part of their initial distribution or at any time thereafter any notes to or for the benefit of any person (including legal entities) resident, incorporated, established or having their usual residence in the Russian Federation or to any person located within the territory of the Russian Federation unless to the extent otherwise permitted by Russian law or regulations. The notes may not be sold or offered to or for the benefit of any person (including legal entities) that are resident, incorporated, established or having their usual residence in the Russian Federation or to any person located within the territory of the Russian Federation except in compliance with Russian law.

Luxembourg

Each initial purchaser has represented and agreed in the purchase agreement that the notes have not been offered or sold, and will not be offered or sold in Luxembourg except under circumstances that do not constitute a public offering or distribution under applicable Luxembourg laws and regulations.

Republic of Italy

As the offering of the notes has not been cleared by CONSOB (the Italian Securities Exchange Commission) pursuant to Italian securities legislation, each initial purchaser has represented and agreed that it will not offer, sell or deliver notes, nor distribute copies of the offering memorandum nor any other document relating to the notes in the Republic of Italy, except:

- (i) to professional investors (“*operatori qualificati*”), as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1st July, 1998, as amended;
- (ii) in circumstances which are exempted from the rules on solicitation of investment pursuant to Article 100 of Legislative Decree No. 58 of 24th February, 1998 and Article 33, first paragraph, of CONSOB Regulation No. 11971 of 14th May, 1999, as amended; or
- (iii) to an Italian resident who submits an unsolicited offer to purchase the notes.

Each initial purchaser has also represented and agreed that the notes shall not be placed, sold and/or offered in the primary market to retail individuals residing in Italy.

The notes shall not be placed, sold and/or offered either in the primary or in the secondary market to individuals residing in Italy.

The notes are a new issue of securities with no established trading market. Application has been made to list the notes on the Luxembourg Stock Exchange and the notes are eligible for trading on the PORTAL system. We have been advised by the initial purchasers that they intend to make a market in the notes. The initial purchasers, however, have no obligation to do so and may discontinue market-making at any time without providing any notice. No assurance can be given as to the liquidity of any trading market for the notes.

In connection with the offering, the initial purchasers or any person acting for them may over-allot or effect transactions with a view to supporting the market price of the notes at a level higher than that which might otherwise prevail for a limited period after the issue date. However, there may be no obligation on the initial purchasers or any of their agents to do this. Neither we, the issuer nor the initial purchasers make any representation or prediction as to the direction or magnitude of any effect that the transactions described above may have on the price of the notes. Such stabilizing, if commenced, may be discontinued at any time, and must be brought to an end after a limited period.

We and the issuer have agreed to indemnify the initial purchasers against certain liabilities, including liabilities under the U.S. Securities Act, or to contribute to payments which the initial purchasers may be required to make in respect of any such liabilities.

We and the issuer have agreed that neither us, nor any of our subsidiaries or other affiliates over which we exercise management or voting control, nor any person acting on our or their behalf will, for a period of 90 days after the closing date, without the prior written consent of the initial purchasers, issue, offer, sell, contract to sell, pledge or otherwise dispose (or publicly announce any such issuance, offer, sale or disposal) of debt securities issued or guaranteed by us and having a maturity of more than one year from the date of issue.

CSFB, ING and their respective affiliates have engaged in transactions with and performed various investment banking, financial advisory and other services for us, for which they received customary fees, and CSFB, ING and their respective affiliates may provide such services in the future. In addition, on September 22, 2003, Credit Suisse First Boston International made a loan to us in the amount of \$100 million, and on September 23, 2003, ING Bank (Eurasia) ZAO and ING (Ireland) Limited made a loan to us in the amount of \$100 million. We intend to repay each of these loans out of the proceeds of this offering. See “Use of Proceeds” and “Operating and Financial Review and Prospects—Recent Developments—CSFBi Loan” and “—ING Loan.”

TRANSFER RESTRICTIONS

Because of the following restrictions, you are advised to consult legal counsel prior to making any offer, resale, pledge or other transfer of the notes offered hereby.

The notes have not been registered under the U.S. Securities Act and may not, except as provided below, be offered or sold in the United States (as defined in Regulation S under the U.S. Securities Act (“Regulation S”)), except that the notes may be offered or sold by the initial purchasers:

- through their respective registered broker-dealer affiliates in the United States to “qualified institutional buyers” (as defined in Rule 144A under the U.S. Securities Act (“Rule 144A”)) in accordance with the exemption provided by Rule 144A, and
- to, or for the account or benefit of, non-U.S. persons in offshore transactions in accordance with Regulation S.

Each purchaser of the notes offered hereby and sold in the United States pursuant to Rule 144A will, by its purchase of such notes, be deemed to have represented and agreed as follows (terms used herein that are defined in Rule 144A or Regulation S are used herein as defined therein):

- (1) The purchaser (a) is a qualified institutional buyer; (b) is aware that the sale of the notes to it is being made in reliance on Rule 144A; and (c) is acquiring such notes for its own account or for the account of a qualified institutional buyer, as the case may be;
- (2) The purchaser understands that the notes have not been and will not be registered under the U.S. Securities Act and may not be transferred or sold in the United States except as permitted below; and
- (3) The purchaser agrees that if it decides to offer, sell or otherwise transfer such notes, it will do so only in compliance with the U.S. Securities Act and all applicable securities laws of the States of the United States and other jurisdictions and only (a) outside the United States in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S; (b) in accordance with Rule 144A to a person whom the seller and any person acting on behalf of the seller reasonably believe is a qualified institutional buyer within the meaning of Rule 144A purchasing for its own account or for the account of a qualified institutional buyer in a transaction meeting the requirements of Rule 144A and to whom notice is given that such offer, sale or transfer is being made in reliance on Rule 144A; (c) pursuant to a registration statement which has been declared effective under the U.S. Securities Act; or (d) pursuant to an exemption from registration under the U.S. Securities Act provided by Rule 144 thereunder (if available).

The notes offered and sold hereby pursuant to Rule 144A will constitute “restricted securities” within the meaning of Rule 144(a)(3) of the U.S. Securities Act, and any sale pursuant to Rule 144 will be subject to the requirements of that rule, including its holding period requirements. No representation can be made as to the availability of the exemption provided by Rule 144 under the U.S. Securities Act for the resale of the notes.

The notes sold pursuant to Rule 144A will bear a legend to the following effect:

“THE NOTES EVIDENCED HEREBY WERE ORIGINALLY ISSUED IN A TRANSACTION EXEMPT FROM REGISTRATION UNDER THE UNITED STATES SECURITIES ACT OF 1933, AS AMENDED (THE “SECURITIES ACT”), AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (A) OUTSIDE THE UNITED STATES IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S; OR (B) IN ACCORDANCE WITH RULE 144A TO A PERSON WHOM THE SELLER AND ANY PERSON ACTING ON BEHALF OF THE

SELLER REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A PURCHASING FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QUALIFIED INSTITUTIONAL BUYER IN A TRANSACTION MEETING THE REQUIREMENTS OF RULE 144A AND TO WHOM NOTICE IS GIVEN THAT SUCH OFFER, SALE OR TRANSFER IS BEING MADE IN RELIANCE ON RULE 144A.”

Each purchaser of the notes, by such purchase, will also be deemed to acknowledge that we, the issuer, the initial purchasers and others will rely upon the truth and accuracy of the foregoing acknowledgements, representations and agreements, and agree that if any of the acknowledgements, representations or agreements deemed to have been made by it by its purchase of the notes are no longer accurate, it shall promptly notify us, the issuer and the initial purchasers. If it is acquiring any notes as a fiduciary or agent for one or more investor accounts, it represents that it has sole investment discretion with respect to each such account, and it has full power to make the foregoing acknowledgements, representations and agreements on behalf of each such account.

TAXATION

The following is a general description of certain tax laws relating to the acquisition, ownership and disposition of notes and does not purport to be a comprehensive discussion of the tax treatment of the notes. You should consult your own tax adviser as to the tax consequences of the purchase, ownership and disposition of the notes in light of your particular circumstances, including but not limited to, the consequences of receipt of interest and sale and redemption of the notes.

Luxembourg

General

The following is a general summary of certain Luxembourg tax considerations regarding the purchase, ownership and disposition of the notes and based upon the tax laws of Luxembourg which were in effect on the date of this offering memorandum and are subject to any change that may come into effect after that date.

Under the existing laws of Luxembourg:

- (a) All payments of interest (or coupon) and principal by the issuer under the notes can be made free of withholding or deduction for or on account of any taxes of whatsoever nature imposed, levied, withheld, or assessed by Luxembourg or any political subdivision or taxing authority thereof or therein;
- (b) A holder of a note who derives income from a note or who realizes a gain on the disposal or redemption of a note will not be subject to Luxembourg taxation on income or capital gains unless:
 - (i) the holder is, or is deemed to be, resident in Luxembourg for the purpose of the relevant provisions; or
 - (ii) such income or gain is attributable to an enterprise or part thereof which is carried on through a permanent establishment or a permanent representative in Luxembourg;
- (c) Luxembourg net wealth tax will not be levied on a holder of a note unless:
 - (i) the holder is, or is deemed to be, resident in Luxembourg for the purpose of the relevant provisions; or
 - (ii) such note is attributable to an enterprise or part thereof which is carried on through a permanent establishment or a permanent representative in Luxembourg;
- (d) Luxembourg gift or inheritance taxes will not be levied on the transfer of a note by way of gift by, or on the death of, a holder unless:
 - (i) the holder is, or is deemed to be, resident in Luxembourg for the purpose of the relevant provisions; or
 - (ii) the transfer is construed as an inheritance or as a gift made by or on behalf of a person who, at the time of death or gift, is, or is deemed to be, resident in Luxembourg for the purpose of the relevant provisions; or
 - (iii) such note is attributable to an enterprise or part thereof which is carried on through a permanent establishment or a permanent representative in Luxembourg; or
 - (iv) the gift is registered in Luxembourg, which is not mandatory;
- (e) There is no Luxembourg registration tax, capital tax, stamp duty or any other similar tax or duty (other than nominal court fees and contributions for the registration with the Chamber

of Commerce) payable in Luxembourg in respect of or in connection with the execution, delivery and enforcement by legal proceedings (including any foreign judgment in the courts of Luxembourg) of the notes or the performance of the Issuer's obligations under the notes, except that in the case of court proceedings in a Luxembourg court or the presentation of the documents relative to the note issue to an "autorité constituée", such court or "autorité constituée" may require registration thereof, in which case the documents will be subject to registration duties depending on the nature of the documents and, in particular, a loan will be subject to an ad valorem registration duty of 0.24% calculated on the amounts mentioned therein;

- (f) There is no Luxembourg value added tax payable in respect of payments in consideration for the issue of the notes or in respect of the payment of interest or principal under the notes or the transfer of a note, provided that Luxembourg value added tax may, however, be payable in respect of fees charged for certain services rendered to the Issuer, if for Luxembourg value added tax purposes such services are rendered, or are deemed to be rendered, in Luxembourg and an exemption from value added tax does not apply with respect to such services;
- (g) A holder of a note will not become resident, or deemed to be resident, in Luxembourg by reason only of the holding of a note or the execution, performance, delivery and/or enforcement of the note.

EU Savings Directive

On June 3, 2003, the European Parliament approved the Directive 2003/48/CE on taxation of savings income in the form of interest payments. Under this Directive, paying agents from a Member State will be required to provide the tax authorities of another Member State with details of payments of interest or other similar income paid by a person within its jurisdiction to an individual resident in the other Member State, subject to the right of certain Member States to opt instead for a withholding system for a transitional period in relation to such payments. The Member States will have to include this Directive into their national legislation by January 1, 2004. During the transitional period, Luxembourg may levy the withholding tax at a rate of 15% through 2007, increased to 20% from 2008 to 2010 and to 35% thereafter. Luxembourg will participate in the proposed exchange of information once all other Member States apply such an exchange of information. The Directive will normally become effective on January 1, 2005 provided that some conditions are met (article 17, §2 of this Directive). The Directive was not yet transposed in the Luxembourg internal legislation as of September 25, 2003.

Russian Federation

General

The following general summary of the principal Russian tax consequences relevant to the purchase, ownership, and disposal of the notes and the payment of interest pursuant to the notes is based upon the tax laws of the Russian Federation and the interpretations thereof by the Russian Ministry of Taxes and Levies as in effect on the date of this offering memorandum and is subject to any change that may come into effect after that date.

Many aspects of Russian tax law are subject to uncertainty. Moreover, the provisions of the Russian tax law applicable to financial instruments may be subject to more rapid and unpredictable change than in jurisdictions with more developed financial markets or more developed taxation systems.

Taxation of Gains

A holder of the notes who derives income from the notes or who realizes a gain on the disposal or redemption of the notes will not be subject to Russian taxation on income or capital gains unless:

- (i) such a holder is a legal person organized under Russian law or an individual who is resident in Russia for tax purposes (a person factually present in Russia for a period of not less than 183 days in a given calendar year); or
- (ii) such a holder is an entity not organized under Russian law and such income or gain is attributable to a permanent establishment of such a holder in Russia.

A holder meeting either of the above criteria will be subject to all normally applicable Russian taxes in respect of income or gains from disposal of notes and interest received on notes.

Holders of notes who do not fall into one of the above categories are hereinafter referred to as “non-resident holders.” Non-resident holders who are individuals may be subject to Russian taxation if the place of disposal or redemption of the notes is the Russian Federation.

Individuals

Resident holders who are individuals will be subject to Russian taxation on income at the rate of 13% of gross proceeds less available cost deductions. Non-resident holders who are individuals should not be subject to Russian taxation on income or capital gains if disposal of their holdings takes place outside the Russian Federation. There is a risk that if the notes are disposed of to a resident of the Russian Federation and payment is made within or from the Russian Federation, the proceeds from such disposal may be recognized for personal income tax purposes as income from a source within Russia and taxed at a rate of 30% from the gross proceeds less available cost deductions (which includes the purchase price of the notes). The tax law is unclear as to whether the tax should be withheld from proceeds from the disposal or individual non-resident holders should pay tax based on personal tax returns. If proceeds from the disposal are treated as income from a source within Russia, non-resident holders may be required to file personal tax returns with the Russian tax authorities.

The individual income tax may be reduced or eliminated pursuant to the provisions of any applicable double tax treaty. However, advance relief will not be available and obtaining a refund should be done by submission of the personal tax return.

Please note that in order to claim the exemption or reduction relief, a non-resident holder must be prepared to provide the Russian tax authorities with an official confirmation from the tax authorities of residence in a treaty country as well as an official confirmation of the taxes paid.

Legal persons and organizations

Non-resident holders who are not individuals generally should not be subject to any Russian income or withholding taxes in respect of any gain realized on the sale, exchange, or other disposition of notes.

However, it is not clear how the tax authorities will, in practice, apply the Russian Tax Code. For example, there is a risk that a portion of proceeds allocable to accrued interest may be subject to withholding tax at the rate of 20%. Withholding tax on interest may be reduced or eliminated in accordance with the provisions of any applicable double taxation treaty. However, the confirmation of the treaty country residence of a non-resident holder must be obtained in advance, and there is no assurance that this will be practically possible. Obtaining a refund can be extremely difficult, if not impossible.

Taxation of Interest on the Loan

Interest paid by a Russian entity to a non-resident of Russia (who is not an individual) is subject to a 20% Russian withholding tax. Pursuant to the provisions of an applicable double taxation treaty the withholding tax may be reduced or eliminated, provided that the relevant administrative procedures are complied with. The payments of interest on the loan will not be subject to Russian withholding tax under the terms of the double taxation treaty between the Russian Federation and the Grand Duchy of Luxembourg.

Russian value added tax, or VAT, is not applicable to interest or principal of the loan.

If the payments under the loan are subject to any withholding tax, we are obliged to pay such additional amounts as may be necessary so that the net payments received by the issuer will not be less than the amount it would have received in the absence of such withholding. There is a risk that gross-up provisions in the contract may not be enforceable under Russian law.

Payments under the Guarantee

Pursuant to the Russian Tax Code provisions relating to the payment of income and withholding taxes, payments under the guarantee to non-resident holders who are not individuals should not be subject to Russian withholding tax to the extent that such payments do not represent payments of interest on the notes. It is unclear whether payments representing interest on the notes made by us under the guarantee to non-resident holders who are not individuals may be characterized as Russian source income subject to withholding tax. If the Russian tax authorities took such a position, those payments would be subject to 20% withholding tax at source.

It is unclear whether payments by us to individual non-resident holders under the guarantee might be characterized as Russian source income subject to withholding tax. If the Russian tax authorities took such a position, some or all of the amount paid under the guarantee to an individual non-resident holder would be subject to 30% withholding tax at source.

It may be possible to reduce this tax under any applicable double taxation treaty. However, advance relief will not be available and obtaining a refund should be done by submission of the personal tax return by April 30 following the end of the calendar year.

In addition, it is possible that payments under the guarantee to non-resident holders may be subject to withholding of Russian value-added tax (VAT) at the current VAT inclusive rate of 20/120%. The VAT inclusive rate will be reduced to 18/118% as of January 1, 2004.

United States

General

The following summary contains a description of the material U.S. federal income tax consequences of the purchase, ownership and disposition of the notes by a U.S. holder (defined below). This summary is not a comprehensive description of all of the tax considerations that may be relevant to a decision to purchase notes. In particular, this summary of U.S. federal income tax matters deals only with U.S. holders that will hold notes as capital assets for U.S. federal income tax purposes (generally, assets held for investment) and does not address special tax situations, such as the tax treatment of holders that are (i) subject to special tax rules (e.g. banks, financial institutions, securities or currency dealers, brokers, insurance companies, regulated investment companies and tax-exempt organizations); (ii) holding notes as part of a hedging or larger integrated financial transaction; or (iii) U.S. holders with a currency other than the U.S. dollar as their functional currency.

This summary is based upon the U.S. Internal Revenue Code of 1986, as amended (the “Code”), Treasury regulations issued thereunder, and judicial and administrative interpretations thereof, each as

in effect on the date hereof, all of which are subject to change, possibly with retroactive effect. Furthermore, there can be no assurance that the Internal Revenue Service, or IRS, will not assert a position contrary to those discussed herein.

This discussion is limited to the tax consequences to holders who purchase the notes in the initial offering of such notes and who purchased such notes for cash at the price set forth on the cover page of this offering memorandum.

As used herein, a “U.S. holder” means a beneficial owner of a note who is for U.S. federal income tax purposes (i) a citizen or resident of the United States; (ii) a corporation, or any entity treated as a corporation for U.S. federal income tax purposes, created or organized in the United States or under the laws of the United States or of any political subdivision thereof; (iii) any estate the income of which is subject to U.S. federal income taxation regardless of its source; and (iv) any trust if a court within the United States is able to exercise primary supervision over the administration of the trust and one or more U.S. persons have the authority to control all substantial decisions of the trust, or if a valid election is in place to treat the trust as a United States person. The tax consequences to a partner of a partnership holding the notes generally depend on the status of the partner and the activities of the partnership. Such partner should consult its own tax advisor as to such tax consequences.

PROSPECTIVE PURCHASERS OF THE NOTES SHOULD CONSULT THEIR OWN TAX ADVISERS AS TO THE U.S. FEDERAL TAX CONSEQUENCES OF THE PURCHASE, OWNERSHIP AND DISPOSITION OF THE NOTES, IN ADDITION TO THE EFFECT OF ANY STATE OR LOCAL TAX LAWS OR THE LAWS OF ANY JURISDICTION OTHER THAN THE UNITED STATES.

Classification of the Notes

Whether a note is treated as debt (and not equity) for U.S. federal income tax purposes is an inherently factual question and no single factor is determinative. We will treat the notes as indebtedness for U.S. federal income tax purposes and the following discussion assumes that such treatment will be respected.

Interest

Stated interest on the notes must be included in a U.S. holder’s income at the time the interest is accrued or received, in accordance with the holder’s method of tax accounting and will generally constitute foreign source income.

Sale or Other Taxable Disposition of the Notes

A U.S. holder generally will recognize capital gain or loss on the sale, exchange, retirement or other taxable disposition of a note equal to the difference between the amount realized upon the disposition (less a portion allocable to accrued but unpaid interest not previously included in such holder’s income, which will be taxable as ordinary income) and the U.S. holder’s adjusted tax basis in the note. A U.S. holder’s adjusted tax basis in a note generally will be the U.S. holder’s cost for the note. Capital gain or loss realized by a U.S. holder on the sale, exchange, retirement or other taxable disposition of a note generally will be U.S. source if the U.S. holder is a “United States resident” within the meaning of Section 865 of the Code and generally will be long-term capital gain or loss if the note is held for more than one year. Under current law, net long-term capital gains of individuals are, under certain circumstances, taxed at lower U.S. federal income tax rates than are items of ordinary income. The deductibility of capital losses is subject to limitation.

Additional Amounts and Premium Payments

Under certain circumstances, we are required to pay Additional Amounts (i.e., additional interest to be paid on the notes if certain withholding or similar taxes are imposed) or certain premium (upon certain early redemptions of the notes at the holders' option). Although the tax treatment of such amounts is not free from doubt, we intend to take the position that the likelihood that any such amounts will become payable is remote. Assuming such position is upheld, a U.S. holder will generally be required to include the gross amount of any Additional Amounts or premium as income at the time such amount is received or accrued in accordance with the U.S. holder's method of accounting for tax purposes.

Withholding Taxes

If any foreign withholding taxes are paid with respect to a payment of interest on the notes or guarantee, the amount withheld and any Additional Amounts paid to a U.S. holder will be included in such holder's gross income and such withholding tax paid at the rate applicable to a U.S. holder will be treated as foreign income taxes eligible for credit against such holder's U.S. federal income tax liability, subject to generally applicable limitations and conditions or, at the election of the U.S. holder, eligible for deduction in computing such U.S. holder's taxable income. Such interest income will generally constitute "high withholding tax interest" for U.S. foreign tax credit purposes, unless the withholding tax applicable to the U.S. holder is imposed at a rate below 5%, in which case such income generally will constitute "passive income" (or, for a U.S. holder that is a financial services entity, "financial services income"). The calculation of foreign tax credits and, in the case of a U.S. holder that elects to deduct foreign taxes, the availability of deductions, involves the application of complex rules that depend on a U.S. holder's particular circumstances. Accordingly, investors should consult their own tax advisers regarding the creditability or deductibility of those taxes.

Information Reporting and Backup Withholding

Information reporting requirements may apply to certain payments of interest and proceeds of a sale, redemption or other disposition of notes paid within the United States or through certain U.S. related financial intermediaries. A "backup withholding" tax may apply to such payments or proceeds if the beneficial owner fails to provide a correct taxpayer identification number or certification of exempt status. Any amounts withheld under the backup withholding rules from a payment to a beneficial owner will be allowed as a refund or credit against such beneficial owner's U.S. federal income tax liability provided the required information is timely furnished to the IRS.

LEGAL MATTERS

Certain legal matters with respect to the notes offered in this offering will be opined upon for us by Latham & Watkins LLP, Moscow, Russian Federation; Andrey Gorodissky & Partners, Moscow, Russian Federation; and Elvinger, Hoss & Prussen, Luxembourg. Material tax considerations will be opined upon for us by Latham & Watkins LLP to the extent they relate to United States federal income tax considerations. Certain legal matters with respect to the offering will be opined upon for the initial purchasers by Cleary, Gottlieb, Steen & Hamilton.

INDEPENDENT AUDITORS

The consolidated financial statements of Mobile TeleSystems OJSC as of December 31, 2001 and 2002, and for each of the three years in the period ended December 31, 2002 included in this offering memorandum have been audited by ZAO Deloitte & Touche CIS, independent auditors, as stated in their report appearing herein.

AVAILABLE INFORMATION

We have agreed that, for so long as any notes remain outstanding, we will (i) submit to the U.S. Securities and Exchange Commission or otherwise make public and deliver to the trustee under the indenture, within 180 days after the end of each fiscal year, annual reports on Form 20-F (or any successor form) containing the information required to be contained therein (or required in such successor form), regardless of whether we are then required to file a Form 20-F under the rules promulgated by the Commission; (ii) make public and deliver to the trustee under the indenture, within 120 days of the end of each fiscal year, reports with respect to the fourth quarter containing our consolidated balance sheet, statement of operations and cash flow statement prepared in accordance with U.S. GAAP (but excluding footnotes) and a discussion by management highlighting critical financial developments during the period; and (iii) submit to the Commission or otherwise make public and deliver to the trustee under the indenture, within 60 days of the end of the first three fiscal quarters of each fiscal year, quarterly reports on Form 6-K (or any successor form) containing our consolidated balance sheet, statement of operations and cash flow statement prepared in accordance with U.S. GAAP (but excluding footnotes) and a discussion by management highlighting critical financial developments during the period.

In addition, for so long as any notes remain outstanding and during any period during which we are not subject to and in compliance with Section 13 or 15(d) of the U.S. Securities Exchange Act of 1934, or the Exchange Act, or we are not exempt therefrom pursuant to and in compliance with Rule 12g3-2(b) under the Exchange Act, we have agreed to furnish to the holders and beneficial holders of the notes and to prospective investors, upon their request, the information required to be delivered pursuant to Rule 144A(d)(4) under the U.S. Securities Act.

We have been filing reports with the Commission pursuant to the periodic reporting and other information requirements of the Exchange Act. You may read and copy any of these reports, statements or other documents at the Commission's public reference room at Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549. You may also review our filings with the Commission by accessing the EDGAR system through the Commission's Web site at <http://www.sec.gov>. Copies of such reports will also be deposited with the Luxembourg paying and listing agent and may be read and obtained at the offices of such agent.

Each purchaser of the notes from the initial purchasers will be furnished with a copy of this offering memorandum and any related amendments or supplements to this offering memorandum. Each person receiving this offering memorandum acknowledges that:

- such person has been afforded an opportunity to request from us, and to review and has received, all additional information considered by it to be necessary to verify the accuracy and completeness of the information herein;
- such person has not relied on the initial purchasers or any person affiliated with the initial purchasers in connection with its investigation of the accuracy of such information or its investment decision; and
- except as provided above, no person has been authorized to give any information or to make any representation concerning the notes offered hereby other than those contained herein and, if given, or made, such other information or representation should not be relied upon as having been authorized by us, the issuer or the initial purchasers.

Potential investors may obtain a copy of the indenture and certain other documents described herein as being available from us, without charge, by writing to us at 4 Marksistskaya Street, Moscow 109147, Russian Federation, Attn: Chief Financial Officer.

LISTING INFORMATION

1. Application has been made to list the notes on the Luxembourg Stock Exchange. In connection therewith, our charter and the articles of association of the issuer, as well as a legal notice relating to the issuance of the notes will have been deposited prior to listing with the Register of Trade and Commerce (*Registre de Commerce et des Sociétés*) in Luxembourg, where such documents may be examined and copies thereof may be obtained on request.

According to Chapter VI, Article 3, point A/II/2 of the Rules and Regulations of the Luxembourg Stock Exchange, the notes shall be freely transferable and therefore no transaction made on the Luxembourg Stock Exchange shall be cancelled.

2. So long as the notes are listed on the Luxembourg Stock Exchange and the rules of such stock exchange shall so require, 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 J.P. Morgan Bank Luxembourg S.A., 5 rue Plaetis, L-2338 Luxembourg:

- our charter;
- the articles of association of the issuer;
- the indenture (including the terms of the guarantee);
- copies of all of our most recent and future accounts and the statutory accounts and interim financial statements, if any, of the issuer; and
- any and all of our future statutory accounts and half-yearly reports, and such accounts and reports of the issuer.

We prepare only consolidated financial statements, and do not prepare unconsolidated financial statements, in accordance with U.S. GAAP. The issuer prepares its statutory annual accounts in accordance with accounting principles generally accepted in Luxembourg. The issuer does not prepare interim financial statements. We publish our annual unconsolidated financial statements prepared in accordance with Russian accounting standards in Russia in the Russian language and will make their translations into the English language available at the office of the paying agent in Luxembourg.

3. In the event that a future subsidiary of ours becomes a guarantor of the notes, the issuer will prepare a supplemental listing document, copies of which will be made available at the office of the paying agent at 5 rue Plaetis, L-2338 Luxembourg. The supplemental listing document will be subject to review by the Luxembourg Stock Exchange.
4. We have appointed J.P. Morgan Bank Luxembourg S.A. as the paying and transfer agent in Luxembourg.
5. The notes will be accepted for clearance through DTC, Euroclear and Clearstream. The Common Code for the Regulation S notes is 017841904, the ISIN for the Regulation S notes is XS0178419049 and the CUSIP number for the Regulation S notes is L64395AG8.

The Common Code for the Rule 144A notes is 017842331, the ISIN for the Rule 144A notes is US60741AAE55 and the CUSIP number for the Rule 144A notes is 60741AAE5.

6. Except as otherwise disclosed in this offering memorandum, no legal proceedings are pending or, to the best of our knowledge, threatened to which we or any of our subsidiaries or the issuer is a party and which are material to us and our subsidiaries, taken as a whole, or the issuer in the context of the issue of the notes.

7. Except as otherwise disclosed in this offering memorandum, there have been no material adverse changes in the financial position of the issuer, or in our financial position, since December 31, 2002, the date of our last audited consolidated financial statements.
8. The issuance of the notes has been approved in accordance with the issuer's Articles of Incorporation and the laws of Luxembourg by a resolution of the Board of Directors of the issuer on October 10, 2003. The issuance of the guarantee has been approved in accordance with the laws of the Russian Federation by a resolution of our Board of Directors on September 24, 2003.

UKRAINIAN MOBILE COMMUNICATIONS UNAUDITED MANAGEMENT FINANCIAL INFORMATION

The following unaudited management financial information presents the financial position, the results of operations and cash flows of Ukrainian Mobile Communications (“UMC” or the “Company”) as of December 31, 2002 and for the year then ended, in accordance with accounting principles generally accepted in the United States of America. This financial information has not been subject to an audit or a review. Accordingly, no opinion has been expressed on this unaudited management financial information. In addition, the unaudited management financial information is not a complete set of financial statements as it does not present comparative financial information, footnote disclosure or a statement of changes in equity. Ukraine Mobile Communications (“UMC” or the “Company”) does not as a matter of course prepare financial statements in accordance with accounting principles generally accepted in the United States of America. However, the management of the Company has prepared the financial information included herein to present the historical financial position of the Company as of December 31, 2002 and the results of operations and cash flows for the year then ended. The accompanying financial information reflects the best currently available estimates and judgments, and presents, to the best of management’s knowledge and belief, the financial position of the company as of December 31, 2002 and the results of operations and cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America. However, this information should not be relied upon as being necessarily indicative of future results, and readers of the UMC unaudited management financial information are cautioned not to place undue reliance on this financial information.

UKRAINE MOBILE COMMUNICATIONS
UNAUDITED MANAGEMENT BALANCE SHEET

December 31, 2002

(Amounts in thousands of U.S. dollars)

	December 31, 2002
CURRENT ASSETS:	
Cash and cash equivalents	\$ 2,951
Trade receivables, net	28,508
Accounts receivable, related parties	704
Inventory	17,677
Prepaid expenses	23,107
Deferred tax asset, current portion	16,803
Total current assets	<u>89,750</u>
PROPERTY, PLANT AND EQUIPMENT	217,256
LICENSES AND OTHER INTANGIBLE ASSETS	56,617
Total assets	<u><u>\$363,623</u></u>
CURRENT LIABILITIES:	
Accounts payable, related parties	\$ 1,977
Trade accounts payable	30,486
Subscriber prepayments and deposits	39,128
Debt, current portion	58,601
Accrued liabilities	10,018
Total current liabilities	<u>140,210</u>
LONG-TERM LIABILITIES:	
Debt, net of current portion	3,933
Total liabilities	<u>144,143</u>
SHAREHOLDERS' EQUITY:	
Capital contributions	15,000
Retained earnings	204,480
Total shareholders' equity	<u>219,480</u>
Total liabilities and shareholders' equity	<u><u>\$363,623</u></u>

UKRAINE MOBILE COMMUNICATIONS
UNAUDITED MANAGEMENT STATEMENT OF OPERATIONS

For the year ended December 31, 2002

(Amounts in thousands of U.S. dollars)

	<u>2002</u>
NET REVENUES	\$296,398
COST OF SERVICES AND PRODUCTS	68,407
OPERATING EXPENSES	43,968
SALES AND MARKETING EXPENSES	36,045
DEPRECIATION AND AMORTIZATION	42,851
Net operating income	105,127
CURRENCY EXCHANGE AND TRANSLATION LOSSES	2,889
 OTHER EXPENSES:	
Interest expense	4,241
Other expense, net	384
Total other expenses, net	4,625
Income before provision for income taxes	97,613
PROVISION FOR INCOME TAXES	32,424
NET INCOME	<u><u>\$ 65,189</u></u>

UKRAINE MOBILE COMMUNICATIONS
UNAUDITED MANAGEMENT STATEMENT OF CASH FLOWS
For the year ended December 31, 2002
(Amounts in thousands of U.S. dollars)

	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net income	\$ 65,189
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	42,851
Interest accrued	4,241
Interest paid	(1,619)
Deferred taxes	(10,482)
Changes in operating assets and liabilities:	
Increase in trade receivables	(10,442)
Increase in inventory	(6,411)
Increase in prepaid expenses	(2,523)
Increase in accounts payable	263
Increase in subscriber prepayments and deposits	16,333
Decrease in income tax payable	(5,211)
Increase in accrued liabilities and other payables	5,191
Net cash provided by operating activities	<u>97,380</u>
CASH FLOWS FROM INVESTING ACTIVITIES:	
Purchases of property, plant and equipment	(87,415)
Purchases of intangible assets	(20,611)
Net cash used in investing activities	<u>(108,026)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:	
Proceeds from overdrafts	1,441
Loan principal paid	(1,313)
Net cash provided by financing activities	<u>128</u>
NET DECREASE IN CASH AND CASH EQUIVALENTS	<u>(10,518)</u>
CASH AND CASH EQUIVALENTS, at beginning of year	<u>13,469</u>
CASH AND CASH EQUIVALENTS, at end of year	<u>\$ 2,951</u>

FINANCIAL STATEMENTS

Mobile TeleSystems

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Independent Auditor's Report

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, 2002 and 2001, and the related consolidated statements of operations, cash flows and shareholders' equity for each of the three years in the period ended December 31, 2002. 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, such consolidated financial statements present fairly, in all material respects, the financial position of Mobile TeleSystems and its subsidiaries as of December 31, 2002 and 2001, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2002, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 4 to the consolidated financial statements, the Group changed its method of accounting for subscriber acquisition costs in 2001.

/s/ ZAO Deloitte & Touche CIS

Moscow, Russia

May 20, 2003, except for Note 26,
as to which the date is July 29, 2003

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
AT DECEMBER 31, 2001 and 2002
(Amounts in thousands of U.S. dollars, except share amounts)

	December 31,	
	2001	2002
CURRENT ASSETS:		
Cash and cash equivalents (Note 7)	\$ 219,629	\$ 34,661
Short-term investments (Note 8)	85,304	30,000
Trade receivables, net (Note 9)	24,258	40,501
Accounts receivable, related parties (Note 20)	2,377	3,569
Inventory (Note 10)	26,184	41,386
Prepaid expenses	22,712	26,537
Deferred tax asset, current portion (Note 17)	5,802	12,223
VAT receivable	82,216	154,061
Other current assets	8,374	15,392
Total current assets	<u>476,856</u>	<u>358,330</u>
PROPERTY, PLANT AND EQUIPMENT , net of accumulated depreciation of \$168,989 and \$299,216, respectively (Note 11)	856,056	1,344,633
LICENSES , net of accumulated amortization of \$100,429 and \$143,402, respectively (Notes 6 and 23)	298,827	386,919
OTHER INTANGIBLE ASSETS , net of accumulated amortization of \$52,953 and \$78,889, respectively (Note 12)	84,778	138,090
DEBT ISSUANCE COSTS , net of accumulated amortization of \$1,209 and \$2,898, respectively (Note 14)	3,997	2,957
INVESTMENTS IN AND ADVANCES TO AFFILIATES (Note 22)	740	34,034
DEFERRED TAX ASSET , net of current portion (Note 17)	6,238	18,333
Total assets	<u><u>\$1,727,492</u></u>	<u><u>\$2,283,296</u></u>

The accompanying notes to financial statements are an integral part of these statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (Continued)
AT DECEMBER 31, 2001 and 2002
(Amounts in thousands of U.S. dollars, except share amounts)

	December 31,	
	2001	2002
CURRENT LIABILITIES:		
Accounts payable, related parties (Note 20)	\$ 6,142	\$ 4,968
Trade accounts payable	106,068	117,623
Deferred connection fees, current portion (Note 13)	21,419	22,210
Subscriber prepayments and deposits	63,741	110,950
Debt, current portion (Note 14)	18,825	67,098
Capital lease obligation, current portion (Notes 15 and 20)	14,401	21,232
Income tax payable	23,078	3,987
Accrued liabilities (Note 16)	51,626	73,919
Other payables	3,357	2,225
Total current liabilities	<u>308,657</u>	<u>424,212</u>
LONG-TERM LIABILITIES:		
Notes payable (Note 14)	248,976	300,638
Debt, net of current portion (Note 14)	35,942	58,276
Capital lease obligation, net of current portion (Notes 15 and 20)	7,696	7,241
Deferred connection fees, net of current portion (Note 13)	25,993	19,694
Deferred taxes (Note 17)	67,505	105,818
Total long-term liabilities	<u>386,112</u>	<u>491,667</u>
Total liabilities	<u>694,769</u>	<u>915,879</u>
COMMITMENTS AND CONTINGENCIES (Note 24)		
MINORITY INTEREST	14,444	65,373
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, 2001 and 2002, 345,244,080 of which are in the form of ADS (Note 1))	50,558	50,558
Treasury stock (9,966,631 common shares at cost) (Note 19)	(10,206)	(10,206)
Additional paid-in capital	555,794	558,102
Unearned compensation (Note 19)	—	(212)
Shareholder receivable (Note 14)	(38,958)	(34,412)
Retained earnings	461,091	738,214
Total shareholders' equity	<u>1,018,279</u>	<u>1,302,044</u>
Total liabilities and shareholders' equity	<u>\$1,727,492</u>	<u>\$2,283,296</u>

The accompanying notes to financial statements are an integral part of these statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE YEARS ENDED DECEMBER 31, 2000, 2001 and 2002
(Amounts in thousands of U.S. dollars, except share and per share amounts)

	2000	2001	2002
NET REVENUES:			
Service revenues	\$ 484,469	\$ 830,308	\$ 1,274,287
Connection fees	14,885	21,066	24,854
Equipment sales	36,358	41,873	62,615
	<u>535,712</u>	<u>893,247</u>	<u>1,361,756</u>
COST OF SERVICES AND PRODUCTS (including related party amounts of \$20,040, \$30,537 and \$31,607, respectively):			
Interconnection and line rental	41,915	75,278	113,052
Roaming expenses	41,178	68,387	83,393
Cost of equipment	39,217	39,828	90,227
	<u>122,310</u>	<u>183,493</u>	<u>286,672</u>
OPERATING EXPENSES (including related party amounts of \$5,064, \$8,882 and \$9,602, respectively) (Note 21):	110,242	134,598	229,056
SALES AND MARKETING EXPENSES (including related party amounts of \$6,400, \$8,707 and \$12,140, respectively):	76,429	107,729	171,977
DEPRECIATION AND AMORTIZATION	87,684	133,318	209,680
IMPAIRMENT OF INVESTMENT (Note 22)	—	10,000	—
Net operating income	139,047	324,109	464,371
CURRENCY EXCHANGE AND TRANSLATION LOSSES	1,066	2,264	3,474
OTHER EXPENSES (INCOME) (including related party amounts of \$952, \$2,978 and \$5,141, respectively):			
Interest income (Note 8)	(7,626)	(11,829)	(8,289)
Interest expense, net of amounts capitalized	11,335	6,944	44,389
Other income, net	(502)	(2,672)	(2,454)
Total other expenses (income), net	3,207	(7,557)	33,646
Income before provision for income taxes and minority interest	134,774	329,402	427,251
PROVISION FOR INCOME TAXES (Note 17)	51,154	98,128	110,417
MINORITY INTEREST	(6,428)	7,536	39,711
NET INCOME before cumulative effect of a change in accounting principle	90,048	223,738	277,123
Cumulative effect of a change in accounting principle, net of income taxes of \$9,644 (Note 4)	—	(17,909)	—
NET INCOME	<u>\$ 90,048</u>	<u>\$ 205,829</u>	<u>\$ 277,123</u>
Weighted average number of common shares outstanding	1,806,968,096	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	\$ 0.050	\$ 0.113	\$ 0.140
Net income	\$ 0.050	\$ 0.104	\$ 0.140

The accompanying notes to financial statements are an integral part of these statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
FOR THE YEARS ENDED DECEMBER 31, 2000, 2001 and 2002
(Amounts in thousands of U.S. dollars, except share amounts)

	<u>Common Stock</u>		<u>Treasury Stock</u>		<u>Additional</u>	<u>Unearned</u>	<u>Share-</u>	<u>Retained</u>	
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Paid-in</u>	<u>Compensation</u>	<u>holder</u>	<u>Earnings</u>	<u>Total</u>
					<u>Capital</u>		<u>Receivable</u>		
BALANCES,									
December 31, 1999 . .	1,634,527,440	\$49,276	—	—	\$182,975	—	\$(70,331)	\$181,804	\$ 343,724
Receivable from									
Sistema (Note 14):									
Increases for interest . .	—	—	—	—	6,268	—	(6,268)	—	—
Payments from Sistema .	—	—	—	—	—	—	27,080	—	27,080
Issuance of common									
shares, net of direct									
expenses (Note 1) . . .	345,244,080	1,233	—	—	347,320	—	—	—	348,553
Purchase of treasury									
stock under the stock									
bonus plan (Note 19) .	13,554,618	49	(13,554,618)	(13,880)	13,831	—	—	—	—
Exercise of stock bonus									
plan (Note 19)	—	—	3,587,987	3,674	(3,661)	—	—	—	13
Non-cash expense									
associated with									
issuance of stock									
bonus (Note 19)	—	—	—	—	5,297	—	—	—	5,297
Net income	—	—	—	—	—	—	—	90,048	90,048
Dividends declared . . .	—	—	—	—	—	—	—	(13,631)	(13,631)
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 14):									
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 14):									
Increases for interest . .	—	—	—	—	2,073	—	(2,073)	—	—
Payments from Sistema .	—	—	—	—	—	—	6,619	—	6,619
Issuance of stock									
options (Note 19) . . .	—	—	—	—	235	(235)	—	—	—
Amortization of deferred									
compensation									
(Note 19)	—	—	—	—	—	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

The accompanying notes to 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, 2000, 2001 and 2002
(Amounts in thousands of U.S. dollars, except share amounts)

	<u>2000</u>	<u>2001</u>	<u>2002</u>
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income	\$ 90,048	\$ 205,829	\$ 277,123
Adjustments to reconcile net income to net cash provided by operating activities:			
Minority interest	(6,428)	7,536	39,475
Depreciation and amortization	87,684	133,318	209,680
Amortization of deferred connection fees	(14,867)	(20,027)	(24,854)
Deferred subscriber acquisition cost	(49,232)	—	—
Amortization of deferred subscriber acquisition costs	53,604	—	—
Cumulative effect of a change in accounting principle	—	17,909	—
Gain on debt extinguishment	—	(2,780)	—
Inventory obsolescence expense	2,114	2,543	5,614
Provision for doubtful accounts	2,403	3,219	7,047
Interest accrued	11,335	5,845	44,388
Interest paid	(17,850)	(4,068)	(43,438)
Deferred taxes	(932)	(39,964)	(18,989)
Non-cash expenses associated with stock bonus and stock option plans	5,297	—	23
Impairment of investment	—	10,000	—
Changes in operating assets and liabilities:			
Decrease/(Increase) in trade receivables	6,730	(7,181)	(18,945)
Decrease/(Increase) in accounts receivable, related parties	4,223	(3,091)	(1,360)
Increase in inventory	(8,922)	(4,129)	(18,186)
Increase in prepaid expenses	(1,680)	(8,552)	(2,634)
Increase in VAT receivable	(6,033)	(59,618)	(64,154)
(Increase)/Decrease in other current assets	(7,363)	1,613	(7,422)
Increase in accounts payable, related parties	743	1,049	81
(Decrease)/Increase in trade accounts payable	(29,801)	20,470	(16,058)
Increase in subscriber prepayments and deposits	43,382	49,980	46,064
Increase/(Decrease) in income tax payable	19,787	10,753	(19,778)
Increase in accrued liabilities and other payables	6,672	17,547	19,095
Net cash provided by operating activities	<u>190,914</u>	<u>338,201</u>	<u>412,772</u>
CASH FLOWS FROM INVESTING ACTIVITIES:			
Acquisitions of subsidiaries, net of cash acquired	(16,085)	(75,858)	(143,396)
Purchases of property, plant and equipment	(194,983)	(396,667)	(502,054)
Purchases of intangible assets	(29,915)	(44,533)	(72,218)
Purchases of short term investments	(170,000)	(110,000)	—
Proceeds from sale of short term investments	—	195,602	55,304
Investments in and advances to affiliates	(12,366)	(10,067)	(35,557)
Net cash used in investing activities	<u>(423,349)</u>	<u>(441,523)</u>	<u>(697,921)</u>
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuance of capital stock, net of direct expenses	348,553	—	—
Proceeds from issuance of notes	—	248,135	50,808
Notes issuance cost	—	(3,856)	(649)
Capital lease obligation principal paid	—	(7,947)	(1,804)
Dividends paid	(14,425)	(2,959)	—
Proceeds from loans	—	13,577	52,851
Loan principal paid	(62,665)	(13,683)	(7,008)
Payments from Sistema	27,080	14,325	6,619
Net cash provided by financing activities	<u>298,543</u>	<u>247,592</u>	<u>100,817</u>
Effect of exchange rate changes on cash and cash equivalents	(280)	(469)	(636)
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS:	<u>65,828</u>	<u>143,801</u>	<u>(184,968)</u>
CASH AND CASH EQUIVALENTS, at beginning of year	<u>10,000</u>	<u>75,828</u>	<u>219,629</u>
CASH AND CASH EQUIVALENTS, at end of year	<u>\$ 75,828</u>	<u>\$ 219,629</u>	<u>\$ 34,661</u>
SUPPLEMENTAL INFORMATION:			
Income taxes paid	\$ 35,052	\$ 129,418	\$ 147,346
Additions to network equipment and software under capital lease	\$ —	\$ 34,072	\$ 18,917

The accompanying notes to financial statements are an integral part of these statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

1. General

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”) in terms of the number of subscribers and revenues. The Group has operated exclusively in the GSM standard since 1994 and as of December 31, 2002, had over 6.6 million subscribers in the Russian Federation.

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 a majority stakes in local GSM operators (see Note 23 Operating Licenses and Note 6 Businesses Acquired).

Reorganization

In March 2000, MTS CJSC was merged with RTC CJSC, to create MTS OJSC. This corporate merger has been accounted for at historical cost in a manner similar to that in pooling of interest accounting because the merged companies were entities under common control.

The accompanying consolidated financial statements represent those of Open Joint-Stock Company Mobile TeleSystems and its legal predecessor, Closed Joint-Stock Company Mobile TeleSystems. Shares, earnings per share and other share information have been restated in the accompanying consolidated financial statements to give retroactive effect to the capital structure of MTS OJSC.

Initial Public Offering

In July 2000, MTS OJSC issued additional shares in an initial public offering on the New York Stock Exchange. 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. The Company issued a total of 17,262,204 ADS, representing 345,244,080 common shares in the offering. Proceeds from the offering, net of underwriting discount, were \$349 million (see also Note 19 Management Stock Bonus and Stock Option Plans).

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

Ownership

As of December 31, 2001 and 2002, MTS' shareholders of record and their respective percentage direct interests were as follows:

Joint-Stock Financial Corporation "Sistema" ("Sistema")	34.8%
T-Mobile International AG ("T-Mobile")	36.2%
VAST, Limited Liability Company ("VAST")	3.0%
Invest-Svyaz-Holding, Closed Joint-Stock Company	8.0%
ADS Holders	18.0%
	<u>100.0%</u>

Sistema owns 51% equity interest in VAST, a limited liability company incorporated under the laws of the Russian Federation; the remaining 49% interest is held by ASVT, a Russian open joint-stock company. Invest-Svyaz-Holding, a closed joint-stock company incorporated under the laws of the Russian Federation, is controlled by Sistema through a 51% equity interest. The remaining 49% interest is owned by T-Mobile.

Subsequently to December 31, 2002, Sistema increased its share in MTS through a series of transactions with T-Mobile.

2. Russian Environment

Over the past decade Russia has undergone substantial political, economic and social changes. As an emerging market, Russia does not possess a fully developed business and regulatory infrastructure that would generally exist in a more mature market economy. The current government is attempting to address these issues; however, it has not yet fully implemented the reforms necessary to create banking, judicial and regulatory systems that usually exist in more developed markets. As a result, and as reflected in the government's debt default and the ruble devaluation in 1998, operations in Russia involve risks that are not typically associated with those in developed markets. Such risks persist in the current environment with results that include but are not limited to, a currency that is not freely convertible outside of the country, various currency controls, low liquidity levels for debt and equity markets, and continuing inflation. Foreign currencies, in particular the U.S. dollar, play a significant role in the underlying economics of many business transactions in Russia. Following the 1998 economic crisis, the ruble's value fell significantly against the U.S. dollar, falling from a pre-crisis rate of approximately 6 rubles to 1 U.S. dollar, to 27 rubles to 1 U.S. dollar by the end of 1999. During 2000, 2001 and 2002, the ruble's value fluctuated between 26.9 and 31.8 to 1 U.S. dollar.

Currency Exchange and Control

The Central Bank of Russia has established strict currency control regulations designed to promote the commercial utilization of the ruble. Such regulations place restrictions on the conversion of rubles into foreign currencies and establish requirements for conversion of foreign currency sales into rubles. MTS' principal currency exchange rate risk arises from the fact that the majority of cash outflows as well as debt and accounts payable balances are either denominated in or tightly linked to the U.S. dollar. As a result, devaluation of the ruble against the U.S. dollar can adversely affect the Group by increasing its costs in ruble terms. In order to manage against this risk, the Group links its tariffs,

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

which are payable in rubles, to the U.S. dollar. The devaluation of the ruble also results in losses in the value of ruble-denominated assets, such as ruble deposits. These losses, which are included in currency exchange and translation losses in the accompanying consolidated statements of operations, were approximately \$1.1 million in 2000, \$2.3 million in 2001 and \$3.5 million in 2002. Continued devaluation of the ruble against the U.S. dollar may have a significant negative effect on the Group's financial position and results of its operations.

Inflation

The Russian economy has been characterized by high rates of inflation. The following table summarizes the annual rate of inflation for the past three years:

	<u>Annual Inflation</u>
2002	15.1%
2001	18.6%
2000	20.2%

The Group's principal inflation rate risk arises in connection with the probable decrease of sales resulting from a decrease of customers' demand, as the Group's services may become expensive and exclusive. As substantially all of the Group's costs are denominated in U.S. dollars or are tightly linked to the U.S. dollar, when the rate of inflation exceeds the rate of devaluation of the ruble against the U.S. dollar, the Group can experience inflation-driven increases in dollar terms of certain of its costs. These include salaries and rents, which are sensitive to rises in the general price level in Russia. In this situation, due to competitive pressures, the Group may not be able to raise its tariffs sufficiently to preserve operating margins. Accordingly, high rates of inflation relative to the rate of devaluation could increase the Group's costs and decrease the Group's operating margins.

Management is unable to estimate what developments may occur or the resulting effect of any such developments on MTS' financial condition or future results of operations. MTS will continue to be affected, for the foreseeable future, by the country's unstable economy. The consolidated financial statements do not include any adjustment that may result from these uncertainties.

Taxation

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 substantially 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

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)**

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, 2002, substantially all of the tax declarations of the Group for the preceding three 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 differing positions with regard to interpretive issues and the effect could be significant.

3. Summary of Significant Accounting Policies

Accounting principles

MTS maintains its accounting books and records in Russian rubles based on Russian accounting regulations. 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.

Basis of presentation

The accompanying consolidated financial statements include the accounts of MTS OJSC and its wholly owned and majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

As of December 31, 2001 and 2002, MTS has investments in the following legal entities:

	Accounting Method	December 31,	
		2001	2002
Rosico	Consolidated	100.0%	100.0%
ReCom	Consolidated	53.9%	53.9%
MTS-Komi Republic (“MTS-RK”)	Equity	26.0%	26.0%
MTS-Kostroma	Equity	26.0%	26.0%
MTS-Tver (“MTS-T”)	Equity	26.0%	26.0%
UDN-900	Consolidated	51.0%	51.0%
ACC	Consolidated	100.0%	100.0%
MSS	Consolidated	83.5%	83.5%
MTS-Nizhny Novgorod (“MTS-NN”)	Consolidated	65.0%	65.0%
Telecom XXI	Consolidated	100.0%	100.0%
Telecom-900	Consolidated	81.0%	100.0%
Novitel	Consolidated	51.0%	51.0%
MTS Finance ⁽¹⁾	Consolidated	100.0%	100.0%
BM-Telecom	Consolidated	—	100.0%
MTS Belarus	Equity	—	49.0%
MTS-P	Consolidated	—	51.0%
Kuban-GSM	Consolidated	—	52.7%
Dontlecom	Consolidated	—	100.0%
Mobicom-Barnaul	Consolidated	—	100.0%
BIT	Consolidated	—	100.0%

⁽¹⁾ Represents beneficial ownership.

Translation methodology

Translation (re-measurement) of MTS’ ruble denominated financial statements into U.S. dollars has been performed in accordance with the provisions of Statement of Financial Accounting Standard (“SFAS”) No. 52 “Foreign currency translation,” as they relate to hyperinflationary economies.

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.

Effective January 1, 2003, Russian economy ceased to be considered hyperinflationary, however management believes that U.S. dollar will still be the appropriate functional currency due to pervasive use of the dollar in the Group’s operations.

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

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

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.

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, accessories and spare parts for equipment.

Inventories are written down to their market values based on specific monthly reviews of significant inventoried items and expensed as cost of services and products.

Value-added taxes

Value-added taxes related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the subscriber. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales.

VAT related to purchase transactions that are not currently reclaimable as of the balance sheet dates are recognized in the balance sheets on a gross basis.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

Property, plant and equipment

Property, plant and equipment with a useful life of more than one year is 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 are capitalized. MTS capitalizes interest costs with respect to qualifying construction projects.

License costs

License costs are capitalized as a result of (a) purchase price allocated to licenses acquired in business combinations (see Note 6 Business Acquired) and (b) licenses granted directly from government organizations, which require license payments.

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 the straight-line basis over the term of the license commencing 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 million relating to the 1998 acquisition of Rosico from goodwill to licenses.

Other intangible assets

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. Deferred telephone numbering capacity costs with limited contractual life are being amortized over five to ten years and the rights to use premises are being amortized over ten years. Telephone numbering capacity with limited contractual life is amortized over its contractual term of five to ten years. 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, “Goodwill and Other Intangible Assets.” Amortization of deferred numbering capacity costs starts immediately upon the purchase of numbering capacity. Software costs are amortized over four years. Acquired customer base is amortized over the estimated average subscriber life. Other intangible assets are being amortized over three to four years. All finite-life intangible assets are being amortized using the straight-line method.

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Leasing arrangements

The Group accounts for leases based on the requirements of SFAS No. 13, "Accounting for Leases." Certain subsidiaries of the Group lease operating facilities, which include switches, base stations and other cellular network equipment as well as billing systems. The present value of future minimum lease payments at the inception of the lease which is classified as a capital lease is reflected as 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. The interest rate implicit in the leases varies from 4% to 44% (see Note 15 Capital Lease Obligations).

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 4 Change in Accounting Principle).

Investments

Beginning in 1998, MTS has acquired interests in several Russian legal entities, engaged in telecommunications activity. Investments in entities where MTS holds 20% to 50% and can exercise significant influence but not control are accounted for using the equity method. All investments have been made in companies that are not traded in open markets. 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. During the years ended December 31, 2000, 2001 and 2002, management believes that no such impairments have occurred, except as discussed in Note 22 Investments In and Advances to Affiliates.

Debt issuance costs

Debt issuance costs are amortized using the effective interest method over the terms of the related loans.

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 will 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, MTS will 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. Management believes that during the years ended December 31, 2000, 2001 and 2002, no such impairments have occurred, except as discussed in Note 22 Investments In and Advances to Affiliates.

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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 the goods and services are actually provided 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 the caller, the destination of the call and the service utilized.

Value added services 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 \$43,214, \$52,639 and \$83,393 for the years ended December 31, 2000, 2001 and 2002, respectively.

Pre-paid phone cards

MTS sells to subscribers pre-paid 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 pre-paid phone card is purchased, MTS records the receipt of cash as a subscriber deposit. 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 pre-paid phone card has expired.

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In 2002 MTS introduced a new line of pre-paid 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 three and one quarter years (see also Note 13 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 upon the delivery to the customer, regardless of whether the customer concurrently enters into a service contract, as these contracts do not require the customer to maintain future services with MTS. MTS records estimated returns as a direct reduction of sales at the time the related sales are recorded.

Expense recognition

Expenses incurred by MTS in relation to the provision of wireless communication services 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 roaming charges are recorded as air time revenues on a gross basis, with the related roaming charges being recorded as operating expense, as MTS acts as the principal in the transaction with the subscriber and bears the risk of non-collection from the subscriber.

The costs of handsets and accessories, whether sold to subscribers through the distribution channel or as part of the service contract, are expensed at the initial delivery of equipment to the customer. Any fees paid to dealers in 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, 2000, 2001 and 2002 were \$22,218, \$42,715 and \$48,624, respectively, and are reflected as a component of sales and marketing expenses in the accompanying consolidated statements of operations.

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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 4,648,421 stock options outstanding as of December 31, 2002. Earnings and other per share information have been restated to give retroactive effect to the merger of MTS CJSC and RTC CJSC in 2000 (see Note 1 General).

The net income component of the diluted EPS equals the reported net income of the Group. The following is the reconciliation of the share component for basic and diluted EPS with respect to the Group’s net income:

	December 31,	
	2001	2002
Weighted average number of common share outstanding	1,983,359,507	1,983,359,507
Dilutive effect of stock options	30,133	405,946
Weighted average number of common shares and potential shares outstanding	<u>1,983,389,640</u>	<u>1,983,765,453</u>

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. Based on the borrowing rates currently available to the Group for debt with similar terms and average maturities of the outstanding debt, at December 31, 2001 and 2002, the fair value of long-term debt approximated its carrying amount. The fair value of variable rate debt is equivalent to carrying value.

It is not practical to determine the fair value of MTS’ receivable from Sistema and advances to affiliates, due to the instability of the Russian economy and its effect on interest rates appropriate for determining fair value.

Comprehensive income

Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. For the years ended December 31, 2000, 2001 and 2002, comprehensive income equaled net income.

Comparative information

Certain prior year 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.” These statements allow measuring compensation to employees and

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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.

If the Group had elected to recognize compensation costs based on the fair values of options at the date of the grant, consistent with the provisions of SFAS No. 123, net income and earning per share amounts would have been as follows:

	December 31,		
	2000	2001	2002
Net income as reported	\$90,048	\$205,829	\$277,123
Pro-forma effect of the application of fair value method of accounting for stock options	—	(129)	(460)
Pro-forma net income	<u>\$90,048</u>	<u>\$205,700</u>	<u>\$276,663</u>
Earnings per share—basic and diluted			
As reported	\$ 0.050	\$ 0.104	\$ 0.140
Pro-forma	\$ 0.050	\$ 0.104	\$ 0.140

Recently adopted accounting pronouncements

In June 2001, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 141, “Business Combinations” and SFAS No. 142, “Goodwill and Other Intangible Assets.” SFAS No. 141 requires the use of the purchase method of accounting for all business combinations initiated after June 30, 2001. SFAS No. 141 requires intangible assets to be recognized if they arise from contractual or legal rights or are “separable,” i.e., it is feasible that they may be sold, transferred, licensed, rented, exchanged or pledged. As a result, it is likely that more intangible assets will be recognized under SFAS No. 141 than its predecessor, Accounting Principles Board Opinion (“APB Opinion”) No. 16.

Under SFAS No. 142, goodwill is no longer amortized on a straight-line basis over its estimated useful life, but is tested for impairment on an annual basis and whenever indicators of impairment arise. The goodwill impairment test, which is based on fair value, is performed on a reporting unit level. A reporting unit is defined as a SFAS No. 131 operating segment or one level lower. Goodwill is no longer allocated to other long-lived assets for impairment testing under SFAS No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets.” Additionally, goodwill on equity method investments is no longer amortized; however, it continues to be tested for impairment in accordance with Accounting Principles Board Opinion No. 18, “The Equity Method of Accounting for Investments in Common Stock.” Under SFAS No. 142, intangible assets with indefinite lives are not amortized. Instead they are carried at the lower cost or fair value and tested for impairment at least annually. All other recognized intangible assets are continued to be amortized over their estimated useful lives.

Upon adoption of SFAS No. 142 on January 1, 2002, MTS reclassified the carrying value of goodwill relating to its acquisition of Rosico of \$22 million to licenses. As a result of the useful lives of goodwill and licenses being consistent, the adoption of SFAS No. 142 did not have a significant effect on the Group’s results of operations or financial position.

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In August 2001, FASB issued SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." SFAS No. 144 establishes a single accounting model for long-lived assets to be disposed of by sale consistent with the fundamental provisions of SFAS 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.

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. SFAS No. 144 also establishes criteria for determining when an asset should be treated as held for sale. MTS adopted SFAS No. 144 as of January 1, 2002. This change has not had a material effect on the Group's results of operations or financial position.

Beginning in 2002, MTS adopted the disclosure requirements of SFAS No. 148, "Accounting for Stock-Based Compensation—Transition and Disclosure, an amendment of FASB Statement No. 123" SFAS No. 148 amends SFAS No. 123, "Accounting for Stock-Based Compensation" to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, SFAS No. 148 amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The adoption of SFAS No. 148 did not have a material impact on the results of operations or financial position of the Group.

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 disclosures about the guarantor's obligations under certain guarantees that it has issued. The initial recognition and measurement provisions of this interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. MTS adopted the disclosure requirements of FIN 45 in 2002. The adoption of initial recognition and measurement requirements of FIN 45 did not have a material impact on its results of operations or financial position.

In January 2003, FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46"). FIN 46 clarifies the application of Accounting Research Bulletin 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 from other parties. Under FIN 46, an enterprise is required to consolidate certain entities (so-called "variable interest entities"), if it is the primary beneficiary of the variable interest entity. The primary beneficiaries of a variable interest entity is the party that absorbs a majority of the entity's expected losses or receives the majority of the entity's residual returns. FIN 46 also requires additional disclosure regarding the use of variable interest entities. MTS adopted the disclosure requirements of FIN 46

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effective 2002; consolidation provisions of FIN 46 will become effective January 1, 2004. The Group does not believe that the adoption of the consolidation provisions of FIN 46 will have a material effect on its results of operations or financial position.

New accounting pronouncements

In June 2001, 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 be 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 related 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.

MTS is required to adopt SFAS No. 143 effective January 1, 2003 and does not anticipate that adoption of this statement will have a material impact on its results of operations or financial position.

In April 2002, FASB issued SFAS No. 145, "Rescission of FASB Statements No. 4, 44 and 64, Amendment of FASB Statement No. 13 and Technical Corrections." SFAS No. 4 "Reporting Gains and Losses from Extinguishment 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 require sale-leaseback accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. See Note 26 Subsequent Events regarding the application of SFAS No. 145.

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 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. MTS will adopt the provisions of SFAS No. 146 for exit or disposal activities that are initiated after December 31, 2002. The Group does not anticipate that adoption of SFAS No. 146 will have a material impact on its results of operations or financial position.

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. EITF Issue No. 00-21 is effective prospectively for arrangements entered into after June 15, 2003. The Group does not anticipate the adoption of EITF Issue No. 00-21 to have a material impact on its results of operations or financial position.

4. 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

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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.

5. New Investments

In September 2001, MTS won a tender initiated by the Telecommunications Ministry of the Republic of Belarus for a GSM-900/1800 license to operate in Belarus. Under the tender conditions, MTS paid \$10 million, which was written off at December 31, 2001, as the Group believed that there was significant doubt regarding the ability of the Group to commence its operations in Belarus (see also Note 22 Investments In and Advances to Affiliates). During 2002, MTS received all permissions necessary to launch commercial services in Belarus and at December 31, 2002, the Group reflected its share of the results of operations and investment in the joint venture in Belarus in the accompanying consolidated financial statements.

During 2002, MTS and a subsidiary of Sistema established Mobile Positioning Systems ("MTS-P"), a Russian open joint-stock company, to design, develop and operate a positioning system based on the Group's GSM network.

6. Businesses Acquired

Rosico acquisition

In August 1998, MTS acquired from Sistema 80% of the outstanding common stock of Rosico, a Russian closed joint-stock company, in exchange for 408,631,860 shares of newly issued common stock of MTS representing 25% of then issued and outstanding shares of MTS. Prior to the acquisition, Sistema held a 90% interest in Rosico. Rosico holds GSM-1800 licenses covering the Moscow area, 18 regions of Central Russia and 11 regions in the Northern, the Urals and Western Siberia Regions of Russia.

During 2000, MTS acquired the remaining 20% of common stock of Rosico in a number of other acquisitions, for a total of \$16.1 million in cash. As of December 31, 2001 and 2002, MTS owned 100% interest of Rosico.

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 \$49,742. 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

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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	<u>\$ 49,742</u>

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 \$26,812 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. 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	<u>\$ 26,812</u>

In November 2002, MTS acquired the remaining 19% of Telecom-900 from Invest-Svyaz-Holding, a shareholder of the Group, for a cash consideration of \$6,900. The acquisition was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by \$2,695.

License costs are amortized over the remaining contractual terms of the respective license, ranging from six to ten years at the date of the first acquisition.

Kuban-GSM acquisition

In March 2002, MTS acquired 51% of Kuban-GSM, a Russian closed joint-stock company, for \$71,400 in cash. At the date of acquisition, Kuban-GSM had approximately 500,000 subscribers and it operates in thirteen major cities throughout the south of the European part of the Russian Federation,

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including Sochi, Krasnodar and Novorossisk. 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	84,409
License costs	62,549
Current liabilities	(31,289)
Non-current liabilities	(19,827)
Deferred taxes	(15,866)
Minority interest	(20,327)
Purchase price	<u>\$ 71,400</u>

The remaining interest in Kuban-GSM is owned by KubTelecom, a Russian limited liability company. MTS has the right to buy and KubTelecom has the right to sell all remaining shares of Kuban-GSM held by KubTelecom at fair value anytime until February 15, 2006.

In October 2002, MTS exercised its option to buy an additional 353 shares for \$5,000 payable in cash, increasing its ownership 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 \$4,370.

License costs are amortized over the remaining contractual term of the license of approximately 5 years at the date of the acquisition.

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 \$41,000 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:

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	<u>\$ 41,000</u>

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 for cash consideration of \$15,000 (including 33.33% acquired from Sistema for

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\$7,500). 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 by 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	<u>\$15,000</u>

In October 2002, the Group completed the acquisition of the remaining 33.33% of the outstanding common stock of Dontelecom for \$7,500. The acquisition was accounted for using the purchase method of accounting. The purchase increased the recorded license costs by \$7,328.

License costs are amortized over the remaining contractual term of the license of approximately 3 years at the date of the acquisition.

Pro forma results of operations (unaudited)

The following unaudited pro forma financial data for the years ended December 31, 2001 and 2002, give effect to the acquisitions of Kuban-GSM, BM Telecom and Dontelecom as if they had occurred at the beginning of the respective years.

	December 31,	
	2001	2002
Pro forma:		
Net revenues	\$971,562	\$1,394,148
Net operating income	363,856	476,314
Net income	234,556	284,347
Earnings per share, basic	0.118	0.143
Earnings per share, diluted	\$ 0.118	\$ 0.143

7. Cash and Cash Equivalents

Cash and cash equivalents as of December 31, 2001 and 2002 comprised of the following:

	December 31,	
	2001	2002
Rubles	\$ 15,282	\$19,860
U.S. dollar time deposits	195,000	7,999
U.S. dollars current accounts	7,578	6,404
Other	1,769	398
Total cash and cash equivalents	<u>\$219,629</u>	<u>\$34,661</u>

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8. Short-Term Investments

Short-term investments, denominated in U.S. dollars, as of December 31, 2002 comprised of the following:

	<u>Annual interest rate</u>	<u>Maturity date</u>	<u>December 31, 2002</u>
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			<u>\$30,000</u>

Short-term investments, denominated in U.S. dollars, as of December 31, 2001 were comprised of the following:

	<u>Annual interest rate</u>	<u>Maturity date</u>	<u>December 31, 2001</u>
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			<u>\$85,304</u>

Interest income for the years ended December 31, 2000, 2001 and 2002 amounted to \$7,626, \$11,829 and \$8,289, respectively.

9. Trade Receivables

Trade receivables as of December 31, 2001 and 2002 were as follows:

	<u>December 31,</u>	
	<u>2001</u>	<u>2002</u>
Accounts receivable, subscribers	\$19,091	\$29,505
Accounts receivable, roaming	10,345	17,266
Allowance for doubtful accounts	(5,178)	(6,270)
Trade receivables, net	<u>\$24,258</u>	<u>\$40,501</u>

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The following table summarizes the changes in the allowance for doubtful accounts for the years ended December 31, 2000, 2001 and 2002:

	December 31,		
	2000	2001	2002
Balance, beginning of year	\$ 5,395	\$1,819	\$ 5,178
Balance of business acquired	—	140	34
Provision for doubtful accounts	2,403	3,219	7,047
Accounts receivable written off	(5,979)	—	(5,989)
Balance, end of year	<u>\$ 1,819</u>	<u>\$5,178</u>	<u>\$ 6,270</u>

10. Inventory

Inventory as of December 31, 2001 and 2002 comprised of the following:

	December 31,	
	2001	2002
Spare parts for base stations	\$10,795	\$15,519
Handsets and accessories	6,232	18,056
Other inventory	9,157	7,811
Inventory	<u>\$26,184</u>	<u>\$41,386</u>

Obsolescence expense during the year ended December 31, 2000, 2001 and 2002 amounted to \$2,114, \$2,543 and \$5,614, respectively, and was included in operating expenses in the accompanying consolidated statements of operations.

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11. Property, Plant and Equipment

The net book value of property, plant and equipment as of December 31, 2001 and 2002 was as follows:

	December 31,	
	2001	2002
Network and base station equipment (including leased network and base station equipment of \$32,248 and \$49,711, respectively)	\$ 616,699	\$ 959,465
Leasehold improvements	7,233	4,299
Office equipment, computers and software (including leased office equipment, computers and software of \$1,824 and \$1,739, respectively)	42,340	68,271
Buildings	37,412	96,420
Vehicles	4,931	7,607
Property, plant and equipment, at cost	<u>708,615</u>	<u>1,136,062</u>
Accumulated depreciation (including accumulated depreciation on leased equipment of \$9,995 and \$13,420, respectively)	(168,989)	(299,216)
Equipment for installation	263,483	313,222
Construction in-progress	52,947	194,565
Property, plant and equipment, net	<u>\$ 856,056</u>	<u>\$1,344,633</u>

Depreciation expenses during the years ended December 31, 2000, 2001 and 2002 amounted to \$39.9 million, \$73.7 million and \$116.0 million, respectively, including depreciation expenses for leased property, plant and equipment in the amount of \$nil, \$1,589 and \$3,425 respectively.

12. Other Intangible Assets

Intangible assets at December 31, 2001 and 2002 comprised of the following:

	December 31,	
	2001	2002
Numbering capacity	\$ 66,203	\$ 70,885
Rights to use premises	24,380	25,420
Software and other	47,148	120,674
	<u>137,731</u>	<u>216,979</u>
Accumulated amortization	(52,953)	(78,889)
Intangible assets, net	<u>\$ 84,778</u>	<u>\$138,090</u>

As a result of 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 telecommunications operators in Moscow. Costs of acquiring numbering capacity are amortized over period of five to ten years in accordance with the terms of the contract entered into to acquire such capacity.

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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 during the years ended December 31, 2000, 2001 and 2002 amounted to \$12.9 million, \$17.5 million and \$30.0 million, respectively.

13. Deferred Connection Fees

Deferred connection fees for the years ended December 31, 2001 and 2002 were as follows:

	December 31,	
	2001	2002
Balance at beginning of year	\$ 31,553	\$ 47,412
Payments received and deferred during the year	35,886	19,346
Amounts amortized and recognized as revenue during the year	(20,027)	(24,854)
Balance at end of year	47,412	41,904
Less current portion	21,419	22,210
Non-current portion	<u>\$ 25,993</u>	<u>\$ 19,694</u>

MTS defers initial connection fees from the moment of initial signing of the contract with subscribers and the estimated average subscriber life (see Note 3 Summary of Significant Accounting Policies).

14. Debt

The Notes (see also Note 26 Subsequent Events)

On December 21, 2001, MTS Finance, a 100% beneficially owned subsidiary of MTS registered under the laws of Luxembourg, issued \$250 million 10.95% notes at the price of 99.254%. Proceeds received from the notes, net of underwriting discount, were \$248 million. Related debt issuance costs in the amount of \$3,856 were capitalized. On March 20, 2002, MTS Finance issued additional \$50 million 10.95% 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 \$649 were capitalized. All the notes are 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 Luxembourg Stock Exchange. In May 2002 these notes were registered with the SEC under the Securities Act of 1933.

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.

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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 “Ericson Loan”). The loan was repayable in ten equal consecutive quarterly payments of \$6,000 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 plus 4% (5.4% at December 31, 2002). 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 of 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 entered into a long-term, ruble-denominated promissory notes with 0% 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, 2001 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, 2002, Sistema has made payments under this obligation in the amount of \$48,024, \$28,897 of which are repayable in the form of long-term, ruble denominated promissory notes with 0% interest. Amounts receivable from Sistema under this indemnification are recorded as shareholder receivable in the accompanying consolidated balance sheets.

At December 31, 2001 and 2002, \$35 million and \$30 million were outstanding, respectively, under the Ericsson Loan.

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 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 plus 3.2% (4.6% at December 31, 2002) per annum. Default interest is 12% per annum. At December 31, 2001 and 2002 \$3 million and \$20 million were outstanding, respectively, under this agreement and are included in the current portion of long-term debt in the accompanying consolidated balance sheets.

In December 2001 and April 2002, UDN-900 entered into credit agreements with Drezdner Bank, expiring on April 2004. As of December 31, 2001 and 2002, the amounts of borrowings under these agreements were \$ nil and \$4.3 million, respectively. Amounts outstanding under these agreements bear interest of LIBOR plus 3.2% (4.6% December 31, 2002) per annum.

In July 2002, MTS OJSC entered into a credit facility with Dresdner Bank. The credit facility allows borrowings up to \$12 million with the final repayment date no later than June 1, 2004. The amount advanced under the facility bears interest of LIBOR plus 1.95% (3.35% at December 31, 2002)

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per annum. Default interest is 12% per annum. As of December 31, 2002, \$5 million was outstanding under this credit facility.

International Moscow bank credit facility

In November 2001, Telecom XXI entered into a credit facility with the International Moscow Bank to borrow up to \$15 million. Amounts borrowed under the credit facility must be repaid within two months of the first disbursement under the credit facility and bear interest of LIBOR plus 3.1% (4.5% at December 31, 2002) per annum. Default interest is 7.9% per annum. At December 31, 2001 and 2002, \$10 million and \$ nil, respectively, was outstanding under this agreement and is included in the current portion of long-term debt. Amounts outstanding on the facility are guaranteed by MTS OJSC.

Citibank credit facility

In November 2002, Telecom XXI entered into a credit facility with Citibank. Amounts borrowed under the credit facility must be repaid in June 2003 and bear interest of LIBOR plus 3.5% (4.9% at December 31, 2002) per annum. Overdue amounts bear an additional 3% per annum. At December 31, 2002, \$9 million outstanding under this facility is included in the current portion of long-term debt. The amounts outstanding on the facility are guaranteed by MTS OJSC.

Inkombank credit facility to MSS

In August 1997, MSS entered into a \$12 million credit facility with OJSC AB Inkombank (“Inkombank”) for the purposes of financing GSM-900 network development. The facility had a final repayment date of March 31, 2002. The amount advanced under the agreement bore interest of 16% per annum. In December 2001, MTS negotiated with Inkombank to pay \$4,169 immediately to extinguish the outstanding obligation of \$6,949. See Note 26 Subsequent Events regarding the accounting for this transaction.

Sberbank credit facilities

Kuban-GSM has a number of ruble-denominated credit facility agreements with Sberbank of Russian Federation (“Sberbank”). The amounts borrowed under these credit facilities bear interest at rates varying from 17% to 23% and are to be repaid in regular installments on various dates ending June 2005. Borrowings under these facilities are secured by a pledge of equipment with carrying value of \$34.5 million at December 31, 2002.

At December 31, 2002, the total amount payable under these facilities, including accrued interest was \$21 million.

Yugbank loans

Kuban-GSM has a number of credit facility agreements with Yugbank denominated in rubles. The amounts borrowed under these credit facilities bear interest at rates varying from 19% to 21% and are to be repaid between October 2003 and September 2004. Borrowing under these facilities are secured by a pledge of equipment with a carrying value of \$7 million at December 31, 2002. As of December 31, 2002, the total amount payable under these facilities, including accrued interest was \$3 million.

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Rosbank loan

In December 2002, Kuban-GSM entered into a ruble-denominated credit agreement with Rosbank, maturing in December 2003. As of December 31, 2002, the amount of borrowings under this agreement was \$3 million. Amounts outstanding under this agreement bears interest at 19% per annum. Borrowings under this facility are secured by a pledge of equipment with a carrying value of \$13 million at December 31, 2002.

WestLB International loan

In July 2002, MTS-P entered into a credit facility agreement with WestLB International S.A. As of December 31, 2002, the amount of borrowings under this agreement was \$4 million. Amounts outstanding under this agreement bear interest of EURIBOR plus 2% (4.9% at December 31, 2002) 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.

RTDC loan

Dontelecom has a loan agreement with Russian Telecommunications Development Corporation ("RTDC"). The principal outstanding amounted to \$1.4 million as of December 31, 2002. The interest rate is fixed at 9.5% per annum on outstanding principal balance. The final maturity of this agreement is December 31, 2003.

Motorola loan

Dontelecom has a loan agreement with Motorola for GSM cellular equipment, principal and interest which are payable semiannually; the amounts outstanding bear interest of at 8.23% per annum. The principal amounted to \$1.6 million as of December 31, 2002. Final maturity of this agreement is January 2003.

The following table presents aggregate scheduled maturities of long-term debt principal as of December 31, 2002:

Payments due in the year ended December 31,	
2003	\$ 67,098
2004	333,133
2005	17,992
2006	7,151
	<u>\$425,374</u>

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15. 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, 2002:

Payments due in the year ended December 31,	
2003	\$ 25,871
2004	7,697
2005	1,549
2006	16
2007	14
Thereafter	32
Total minimum lease payments (undiscounted)	35,179
Less amount representing interest	(6,706)
Present value of net minimum lease payments	28,473
Less current portion of lease payable	(21,232)
Non-current portion of lease payable	<u>\$ 7,241</u>

For a schedule by years of future minimum lease payments under capital leases to Invest-Svyaz-Holding, a related party, together with the present value of the net minimum lease payments as of December 31, 2002, see Note 20 Related Parties.

16. Accrued Liabilities

Accrued liabilities at December 31, 2001 and 2002 were comprised of the following:

	December 31,	
	2001	2002
VAT	\$31,213	\$29,393
Taxes other than income	13,781	31,810
Interest payable	1,636	1,500
Other accruals	4,996	11,216
Total accrued liabilities	<u>\$51,626</u>	<u>\$73,919</u>

17. Income Tax

MTS' provision for income taxes is as follows for the respective periods ended:

	December 31,		
	2000	2001	2002
Current provision for income taxes	\$52,086	\$138,092	\$129,406
Deferred income tax benefit	(932)	(39,964)	(18,989)
Total provision for income taxes	<u>\$51,154</u>	<u>\$ 98,128</u>	<u>\$110,417</u>

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MTS' statutory income tax rate in 2000 was 30%. From January 1, 2001, MTS' statutory income tax rate was 35% as a result of changes in Russian legislation. The increase in tax rate to 35% resulted in recognition of a deferred tax liability of approximately \$10 million in 2000. 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 million in 2001. The statutory income tax rate reconciled to MTS' effective income tax rate is as follows for the respective periods ended:

	December 31,		
	2000	2001	2002
Statutory income tax rate for year	30%	35%	24%
Adjustments:			
Expenses not deductible for tax purposes	17.4	13.6	2.1
Tax allowance generated from investment in infrastructure	(18.2)	(8.3)	—
Effects of increase in income tax rate	7.0	—	—
Effects of decrease in income tax rate	—	(6.6)	—
Other	1.8	(3.9)	(0.3)
Effective income tax rate	<u>38.0%</u>	<u>29.8%</u>	<u>25.8%</u>

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, 2001 and 2002:

	December 31,	
	2001	2002
Assets/(liabilities) arising from tax effect of:		
Deferred tax assets		
Depreciation of property, plant and equipment	\$ 10,050	\$ 13,606
Deferred connection fees	10,910	10,057
Loss carryforward (Rosico and MSS)	14,709	10,033
Other	2,263	9,555
	<u>37,932</u>	<u>43,251</u>
Valuation allowance	(25,892)	(12,695)
Deferred tax assets	<u>12,040</u>	<u>30,556</u>
Less: current portion	5,802	12,223
Non-current portion	<u>\$ 6,238</u>	<u>\$ 18,333</u>
Deferred tax liabilities		
Licenses acquired	\$(66,745)	\$ (91,606)
Other	(760)	(14,212)
Total deferred tax liabilities	<u>(67,505)</u>	<u>(105,818)</u>
Net deferred tax liability	<u>\$(55,465)</u>	<u>\$ (75,262)</u>

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As of December 31, 2001 and 2002, Rosico and MSS were entitled to loss carryforwards in the amounts of \$61,286 and \$41,803, respectively. These loss carryforwards resulted in deferred tax assets at December 31, 2001 and 2002 in the amounts of \$14,709 and \$10,033, 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. The Group has recorded a valuation allowance for the entire tax loss carryforward related to Rosico and MSS since it is more likely than not that the tax asset will not be realized.

18. 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, 2001 and 2002 which is distributable under Russian legislation totaled 8,587 million rubles (\$294,381) and 10,759 million rubles (\$343,278), respectively.

19. Stock Bonus and Stock Option Plans

On April 27, 2000, contingent on the closing of MTS' initial public offering (see Note 1 General), MTS established a stock bonus plan and stock option plan for selected officers, key employees and key advisors. Under these plans, directors, key employees and key advisors received 3,587,987 of MTS common shares as well as the right to participate in a stock option plan under which they may receive options to purchase up to an additional 9,966,631 of MTS common shares. At the time of the initial public offering, MTS OJSC issued 13,554,618 shares of common stock to its subsidiary Rosico pursuant to these plans at a price of \$1.024 per share for the total amount of \$13.9 million. These shares have been classified as treasury stock in the accompanying consolidated balance sheets.

Under the stock bonus plan, during September 2000, 3,587,987 common shares were purchased from Rosico at nominal price of 0.1 rubles per share as follows:

	<u>Number of shares purchased</u>	<u>Percentage of total shares outstanding</u>
Employees and Directors	3,049,786	0.153
Key Advisors	538,201	0.027
Total	<u>3,587,987</u>	<u>0.180</u>

All those listed above were restricted from selling these shares for 180 days from the date of purchase. On the date the shares were granted, MTS recognized aggregate expenses under this plan as compensation and consulting expenses amounting to \$4,500 and \$797, respectively, based on the fair value of the shares (see also Note 20 Related Parties).

Options under the stock option plan are generally granted at an exercise price equal to the average sale price of MTS stock on New York Stock Exchange over a 100-day period preceding the grant date and vest over the period not exceeding two years, contingent on continued employment or board membership of participants.

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During 2001 and 2002, MTS made several grants pursuant to its stock option plan to employees and directors of the Group. A summary of the status of the Group's stock option plan as of December 31, 2001 and 2002, is presented below:

	Shares	Weighted average exercise price
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 December 31, 2002	<u>4,648,421</u>	<u>\$1.42</u>

None of the options outstanding at December 31, 2001 and 2002, were exercisable. Options outstanding at December 31, 2002, have exercise price ranging from \$1.31-\$1.49 per share and a their weighted average remaining contractual life was approximately 2 years at December 31, 2002.

Fair values of options granted in 2001 and 2002 were \$0.36 and \$0.50 per share, respectively, and were estimated using the Black-Scholes option pricing model. The risk free rates applied for 2001 and 2002 were 15.5% and 6.1%, respectively. The following assumptions were applied to options granted in 2001 and 2002, respectively: (i) expected dividend yields of nil% and nil%; (ii) expected volatility rates of 45% and 50% and (iii) expected lives of 2 years for 2001 and 2002.

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.

20. Related Parties

Related party balances as of December 31, 2001 and 2002 comprised of the following:

	December 31,	
	2001	2002
Accounts receivable:		
T-Mobile receivable for roaming	\$ 677	\$1,374
Receivables from investee companies	1,700	2,195
Total accounts receivable, related parties	<u>\$2,377</u>	<u>\$3,569</u>
Accounts payable:		
T-Mobile payable for consulting services	\$1,970	\$ —
T-Mobile other payables	1,266	—
Telmos for interconnection	207	184
MTU-Inform for interconnection	2,593	4,154
MGTS for interconnection	106	630
Total accounts payable, related parties	<u>\$6,142</u>	<u>\$4,968</u>

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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, 2001, MTS' cash position at MBRD amounted to \$112.4 million including \$105 million in time deposits and \$7.4 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. The related interest accrued and collected on the deposits for the years ended December 31, 2001 and 2002 amounted to \$3.0 million and \$5.1 million, respectively, and was included as a component of interest income in the accompanying consolidated statements of operations.

Rosno OJSC

MTS arranged medical insurance for its employees and insured its property at the amounts of approximately \$274 million, \$612 million and \$781 million in 2000, 2001 and 2002, respectively, with Rosno OJSC, whose significant shareholder is Sistema. Insurance premiums paid to Rosno OJSC for the years ended December 31, 2000, 2001 and 2002, amounted to \$6.5 million, \$8.0 million and \$4.9 million, respectively, including premiums paid for medical insurance amounting to \$1.6 million, \$2.5 million and \$3.6 million, respectively. Management believes that all of the insurance contracts with Rosno OJSC have been entered at market terms.

Maxima Advertising Agency (Maxima)

In 2000, 2001 and 2002, MTS had agreements for advertising services with Maxima. Advertising fees paid to Maxima for the years ended December 31, 2000, 2001 and 2002, were \$6.4 million, \$8.7 million and \$13.1 million, respectively. Maxima is related to MTS through MTS' directors who are also members of Maxima's board of directors.

Telmos

In 2000, 2001 and 2002, 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, 2000, 2001 and 2002, were approximately \$4.3 million, \$4.0 million and \$1.3 million, respectively. Management believes that these arrangements are at market terms.

Moscow City Telephone Network (MGTS)

In 2000, 2001 and 2002, MTS had line rental agreements with MGTS and rented cable plant from MGTS for installation of optic-fiber 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, 2000, 2001 and 2002, were approximately \$1.0 million, \$1.5 million and \$4.4 million, respectively. In 2000, 2001 and 2002, MTS also purchased buildings from MGTS and paid \$2.9 million, \$2.6 million and \$2.0 million, respectively. Management believes that all these transactions were made at market terms. Sistema is the majority shareholder of MGTS.

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MTU-Inform

In 2000, 2001 and 2002, MTS had interconnection and line rental agreements with MTU-Inform, a subsidiary of Sistema. Amounts paid under these agreements for the years ended December 31, 2000, 2001, and 2002, amounted to approximately \$17.4 million, \$29.0 million and \$24.1 million, respectively. In 2000, 2001 and 2002 MTS also purchased telephone numbering capacity from MTU-Inform. Payments under these agreements for the years ended December 31, 2000, 2001 and 2002, amounted to \$11.7 million, \$4.7 million and \$1.6 million, respectively. Management believes that these agreements are at market terms.

T-Mobile

In 2000, 2001 and 2002, the Group had roaming agreements with T-Mobile, a shareholder of the Group and its subsidiaries. Payments made by MTS under these roaming agreements were approximately \$0.7 million, \$0.7 million and \$1.0 million for the years ended December 31, 2000, 2001 and 2002, respectively. In addition, during 2000 T-Mobile provided consulting services to the Group for \$2.7 million.

Invest-Svyaz-Holding

In 2001 and 2002, subsidiaries of Telecom-900, Uraltel, FECS-900 and SCS-900 entered into agreements with Invest-Svyaz-Holding, a shareholder of MTS, 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 1 year are classified as short-term, the remaining balance as long-term liabilities. The interest rate implicit in these leases varies from 15% 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, 2002:

Payments due in the year ended December 31	
2003	\$ 6,554
2004	4,621
2005	1,199
Total minimum lease payments (undiscounted)	12,374
Less amount representing interest	(3,331)
Present value of net minimum lease payments	9,043
Less current portion of lease payable	(4,879)
Non-current portion of lease payable	<u>\$ 4,164</u>

In addition to the above lease transactions, the Group guarantees debt of Invest-Svyaz-Holding in the amount of \$7 million to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to the Group. For the year ended leases to the Group amount to approximately 99% of revenues of Invest-Svyaz-Holding.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

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 \$503 and \$139, respectively. For the year ended December 31, 2002, principal and interest paid to Invest-Svyaz-Holding were \$2.9 million and \$1.4 million, respectively.

Other

In 2000, consultants from MTS' two major shareholders advised MTS in connection with MTS's initial public offering. In April 2000, contingent on the closing of this stock offering, MTS established a stock bonus plan (see Note 19 Management Stock Bonus and Stock Option Plans). Under this plan, consultants purchased 538,201 common shares of MTS from Rosico at nominal price 0.1 rubles per share. In 2000, MTS recognized consulting expenses under this plan in the amount of \$797 based on the fair value of the shares on the date of grant.

As discussed in Note 6 Businesses Acquired, during 2001 and 2002 MTS acquired 81% and 19%, respectively, of the outstanding common stock of Telecom-900, for \$26.8 million and \$6.9 million, respectively, in cash from Sistema and Invest-Svyaz-Holding, respectively. Additionally in 2002, MTS acquired 33.33% of the outstanding common stock of Dontelecom from Sistema for \$7.5 million in cash.

21. Operating Expenses

Operating expenses for 2000, 2001 and 2002, consisted of the following:

	December 31,		
	2000	2001	2002
Salaries and social contributions	\$ 33,753	\$ 44,425	\$ 84,706
Taxes other than income taxes	26,859	25,312	39,119
General and administrative	20,355	21,569	26,549
Rent	7,241	9,479	15,578
Insurance	4,251	5,258	6,774
Repair and maintenance	3,225	10,578	20,361
Provision for doubtful accounts	2,403	3,219	7,047
Consulting expenses	2,621	2,093	7,692
Billing and data processing	2,285	2,981	9,549
Other operating expenses	7,249	9,684	11,681
Total operating expenses	<u>\$110,242</u>	<u>\$134,598</u>	<u>\$229,056</u>

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

22. Investments In and Advances to Affiliates

At December 31, 2001 and 2002, Group's investments in and advances to affiliated included, respectively, the following:

	December 31,	
	2001	2002
MTS Belarus—loans receivable	\$ —	\$30,089
MTS Belarus—equity investment	—	2,455
Receivables from other investee companies	740	1,490
Total investments in and advances to affiliates	<u>\$740</u>	<u>\$34,034</u>

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 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 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 began investing in MTS Belarus.

For the year ended December 31, 2002, the Group provided MTS Belarus with \$30.1 million in loans bearing interest at 11% with repayment terms of between February and June 2003. Based on projected future cash flows, the Group has concluded that an additional impairment is not required as of December 31, 2002.

23. 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

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

through acquisitions. At December 31, 2002, recorded values of the Group's telecommunication licenses were as follows:

	December 31, 2002
Moscow license area (Rosico)	\$ 255,812
North-Western region (Telecom XXI)	74,639
Krasnodar and Adigeys regions (Kuban-GSM)	66,919
Bashkortostan Republic (BM Telecom)	48,932
Five regions of Asian Russia (Telecom-900)	34,237
Rostov region (Dontelecom)	22,067
Seven regions of European Russia	19,503
Other	8,212
Licenses, at cost	530,321
Accumulated amortization	(143,402)
Licenses, net	<u>\$ 386,919</u>

The following table summarizes GSM-900/1800 telecommunication licenses held by the Group at December 31, 2002:

License region	GSM-900		GSM-1800	
	Licensee	Expiry date	License	Expiry date
Moscow License Area				
Moscow	MTS OJSC	December 1, 2004	Rosico	April 28, 2008
Moscow Region	MTS OJSC	December 1, 2004	Rosico	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
Regional License Areas				
European Russia				
Adygeya Republic	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	ReCom	May 15, 2008	Rosico	April 28, 2008
Bryansk	ReCom	May 15, 2008	Rosico	April 28, 2008
Ivanovo	—	—	Rosico	April 28, 2008
Kaliningrad	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Kalmykia Republic	BIT	January 25, 2011	—	—
Kaluga	MTS OJSC	October 1, 2006	Rosico	April 28, 2008
Karelia	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Kirov	Rosico	April 28, 2008	Rosico	April 28, 2008
Komi Republic	MTS OJSC	August 22, 2007	Rosico	April 28, 2008
Komi-Permyatsk	—	—	Rosico	April 28, 2008

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

License region	GSM-900		GSM-1800	
	Licensee	Expiry date	License	Expiry date
Kostroma	MTS OJSC	August 22, 2007	Rosico	April 28, 2008
Krasnodar Region	Kuban-GSM	May 30, 2007	Kuban-GSM	May 30, 2007
Kursk	ReCom	May 15, 2008	Rosico	April 28, 2008
Lipetsk	ReCom	May 15, 2008	Rosico	April 28, 2008
Murmansk	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Nenetsk	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Nizhny Novgorod	Rosico	April 28, 2008	Rosico	April 28, 2008
Novgorod	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Orel	ReCom	May 15, 2008	Rosico	April 28, 2008
Orenburg	—	—	Rosico	April 28, 2008
Perm	Rosico	April 28, 2008	Rosico	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	October 1, 2006	Rosico	April 28, 2008
Saratov	MTS OJSC	July 11, 2012	—	—
Smolensk	MTS OJSC	October 1, 2006	Rosico	April 28, 2008
Tambov	—	—	Rosico	April 28, 2008
Tula	MTS OJSC	October 1, 2006	Rosico	April 28, 2008
Tver	MTS OJSC	April 4, 2007	Rosico	April 28, 2008
Udmurt Republic	UDN-900	February 21, 2007	Rosico	April 28, 2008
Vladimir	MTS OJSC	October 1, 2006	Rosico	April 28, 2008
Vologda	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Voronezh	ReCom	May 15, 2008	Rosico	April 28, 2008
Yaroslavl	—	—	Rosico	April 28, 2008
Samara Region	MTS OJSC	December 30, 2012	MTS OJSC	December 30, 2012
Asian Russian				
Altai Region	Mobicom-Barnaul	September 8, 2010	—	—
Altai Republic	SCS-900	July 19, 2011	—	—
Amursk	ACC	January 10, 2007	—	—
Chelyabinsk	Rosico	April 28, 2008	Rosico	April 28, 2008
Chukotka	BIT	July 19, 2011	—	—
Khabarovsk	FECS-900	January 10, 2007	FECS-900	January 10, 2007
Kurgan	—	—	Rosico	April 28, 2008
Khanty Mansiysk	—	—	Rosico	April 28, 2008
Novosibirsk	SCS-900	February 21, 2007	SCS-900	February 21, 2007
Omsk	MSS	December 20, 2006	—	—
Sakhalin	BIT	July 19, 2011	—	—
Sverdlovsk Region	Uraltel	March 1, 2006	Uraltel	March 1, 2006
Sverdlovsk Region	—	—	Rosico	April 28, 2008
Tyumen	—	—	Rosico	April 28, 2008
Tyva Republic	BIT	July 19, 2011	—	—
Yamalo-Nenetsk	—	—	Rosico	April 28, 2008

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)**

Each of the Group's licenses, except the licenses covering the Moscow license area, contains a requirement that service be commenced and that subscriber-number and territorial-coverage targets 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.

When MTS commenced its operations in 1994, licenses generally contained certain provisions for unspecified fees to be paid for utilization of the frequency. Most of MTS' current licenses now provide for payments to be made to finance telecommunication infrastructure improvements, which in the aggregate could total approximately \$110,244. However, no decisions regulating the terms and conditions of such payments have been formulated. Accordingly, no payments have been made to date pursuant to any of the current licenses, which could require such payments. Further, management believes that the Group 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, no amounts have been recorded in the accompanying financial statements.

24. Commitments and Contingencies

Commitments

As of December 31, 2002, MTS committed to further purchase of network property, plant and equipment in the amount of approximately \$306 million.

As of December 31, 2002, MTS guaranteed bank loans of Invest-Svyaz-Holding ("ISH"), a shareholder of the Group, in the amount of \$7 million, which were primarily used to finance Invest-Svyaz-Holding's leases to the Group. Under these guarantees, MTS is liable for all amounts outstanding under certain bank loans of Invest-Svyaz-Holding in case ISH defaults on the payment. The guarantees expire between August 2003 and April 2005. No liability in respect of these guarantees has been recorded in the accompanying consolidated financial statements.

Negative net equity of Rosico

In accordance with Russian legislation, joint-stock companies must maintain a level of equity (net assets) that is greater than the charter capital. In the event that a company's equity (net assets), as determined under Russian accounting legislation, falls below certain minimum levels, specifically below zero, such company can be forced to liquidation.

During the past several years Rosico reported significant losses in its financial statements compiled in accordance with Russian accounting legislation. As a result, at December 31, 2001 and 2002, Rosico reported a deficit in equity (negative net equity) in its financial statements compiled in accordance with Russian accounting legislation.

25. 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.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

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.

At December 31, 2002, the Group had several operating segments, of which one is a reportable segment—MTS OJSC and Rosico, which operates primarily in the Moscow license area and also has license footprint covering several other regions.

	Year ended December 31,		
	2000	2001	2002
Revenue:			
MTS OJSC and Rosico	\$534,433	\$831,857	\$1,044,877
Other	1,279	64,780	370,309
Intercompany eliminations	—	(3,390)	(53,430)
Total revenue	<u>\$535,712</u>	<u>\$893,247</u>	<u>\$1,361,756</u>
Operating income:			
MTS OJSC and Rosico	\$141,147	\$316,894	\$ 365,698
Other	(2,100)	8,039	102,862
Intercompany eliminations	—	(824)	(4,189)
Total operating income	<u>\$139,047</u>	<u>\$324,109</u>	<u>\$ 464,371</u>
Depreciation and amortization:			
MTS OJSC and Rosico	\$ 85,796	\$114,923	\$ 144,004
Other	1,888	18,395	65,676
Total depreciation and amortization	<u>\$ 87,684</u>	<u>\$133,318</u>	<u>\$ 209,680</u>
Additions to long-lived assets:			
MTS OJSC and Rosico	\$243,037	\$415,336	\$ 360,598
Other	—	176,211	344,739
Total additions to long-lived assets	<u>\$243,037</u>	<u>\$591,547</u>	<u>\$ 705,337</u>

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)

	As of December 31,	
	2001	2002
Long-lived assets:		
MTS OJSC and Rosico	\$1,045,034	\$1,288,062
Other	195,451	585,769
Intercompany eliminations	(824)	(4,189)
Total long-lived assets	<u>\$1,239,661</u>	<u>\$1,869,642</u>
Total assets:		
MTS OJSC and Rosico	\$1,625,053	\$1,923,682
Other	232,846	690,481
Intercompany eliminations	(130,407)	(330,867)
Total assets	<u>\$1,727,492</u>	<u>\$2,283,296</u>

26. Subsequent Events

Issue of Eurobonds

On January 30, 2003, MTS Finance issued \$400 million 9.75% notes at par. These notes are guaranteed by MTS OJSC and mature on January 30, 2008. MTS Finance will make interest payments on the notes semi-annually in arrears on January 30 and July 30 of each year, commencing on July 30, 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes were \$400 million and related debt issuance costs of \$3.9 million were capitalized.

Acquisition of UMC

On March 4, 2003, MTS acquired 57.7% of the outstanding voting interest of Ukrainian Mobile Communications (“UMC”), a provider of mobile services in Ukraine, for cash consideration of \$194,200, including the acquisition of 16.3% of the outstanding voting interest from Deutsche Telekom, a related party, for \$55,000. In connection with the acquisition, MTS also assumed debt of UMC with face value of approximately \$65 million. At the date of acquisition, UMC had approximately 1.8 million subscribers.

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 \$87,600. On June 4, 2003 MTS exercised its call option. As a result of the transaction, MTS’ ownership in UMC has increased from 57.7% to 83.7%.

In addition, MTS entered into a put and call option agreement with TDC International for the purchase of its 16.3% stake in UMC. On July 28, 2003, MTS completed the purchase of this 16.3% stake for \$91.8 million, increasing its ownership interest in UMC to 100%.

Acquisition of TAIF Telcom

On April 2, 2003, MTS acquired 51% of common shares of TAIF Telcom, a Russian open joint-stock company, for \$51 million and 50% of preferred shares of TAIF Telcom for \$10 million.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)**

In addition, MTS has signed call and put option agreements with the existing shareholders of TAIF Telcom to acquire the remaining 49% common and 50% preferred shares of TAIF Telcom. The exercise period of the call options for common shares is 48 months from the date of acquisition of a 51% stake in TAIF Telcom and the put options for common shares are exercisable for 36 months from the date falling 18 months after the date of acquisition of the first stake in TAIF Telcom by MTS. A minimum price of the call and put options for common shares is \$49 million plus 8% per annum starting from the moment of acquisition of the first stake of TAIF Telcom by MTS. The exercise period of the call options for preferred shares is 48 months from the date falling 24 months after the date of acquisition of a 51% of TAIF Telcom and the put options for preferred shares are exercisable for 24 months from the date falling 24 months after the date of acquisition of the first stake in TAIF Telcom by MTS. A minimum price of the call and the put options for preferred shares is \$10 million plus 8% per annum starting from the moment of acquisition of the first stake of TAIF Telcom by MTS.

If all options are exercised, MTS' share in TAIF Telcom will increase to 100%.

TAIF Telcom provides mobile services in the GSM-900/1800 standard in the Republic of Tartarstan and in the Volga region of Russia. At the date of acquisition, TAIF Telcom had approximately 240,000 subscribers. Purchase price allocation for the acquisition of TAIF Telcom has not been finalized at the date of these statements.

Transactions by major shareholders

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 199,322,614 shares of MTS, representing 10% of MTS. The call option is exercisable to September 30, 2003. In connection with this agreement, the Shareholders entered into an additional agreement relating to the management of MTS (subject to approvals by the Russian Ministry of Antimonopoly Policy and Support of Entrepreneurial Activity, or MAP). The major terms of the agreement are as follows:

- T-Mobile is required to vote when necessary to ensure, as much as possible, that Sistema will have the majority of the MTS board of directors;
- T-Mobile will be required to approve certain transactions such as significant acquisitions, share issuances that dilute T-Mobile's ownership, etc;
- a dividend policy will be approved by the Shareholders, with the expectation that annual distributions of not less than 25% of MTS OJSC net profits, according to Russian accounting standards, will be made as dividends annually, beginning effective 2003.

In April 2003, Sistema issued \$350 million 10.25% notes, due in 2008. These notes are secured by 193,473,900 shares of common stock of MTS.

On April 26, 2003, Sistema exercised its option with T-Mobile to purchase an additional 6% of the outstanding common stock of the Group and purchased T-Mobile's 49% interest in Ivest-Svyaz-Holding. Concurrently with this transaction, T-Mobile sold 5% of its holding in the Group on the open market in the form of Global Depository Shares, or GDSs listed on the London Stock Exchange.

On June 30, 2003, the Group approved cash dividends of \$1.12 per ADS (\$0.056 per share) for a total of \$111.4 million.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**(Amounts in thousands of U.S. dollars,
except share and per share amounts or if otherwise stated)**

Additional debt issuance

In March 2003, the Board of Directors of MTS OJSC approved the issuance of ruble denominated bonds for up to 5 billion rubles (\$161 million).

In June 2003, MTS entered into a loan agreement with Moscow Bank for Reconstruction and Development for \$6.2 million with an interest rate of 6.0%. This loan matures on August 29, 2003.

On June 9, 2003, Kuban GSM entered into a 350 million ruble (approximately \$11.5 million) credit facility with the Moscow International Bank. 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.

On June 27, 2003, Kuban GSM entered into a 295 million ruble (approximately \$9.7 million) credit facility with Rosbank. Amounts borrowed under this facility have an interest rate of 15% and mature in June 2005.

On July 29, 2003, MTS entered into a loan facility agreement with Credit Suisse First Boston International in the amount of \$100 million, to be used for acquisitions of mobile telecommunications providers. Amounts outstanding under this loan facility agreement bear interest at 5.1% per annum. MTS intends to repay the loan with the proceeds of its August 2003 Eurobond offering.

Potential acquisition of SibChallenge

On July 23, 2003, MTS signed agreements, contingent on certain conditions, to acquire a 100% stake in SibChallenge, a cellular company in the Krasnoyarsk region, for \$45.4 million.

ACC merger

In April 2003 the Group's shareholders approved the merge of ACC, an MTS' wholly owned subsidiary, into MTS OJSC. The Group intends to complete the merger during 2004.

Rosico merger

In June 2003, MTS's wholly-owned subsidiary Rosico merged into MTS OJSC pursuant to a shareholders' resolution approving the merger and a merger agreement. The intent of this merger is to reduce financial, managerial and other expenses connected with providing communication services in the territories in which Rosico currently operates.

Adoption of New Accounting Standard

Effective January 1, 2003, MTS adopted the requirements of SFAS No. 145. As a result, MTS reclassified the gain on extinguishment of its credit facility with OJSC Inkombank of \$2,780, and the related income tax expense of \$667, from extraordinary gain on debt repayment to other income and income tax expense, respectively, in the accompanying consolidated statement of operations for the year ended December 31, 2001.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
AT DECEMBER 31, 2002 AND JUNE 30, 2003
(UNAUDITED)

(Amounts in thousands of U.S. dollars, except share amounts)

	December 31, 2002	June 30, 2003
CURRENT ASSETS:		
Cash and cash equivalents	\$ 34,661	\$ 113,561
Short-term investments	30,000	30,000
Accounts receivable, net, including related party amounts of \$3,569 and \$4,284, respectively (Note 8)	44,070	87,213
Inventory	41,386	56,443
VAT receivable	154,061	193,452
Prepaid expenses and other current assets	54,152	85,971
Total current assets	358,330	566,640
PROPERTY, PLANT AND EQUIPMENT , net of accumulated depreciation of \$299,216 and \$389,910, respectively (Note 4)	1,344,633	1,866,543
LICENSES AND OTHER INTANGIBLE ASSETS , net of accumulated amortization of \$222,291 and \$301,274, respectively (Note 5)	525,009	808,423
INVESTMENTS IN AND ADVANCES TO AFFILIATES	34,034	51,207
OTHER ASSETS	21,290	7,129
TOTAL ASSETS	\$2,283,296	\$3,299,942

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (Continued)
AT DECEMBER 31, 2002 AND JUNE 30, 2003
(UNAUDITED)

(Amounts in thousands of U.S. dollars, except share amounts)

	<u>December 31, 2002</u>	<u>June 30, 2003</u>
CURRENT LIABILITIES:		
Accounts payable, including related party amounts of \$4,968 and \$5,582, respectively (Note 8)	\$ 122,591	\$ 166,659
Subscriber prepayments	110,950	137,297
Accrued expenses and other current liabilities, including related party amounts of \$nil and \$27,500, respectively (Notes 2, 3 and 8)	102,341	309,607
Current portion of long-term debt and capital lease obligations (Notes 6, 7 and 8)	88,330	200,966
Total current liabilities	424,212	814,529
LONG-TERM LIABILITIES:		
Long-term debt (Notes 6 and 8)	358,914	769,067
Capital lease obligations (Notes 7 and 8)	7,241	7,237
Deferred income taxes	105,818	134,147
Deferred revenue and other long-term liabilities	19,694	39,142
Total long-term liabilities	491,667	949,593
TOTAL LIABILITIES	915,879	1,764,122
COMMITMENTS AND CONTINGENCIES (Note 9)		
MINORITY INTEREST	65,373	132,524
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, 2002 and June 30, 2003, 345,244,080 of which are in the form of ADS)	50,558	50,558
Treasury stock (9,966,631 common shares at cost)	(10,206)	(10,206)
Additional paid-in capital	558,102	558,762
Unearned compensation (Note 1)	(212)	(212)
Shareholder receivable (Note 8)	(34,412)	(31,087)
Retained earnings	738,214	835,481
Total shareholders' equity	1,302,044	1,403,296
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u>\$2,283,296</u>	<u>\$3,299,942</u>

See notes to condensed consolidated financial statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
FOR THE SIX MONTHS ENDED JUNE 30, 2002 AND 2003
(UNAUDITED)

(Amounts in thousands of U.S. dollars, except share and per share amounts)

	Six months ended June 30,	
	2002	2003
NET REVENUES:		
Service revenues	\$ 522,386	\$ 992,673
Connection fees	12,228	16,166
Equipment sales	29,288	43,295
	<u>563,902</u>	<u>1,052,134</u>
COST OF SERVICES AND PRODUCTS (including related party amounts of \$13,501 and \$17,012, respectively):		
Interconnection and line rental	55,081	78,908
Roaming expenses	28,713	45,269
Cost of equipment	38,119	73,639
	<u>121,913</u>	<u>197,816</u>
OPERATING EXPENSES (including related party amounts of \$5,251 and \$5,139, respectively):	91,672	168,944
SALES AND MARKETING EXPENSES (including related party amounts of \$3,727 and \$10,305, respectively):	64,795	135,564
DEPRECIATION AND AMORTIZATION	90,678	174,774
Net operating income	<u>194,844</u>	<u>375,036</u>
CURRENCY EXCHANGE AND TRANSLATION LOSSES/(GAINS)	690	(1,408)
OTHER EXPENSES (INCOME):		
Interest income (including related party amounts of \$3,072 and \$6,187, respectively):	(5,497)	(8,823)
Interest expense	20,687	42,813
Other expenses	2,721	855
Total other expenses, net	<u>17,911</u>	<u>34,845</u>
Income before provision for income taxes and minority interest	<u>176,243</u>	<u>341,599</u>
PROVISION FOR INCOME TAXES	53,954	96,412
MINORITY INTEREST	14,688	36,445
NET INCOME	<u>\$ 107,601</u>	<u>\$ 208,742</u>
Weighted average number of shares outstanding	1,983,359,507	1,983,359,507
Earnings per share, basic and diluted	\$ 0.054	\$ 0.105

See notes to condensed consolidated financial statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
FOR THE SIX MONTHS ENDED JUNE 30, 2002 AND 2003
(UNAUDITED)
(Amounts in thousands of U.S. dollars)

	Six months ended June 30,	
	2002	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 107,601	\$ 208,742
Adjustments to reconcile net income to net cash provided by operating activities:		
Minority interest	14,688	36,445
Depreciation and amortization	90,678	174,774
Amortization of deferred connection fees	(12,228)	(16,166)
Provision for obsolete inventory	1,572	3,278
Provision for doubtful accounts (Note 9)	2,850	22,851
Interest accrued	20,827	42,813
Interest paid	(19,674)	(25,969)
Deferred taxes	(3,375)	(17,064)
Changes in operating assets and liabilities, net of effect from acquisitions:		
Increase in accounts receivable	(15,465)	(41,732)
Increase in inventory	(4,434)	(4,255)
Increase in prepaid expenses and other current assets	(57,246)	(31,412)
(Increase)/decrease in trade accounts payable, accrued liabilities and other current liabilities	(18,479)	43,036
Net cash provided by operating activities	<u>107,315</u>	<u>395,341</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisitions of subsidiaries, net of cash acquired	(112,113)	(301,814)
Purchases of property, plant and equipment	(234,144)	(325,843)
Purchases of intangible assets	(7,872)	(57,396)
Net proceeds from sales of short-term investments	85,304	—
Investments in and advances to affiliates	(10,846)	(17,173)
Net cash used in investing activities	<u>(279,671)</u>	<u>(702,226)</u>

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Continued)
FOR THE SIX MONTHS ENDED JUNE 30, 2002 AND 2003
(UNAUDITED)
(Amounts in thousands of U.S. dollars)

	Six months ended June 30,	
	2002	2003
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of notes	50,808	400,000
Notes issuance cost	(649)	(3,929)
Capital lease obligation principal paid	(6,400)	(6,982)
Proceeds from loans	23,338	58,144
Loan principal paid	(1,800)	(61,895)
Net cash provided by financing activities	65,297	385,338
Effect of exchange rate changes on cash and cash equivalents	(747)	447
NET (DECREASE)/INCREASE IN CASH AND CASH EQUIVALENTS . . .	(107,806)	78,900
CASH AND CASH EQUIVALENTS, at beginning of period	219,629	34,661
CASH AND CASH EQUIVALENTS, at end of period	<u>\$ 111,823</u>	<u>\$ 113,561</u>
SUPPLEMENTAL INFORMATION:		
Income tax paid	\$ 65,633	\$ 84,468
Additions to network equipment and software under capital leases	\$ 7,472	\$ 9,045
Dividends declared	\$ —	\$ 111,412
Financing derivatives (Note 2)	\$ —	\$ 59,965

See notes to condensed consolidated financial statements.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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(UNAUDITED)

(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Principles—OJSC Mobile TeleSystems and its subsidiaries (“MTS” or “the Group”) maintain their accounting books and records in Russian rubles and Ukrainian hryvnas, based on Russian and Ukrainian accounting regulations. The accompanying condensed 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 of America (“U.S. GAAP”) and expressed in terms of U.S. dollars.

Basis of Presentation—The accompanying condensed consolidated financial statements include the accounts of OJSC Mobile TeleSystems (“MTS OJSC”) and its wholly owned and majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

In the opinion of management, these financial statements contain all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of the results of the interim periods. Certain information and related footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted, although the Group believes the disclosures in these financial statements are adequate to make the information presented not misleading. 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.

These interim condensed consolidated financial statements should be read in conjunction with the consolidated balance sheets of the Group as of December 31, 2001 and 2002 and the related consolidated statements of operations, cash flows and changes in shareholders’ equity for each of the three years in the period ended December 31, 2002 and the related notes as filed on Form 20-F with the Securities and Exchange Commission.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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(Amounts in thousands of U.S. dollars, except share and per share amounts or if otherwise stated)

As of December 31, 2002 and June 30, 2003, MTS had investments in the following legal entities:

	Accounting Method	December 31, 2002	June 30, 2003
Rosico ⁽¹⁾	Consolidated	100.0%	—
ReCom	Consolidated	53.9%	53.9%
MTS-Komi Republic (“MTS-RK”)	Equity	26.0%	26.0%
MTS-Kostroma	Equity	26.0%	26.0%
MTS-Tver (“MTS-T”)	Equity	26.0%	26.0%
UDN-900	Consolidated	51.0%	51.0%
ACC	Consolidated	100.0%	100.0%
MSS	Consolidated	83.5%	83.5%
MTS-Nizhny Novgorod (“MTS-NN”)	Consolidated	65.0%	65.0%
Telecom XXI	Consolidated	100.0%	100.0%
Telecom-900	Consolidated	100.0%	100.0%
Novitel	Consolidated	51.0%	51.0%
MTS Finance ⁽²⁾	Consolidated	100.0%	100.0%
BM-Telecom	Consolidated	100.0%	100.0%
MTS Belarus	Equity	49.0%	49.0%
MTS-P	Consolidated	51.0%	51.0%
Kuban GSM	Consolidated	52.7%	52.7%
Dontlecom	Consolidated	100.0%	100.0%
Mobicom-Barnaul	Consolidated	100.0%	100.0%
BIT	Consolidated	100.0%	100.0%
MTS-Capital	Consolidated	—	100.0%
Ukrainian Mobile Communications (“UMC”)	Consolidated	—	83.7%
TAIF Telcom ⁽³⁾	Consolidated	—	52.7%

⁽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.

⁽³⁾ Represents legal ownership. As discussed in Note 2, MTS consolidates 100% of TAIF Telcom.

Translation methodology—Prior to January 1, 2003, the Russian economy was considered hyperinflationary and MTS was required to follow the remeasurement method prescribed by the Statement of Financial Accounting Standards (“SFAS”) No. 52, “Foreign Currency Translation,” for hyperinflationary economies. Following this method, the U.S. dollar has been designated as the functional currency of the Group.

Effective January 1, 2003, the Russian economy is no longer considered hyperinflationary, however, management of the Group believes that the U.S. dollar is still the appropriate functional currency for MTS OJSC and the majority of its subsidiaries due to the pervasive use of U.S. dollars in their operations.

OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
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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.” 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.

If MTS had elected to recognize compensation costs based on the fair values of options at the date of the grant, consistent with the provisions of SFAS No. 123, net income and earning per share amounts would have been as follows:

	Six months ended June 30,	
	2002	2003
Net income as reported	\$107,601	\$208,742
Pro forma effect of the application of fair value method of accounting for stock options	(172)	(517)
Pro forma net income	<u>\$107,429</u>	<u>\$208,225</u>
Earnings per share, basic and diluted		
As reported	\$ 0.054	\$ 0.105
Pro forma	\$ 0.054	\$ 0.105

Comparative information—Certain prior year amounts have been reclassified to conform to the current period presentation.

Recently Adopted Accounting Pronouncements—In June 2001, 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 be 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 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 not 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 require 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

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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 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 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 January 2003, FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46"). FIN 46 clarifies the application of Accounting Research Bulletin 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 from other parties. Under FIN 46, an enterprise is required to consolidate certain entities (so-called "variable interest entities"), if it is the primary beneficiary of the variable interest entity. The primary beneficiaries of a variable interest entity is the party that absorbs a majority of the entity's expected losses or receives the majority of the entity's residual returns. FIN 46 also requires additional disclosure regarding the use of variable interest entities. The Group adopted the disclosure requirements of FIN 46 effective 2002; consolidation provisions of FIN 46 will become effective on January 1, 2004. The Group does not anticipate that the adoption of the consolidation provisions of FIN 46 will 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. EITF Issue No. 00-21 is effective prospectively for all arrangements entered into during fiscal periods after June 15, 2003, and the Group may elect to apply the provisions of EITF Issue No. 00-21 to existing arrangements and record the impact as a cumulative effect of a change in accounting principle in the statement of operations. The Group is currently assessing the impact of adopting EITF Issue No. 00-21.

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New Accounting Pronouncements—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. SFAS No. 149 is effective (with certain exceptions) for contracts entered into or modified and for hedging relationships designated after June 30, 2003. The Group does not anticipate that the adoption of SFAS No. 149 will 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 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 SFAS No. 150 effective August 1, 2003. The adoption of SFAS No. 150 did not have a material impact on the Group’s financial position or results of operations.

2. BUSINESSES ACQUIRED

Acquisition of UMC—On March 4, 2003, MTS acquired 57.7% of the outstanding voting interest of Ukrainian Mobile Communications (“UMC”), a provider of mobile services in Ukraine, for total consideration of \$194.2 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 a face value of approximately \$65.0 million and a fair value of approximately \$62.0 million. The purchase price allocation for the acquisition of UMC was not finalized at the date of these statements. For convenience, MTS began consolidating UMC effective March 1, 2003.

The preliminary purchase price allocation was as follows:

Current assets	\$ 84,838
Non-current assets	237,445
Licenses and other intangibles	131,400
Current liabilities	(67,160)
Non-current liabilities	(74,969)
Deferred taxes	(15,259)
Minority interest	(100,658)
Purchase price	<u>\$ 195,637</u>

MTS paid \$168.1 million of the purchase price in cash and issued a promissory note for the balance of the purchase price of \$27.5 million to Cetel B.V., a wholly owned subsidiary of Deutsche Telekom AG. The note accrues interest of 9% per annum and is payable within one year.

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.

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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%.

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 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 22 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 \$4.6 million of goodwill relating to workforce-in-place.

Acquisition of TAIF Telcom—In April 2003 ("the Acquisition Date"), 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 (see Note 6).

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.

Pursuant to EITF Issue No. 00-4, "Majority Owner's Accounting for a Transaction in the Shares of a Consolidated Subsidiary and a Derivative Indexed to the Minority Interest in That Subsidiary," the Group's call option agreements for the remaining 47.3% of common shares and 50.0% of preferred shares in TAIF Telcom are accounted for as financing derivatives as the risks and rewards of the additional ownership are maintained by the Group for the duration of the derivatives, notwithstanding the legal ownership of the minority interest. The Group consolidated 100.0% of TAIF Telcom from the Acquisition Date and reflected the call option purchase price of \$49.0 million for the common shares and \$10.0 million for the preferred shares as current portion of long-term debt as management intends

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to exercise the call options prior to June 30, 2004. The Group also recognized interest expense of approximately \$1.0 million related to these options for the six months ended June 30, 2003.

If all of the options are exercised, MTS' share in TAIF Telcom will increase to 100.0%. TAIF Telcom provides mobile services in the GSM-900/1800 standard in the Republic of Tartarstan and in the Volga region of Russia. The purchase price allocation for the acquisition of UMC was not finalized at the date of these statements.

The preliminary purchase price allocation was as follows:

Current assets	\$ 3,870
Non-current assets	49,872
License costs	132,761
Current liabilities	(26,099)
Non-current liabilities	(5,550)
Deferred taxes	(32,614)
	<u>122,240</u>
Financing derivatives	(59,000)
Purchase price	<u>\$ 63,240</u>

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately four years and customer base is amortized over the average remaining subscribers life of approximately 41 months.

Pro forma results of operations—The following pro forma financial data for the six months ended June 30, 2002 and 2003 give effect to the acquisition of UMC and TAIF Telcom as if they had occurred at the beginning of the respective period.

	Six months ended June 30,	
	2002	2003
Net revenues	\$707,664	\$1,117,840
Net operating income	231,394	389,843
Net income	107,709	208,828
Earnings per share, basic and diluted	\$ 0.054	\$ 0.105

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, 2003, 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.

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3. TRANSACTIONS BY MAJOR SHAREHOLDERS

In March 2003, AFK Sistema ("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 199,322,614 shares of MTS, representing 10.0% 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. Concurrently with this transaction, T-Mobile sold 5.0% of its holding in MTS on the open market in the form of Global Depository 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 in MTS.

On June 30, 2003, the Group approved cash dividends of \$1.12 per ADS (\$0.056 per share) for a total of \$111.4 million, which are included in accrued expenses and other current liabilities in the consolidated balance sheet as of June 30, 2003.

4. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as of December 31, 2002 and June 30, 2003 was comprised of the following:

	<u>December 31, 2002</u>	<u>June 30, 2003</u>
Network and base station equipment (including leased network and base station equipment of \$49,711 and \$62,252, respectively)	\$ 959,465	\$1,431,307
Leasehold improvements	4,299	5,090
Office equipment, computers and software (including leased office equipment, computers and software of \$1,729 and \$1,739, respectively)	68,271	107,481
Buildings	96,420	121,781
Vehicles	7,607	9,604
Property, plant and equipment, at cost	1,136,062	1,675,263
Accumulated depreciation (including accumulated depreciation on leased equipment of \$13,420 and \$19,394, respectively)	(299,216)	(389,910)
Equipment for installation	313,222	304,731
Construction in-progress	194,565	276,459
Property, plant and equipment, net	<u>\$1,344,633</u>	<u>\$1,866,543</u>

Depreciation expense for the six months ended June 30, 2002 and 2003 amounted to \$55.1 million and \$95.8 million, respectively, including depreciation expense for leased property, plant and equipment of \$2.1 million and \$3.9 million, respectively.

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5. LICENSES AND OTHER INTANGIBLE ASSETS

At December 31, 2002 and June 30, 2003, licenses and other intangible assets was comprised of the following:

		December 31, 2002			June 30, 2003		
	Useful lives	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
Amortized intangible assets							
Acquired customer base . .	22 to 41 months	\$ 7,410	\$ (955)	\$ 6,455	\$ 83,856	\$ (7,141)	\$ 76,715
Numbering capacity with finite contractual life, rights to use premises, software and other	3 to 10 years	195,989	(77,934)	118,055	300,331	(106,261)	194,070
Licenses	3 to 13 years	530,321	(143,402)	386,919	705,767	(187,872)	517,895
		<u>733,720</u>	<u>(222,291)</u>	<u>511,429</u>	<u>1,089,954</u>	<u>(301,274)</u>	<u>788,680</u>
Unamortized intangible assets:							
Numbering capacity with indefinite contractual life		13,047	—	13,047	13,047	—	13,047
Goodwill		<u>533</u>	<u>—</u>	<u>533</u>	<u>6,696</u>	<u>—</u>	<u>6,696</u>
Total intangible assets		\$747,300	\$(222,291)	\$525,009	\$1,109,697	\$(301,274)	\$808,423

Amortization expense for amortized intangible assets amounted to \$35.6 million and \$79.0 million for the six months ended June 30, 2002 and 2003, respectively. Based on the amortized intangible assets existing at June 30, 2003, the estimated amortization expense for the remainder of 2003 is \$126.7 million (totaling \$205.7 million during 2003), \$208.3 million during 2004, \$173.3 million during 2005, \$131.3 million during 2006 and \$95.8 million during 2007. Finalization of the purchase price allocation may result in changes of reported values and/or useful lives of intangible assets, which may result in changes of the actual amortization expense. In addition, actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible asset acquisitions, changes in useful lives and other relevant factors.

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6. DEBT

At December 31, 2002 and June 30, 2003, debt comprised of the following:

	Currency	Annual Interest Rate (Actual Rate at June 30, 2003)	December 31, 2002	June 30, 2003	Available Credit Facilities as of June 30, 2003
9.75% Notes due 2008	USD	9.75%	\$ —	\$400,000	\$ —
10.95% Notes due 2004	USD	10.95%	298,943	299,466	—
Financing derivatives (Note 2) . .	USD	8%	—	59,965	—
Dresdner	USD	LIBOR+1.95%-3.35% (3.09%-4.49%)	39,280	43,200	4,800
Ericsson	USD	LIBOR+4% (5.14%)	30,150	27,000	—
Ruble denominated debt	RBL	13.4%-23%	30,334	36,891	34,043
ZAO Raiffeisen bank loan	USD	LIBOR+2.85% (3.99%)	—	20,000	—
Deutsche Telekom AG	USD	LIBOR+5%-7% (6.14%-8.14%)	—	15,961	—
TDC Mobile International A/S . .	USD	LIBOR+5%-7% (6.14%-8.14%)	—	13,676	—
Citibank	USD	LIBOR+3.5% (4.64%)	9,000	10,000	—
MBRD	USD	6%	—	6,200	—
KfW	EUR	LIBOR+0.95%-4% (2.09%-5.14%)	—	5,407	—
West LB loan	EUR	EUROBOR+2% (4.15%)	4,000	4,659	—
Motorola	USD	2.48%-8.23%	6,181	4,583	—
International Moscow Bank	USD	LIBOR+3.45% (4.59%)	5,000	—	—
Other debt	USD	7%-15%	3,124	8,422	732
Total debt			<u>\$426,012</u>	<u>\$955,430</u>	<u>\$39,575</u>
Less current portion			<u>67,098</u>	<u>186,363</u>	n.a.
Total long-term debt			<u><u>\$358,914</u></u>	<u><u>\$769,067</u></u>	n.a.

Additional Debt Issuances—On January 30, 2003, MTS Finance issued \$400.0 million 9.75% notes at par. These notes are 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.

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In May 2003, the Group entered into a \$20.0 million loan agreement with ZAO Raiffeisen Bank. This loan bears interest at LIBOR+2.85% (3.99% at June 30, 2003), matures one year from the date of the loan and is collateralized by certain property, plant and equipment.

In March 2003, MTS' Board of Directors approved the issuance of ruble denominated bonds in an amount up to 5.0 billion rubles (approximately \$161.0 million). The Group had not issued any of these bonds as of June 30, 2003.

Debt Assumed by Acquisition of UMC—The total amount of principal outstanding under UMC's credit facilities as of June 30, 2003 was \$35.0 million.

In February 1996, UMC signed an uncollateralized long-term revolving credit facility agreement with Deutsche Telekom AG, KPN Telecom and TeleDanmark A/S, effective November 1, 1995 through October 31, 2001. This agreement is denominated in U.S. dollars and had borrowing limit of \$36.0 million. On January 5, 1997, UMC signed an additional uncollateralized long-term revolving credit facility agreement with Deutsche Telekom AG, KPN Telecom and TeleDanmark A/S, that expired on March 31, 2001. This agreement was denominated in U.S. dollars and increased the maximum borrowing limit to \$45.0 million. On November 5, 2002, Deutsche Telekom AG prolonged the maturity of its loans until April 2004. On October 23, 2002, KPN Telecom and TeleDanmark A/S assigned the rights arising from their loan agreements to Telki Holding Company BV (a 100.0% subsidiary of KPN Telecom) and TDC Mobile International A/S, respectively. The amount payable to Telki Holding Company BV matured and was repaid in May 2003. The credit facilities with Deutsche Telekom AG and TDC bear interest at LIBOR + 5% (6.14% at June 30, 2003) and LIBOR + 7% (8.14% at June 30, 2002) and are redeemable in five equal quarterly installments commencing April 2003.

On December 21, 1998, UMC entered into two loan agreements with KfW, a German bank, for EURO 1.9 million (approximately \$2.2 million as of June 30, 2003) and EURO 10.9 million (approximately \$12.5 million as of June 30, 2003). These loans bear interest at LIBOR+4% (5.14% at June 30, 2003) and LIBOR+0.95% (2.09% at June 30, 2003) per annum, respectively, and mature on March 31, 2004 and February 28, 2005, respectively.

Debts assumed by acquisition of TAIF Telecom—The total amount of principal outstanding under TAIF Telecom's credit facilities as of June 30, 2003 was \$15.0 million.

In April 2000, TAIF Telecom issued Russian ruble denominated bonds for 120.0 million rubles (approximately \$4.0 million). The outstanding balance as of June 30, 2003 was 120.0 million rubles (approximately \$4.0 million). The bonds mature in February 2007. The bonds bear interest at 20% per annum, adjustable for the change in U.S. dollar exchange rate, and is payable on a quarterly basis (21.2% per annum as of June 30, 2003).

In July 2001, TAIF Telecom entered into a \$6.0 million U.S. dollar denominated credit facility with TatSotsBank. The proceeds were used to finance the purchase of telecommunications equipment. The amount outstanding under the loan was \$5.7 million as of June 30, 2003. The loan bore interest at 8% per annum. The loan was fully repaid in September 2003.

In October 2001, TAIF Telecom entered into a Russian ruble denominated credit facility with AKBars Bank to borrow up to 180.0 million rubles (approximately \$5.9 million). The amount

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outstanding under this credit facility as of June 30, 2003 was 39.0 million rubles (approximately \$1.2 million). The loan bore interest at 18% to 20%. The loan was fully repaid in September 2003.

In November 2002, TAIF Telecom entered into a short-term Russian ruble denominated credit facility with Sberbank to borrow up to 45.0 million (approximately \$1.5 million). The facility bears interest at 19% to 20% and matures in November 2003. As of June 30, 2003, the amount outstanding under the facility was 45.0 million rubles (approximately \$1.5 million). The loan is collateralized by equipment with a net book value of \$2.4 million as of June 30, 2003.

In January 2003, TAIF Telecom entered into a credit facility agreement with Gута 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% and matures in February 2007. The amount outstanding under this facility was \$1.7 million as of June 30, 2003. The loan is collateralized by equipment with a net book value of \$1.4 million as of June 30, 2003.

See also Note 2 for the description of other indebtedness related to the Group's financing derivatives.

7. CAPITAL LEASE OBLIGATIONS

The following table presents a schedule by years of future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of June 30, 2003:

Payments due in the 12 months ended June 30,	
2004	\$ 18,367
2005	6,906
2006	2,465
Thereafter	<u>273</u>
Total minimum lease payments (undiscounted)	28,011
Less: amount representing interest	<u>(6,171)</u>
Present value of net minimum lease payments	21,840
Less: current portion of lease payable	<u>(14,603)</u>
Non-current portion of lease payable	<u>\$ 7,237</u>

Future minimum lease payments under capital leases to Invest-Svyaz-Holding, a related party, together with the present value of the net minimum lease payments as of June 30, 2003 are presented in Note 8.

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8. RELATED PARTIES

Balances with related parties as of December 31, 2002 and June 30, 2003 were comprised of the following:

	December 31, 2002	June 30, 2003
Accounts receivable, related parties:		
T-Mobile receivable for roaming	\$1,374	\$1,515
STROM Telecom prepayment	—	200
MGTS receivable	—	122
Receivables from investee companies	2,195	2,447
Total accounts receivable, related parties	<u>\$3,569</u>	<u>\$4,284</u>
Accounts payable, related parties:		
Telmos for interconnection	\$ 184	\$ 144
MTU-Inform for interconnection	4,154	4,764
MGTS for interconnection	630	674
Total accounts payable, related parties	<u>\$4,968</u>	<u>\$5,582</u>

Moscow Bank of Reconstruction and Development (“MBRD”)—In 2002 and 2003, MTS maintained certain bank and deposit accounts with MBRD, whose major shareholder is Sistema. As of December 31, 2002, MTS’ cash position at MBRD amounted to \$38.7 million including \$34.0 million in time deposit and \$4.7 million in current accounts. As of June 30, 2003, MTS’s cash position at MBRD amounted to \$109.1 million including \$105.6 million in time deposits and \$3.5 million in current accounts. The related interest accrued and collected on the deposits for the six months ended June 30, 2002 and 2003 amounted to \$3.1 million and \$1.6 million, respectively, and was included in the accompanying statements of operations.

Rosno OJSC (“Rosno”)—In 2002 and 2003, MTS arranged medical insurance for its employees and insured its property with Rosno whose significant shareholder is Sistema. Expenses relating to insurance premiums to Rosno for the six months ended June 30, 2002 and 2003 amounted to \$4.2 million and \$4.8 million, respectively. Management believes that all of the insurance contracts with Rosno have been entered at market terms.

Maxima Advertising Agency (“Maxima”)—In 2002 and 2003, MTS had agreements for advertising services with Maxima. Advertising fees paid to Maxima for the six months ended June 30, 2002 and 2003 were \$4.3 million and \$13.4 million, respectively. Maxima is a related party of Sistema, the Group’s majority shareholder.

Telmos—In 2002 and 2003, 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 six months ended June 30, 2002 and 2003 were approximately \$0.9 million and \$0.8 million, respectively. Management believes that these arrangements are at market terms.

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Moscow City Telephone Network (“MGTS”)—In 2002 and 2003, MTS had a line rental agreement with MGTS and also rented a cable plant from MGTS for installation of optic-fiber 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 six months ended June 30, 2002 and 2003 were approximately \$2.6 million and \$2.3 million, respectively. Management believes that these transactions were made at market terms. MGTS is related to MTS through its directors who are members of MGTS’s board of directors. In addition, Sistema is the majority shareholder of MGTS.

MTU-Inform—In 2002 and 2003, MTS had interconnection and line rental agreements with MTU-Inform, a subsidiary of Sistema. Amounts paid under these agreements for the six months ended June 30, 2002 and 2003 were approximately \$11.4 million and \$14.5 million, respectively. Management believes that these agreements are at market terms.

Comstar—In 2002 and 2003, MTS had interconnection and line rental agreements with Comstar, a subsidiary of Sistema. Amounts paid under these agreements for the six months ended June 30, 2002 and 2003 were approximately \$1.5 million and \$2.2 million, respectively. Management believes that these agreements are at market terms.

T-Mobile—In 2002 and 2003, 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 \$0.5 million and \$0.7 million for the six months ended June 30, 2002 and 2003, respectively.

As discussed in Note 6, UMC had approximately \$16.0 million payable to Deutsche Telekom AG, parent of T-Mobile, under various loan agreements as of June 30, 2003. During the six months ended June 30, 2003, UMC paid \$0.9 million in interest to Deutsche Telekom AG. In March 2003, MTS issued a promissory note related to the purchase of UMC for \$27.5 million to Cetel B.V., a wholly owned subsidiary of Deutsche Telekom AG.

Invest-Svyaz-Holding (“ISH”)—In 2001 and 2002, MTS entered into agreements with ISH, a shareholder of MTS and a wholly owned subsidiary of Sistema, for leasing of network equipment and a 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 13% to 44%.

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The following table represents a schedule by years of future minimum lease payments under capital leases to ISH together with the present value of the net minimum lease payments as of June 30, 2003:

Payments due in the 12 months ended June 30,	
2004	\$ 8,393
2005	5,976
2006	<u>2,383</u>
Total minimum lease payments (undiscounted)	16,752
Less: Amount representing interest	<u>(5,006)</u>
Present value of net minimum lease payments	11,746
Less: current portion of lease payable	<u>(4,568)</u>
Non-current portion of lease payable	<u>\$ 7,178</u>

In addition to the above lease transactions, the Group guarantees the debt of ISH in the amount of \$14.6 million to a third party, which is used by ISH primarily to finance its leases to the Group. For the six months ended June 30, 2003, leases to the Group amount to approximately 99% of revenues of ISH. Principal and interest paid to ISH for the six months ended June 30, 2002 and 2003 were \$1.5 million and \$0.8 million and \$2.0 million and \$1.5 million, respectively. Management believes that these transactions are all on market terms.

STROM Telecom—During 2003, the Group entered into three agreements with STROM Telecom, an affiliate of Sistema. Pursuant to these contracts, the Group purchased a billing system and communications software support system from STROM Telecom for approximately \$12.0 million during six months ended June 30, 2003. The total amount of purchases under these contracts is approximately \$24.4 million, which the Group believes to be the market price.

Sistema—In December 1996, Rosico entered into a credit agreement with Ericsson Project Finance AB (“Ericsson”) that provided for a five year credit facility with an aggregate principal amount of \$60.0 million (the “Ericson Loan”). The loan is repayable in ten equal consecutive quarterly payments of \$60.0 commencing in 1999. On July 24, 2001, MTS OJSC, Rosico and Ericsson signed an amendment to the credit agreement rescheduling Rosico’s principal payments to nineteen consecutive quarterly installments. The amounts advanced under the agreement bear interest of LIBOR plus 4% (5.14% at June 30, 2003). If Rosico fails to meet its payment obligations, its outstanding advances will bear interest at an additional 6% per annum. The credit agreement contains covenants restricting Rosico’s ability to encumber its present and future assets and revenues without the lender’s express consent.

Concurrent with the Group’s acquisition of Rosico, Sistema agreed to fund the repayment of the Ericsson Loan and to indemnify Rosico and MTS OJSC for any costs incurred by either Rosico or MTS OJSC in connection with the repayment of the Ericsson Loan. During 2000, Sistema and MTS OJSC 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 OJSC entered into a long-term, ruble-denominated promissory notes with 0% interest that mature from 2049

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to 2052 to repay a portion of the funding from Sistema. The carrying value of these notes is insignificant at December 31, 2002 and June 30, 2003. 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. Amounts due from Sistema under this indemnification are recorded as shareholder receivable in the accompanying consolidated balance sheets. At December 2002 and June 30, 2003, \$30.0 million and \$27.0 million, respectively, were outstanding under the Ericsson Loan. Subsequent to the merger of Rosico into MTS OJSC, all obligations under the Ericsson loan were assumed by MTS OJSC.

See Notes 2, 3 and 6 for other related parties transactions.

9. COMMITMENTS AND CONTINGENCIES

Commitments—As of June 30, 2003, MTS had purchase commitments of approximately \$261.5 million for purchases of property, plant and equipment.

Operating lease—The Group 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 \$7.5 million and \$12.7 million for the six months ended June 30, 2002 and 2003, respectively, are included in operating expenses in the accompanying statements of operations. Future minimum lease payments due under non-cancelable leases at June 30, 2003 were:

Payments due in the 12 months ended June 30	
2004	\$ 4,490
2005	3,540
2006	2,578
2007	1,946
2008	1,525
Thereafter	15,626
Total	<u>\$29,705</u>

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 at June 30, 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.

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Provision for doubtful accounts—The increase in the provision for doubtful accounts during the six months ended June 30, 2003 was primarily attributable to a \$17.4 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.

10. 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.

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As of June 30, 2003, the Group had several operating segments, of which two are the reportable segments—MTS OJSC, which operates primarily in the Moscow license area and also has license footprint covering several other regions, and UMC, which operates in Ukraine. Intercompany eliminations represent transactions between segments, accounts receivable between companies in different segments and investments of MTS OJSC in companies included in other segments.

	Six months ended June 30,	
	2002	2003
Revenue:		
MTS OJSC ⁽¹⁾	\$455,509	\$ 654,324
UMC	—	130,443
Other	123,594	310,556
Intercompany eliminations	(15,201)	(43,189)
Total revenue	<u>\$563,902</u>	<u>\$1,052,134</u>
Depreciation and amortization:		
MTS OJSC	\$ 66,909	\$ 89,491
UMC	—	23,935
Other	23,769	61,926
Intercompany eliminations	—	(578)
Total depreciation and amortization	<u>\$ 90,678</u>	<u>\$ 174,774</u>
Operating income:		
MTS OJSC	\$165,964	\$ 230,147
UMC	—	46,380
Other	29,701	104,505
Intercompany eliminations	(821)	(5,996)
Total operating income	<u>\$194,844</u>	<u>\$ 375,036</u>
Reconciliation of operating income to income before provision for income taxes and minority interest:		
Total operating income	\$194,844	\$ 375,036
Currency exchange and translation losses (gains)	(690)	1,408
Interest income	5,497	8,823
Interest expense	(20,687)	(42,813)
Other expenses	(2,721)	(855)
Income before provision for income taxes and minority interest	<u>\$176,243</u>	<u>\$ 341,599</u>
Net income:		
MTS OJSC	\$104,056	\$ 150,145
UMC	—	17,826
Other	4,366	47,869
Intercompany eliminations	(821)	(7,098)
Total net income	<u>\$107,601</u>	<u>\$ 208,742</u>

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	As of December 31, 2002	As of June 30, 2003
Total assets:		
MTS OJSC	\$1,923,682	\$2,564,465
UMC	—	259,105
Other	690,481	720,737
Intercompany eliminations	(330,867)	(244,365)
Total assets	<u>\$2,283,296</u>	<u>\$3,299,942</u>

(1) The MTS OJSC segment was previously comprised of MTS OJSC and Rosico. However, as Rosico was merged into MTS OJSC in June 2003, the segment is now referred to as MTS OJSC.

11. SUBSEQUENT EVENTS

Issuance of Floating Rate Notes—On August 5, 2003, MTS Finance issued \$300.0 million floating rate notes bearing interest at LIBOR + 4% (5.1% on August 5, 2003) with a 1.0% discount. The cash proceeds, net of issuance costs of approximately \$1.0 million, amounted to \$296.0 million. These notes are guaranteed by MTS OJSC and will mature on August 5, 2004. MTS Finance is required to make interest payments on the notes quarterly in arrears on November 5, 2003, February 5, 2004, May 5, 2004 and August 5, 2004. The notes are redeemable at 100.0% of their principal amount, plus accrued interest prior to their maturity at the option of the issuer on the second and third interest payment dates and in other limited circumstances, including for tax reasons. The notes are listed on the Luxembourg Stock Exchange.

Additional debt issuances—In September 2003, the Group entered into a \$100.0 million U.S. dollar denominated loan facility agreement with Credit Suisse First Boston International. The facility was fully drawn in September 2003. The proceeds were used for general corporate purposes including dividends. Amounts outstanding under the loan facility agreement bear interest at LIBOR +2.25% per annum.

In September 2003, the Group also entered into a \$100.0 million U.S. dollar denominated loan facility agreement with ING Bank (Eurasia) ZAO and ING (Ireland) Limited. The facility was fully drawn in September 2003. The proceeds were used for capital expenditures. Amounts outstanding under the loan facility agreement bear interest at LIBOR +2.25% per annum.

In September 2003, UMC entered into a \$60.0 million unsecured syndicated credit facility with ING Bank (Eurasia) ZAO, ZAO Standard Bank and Commerzbank Aktiengesellschaft with an interest rate of LIBOR + 4.15%. The loan is guaranteed by MTS and matures on September 12, 2006. The proceeds will be used by UMC to refinance its existing indebtedness. As of the date of these financial statements, UMC had \$48.0 million outstanding under this facility.

In September 2003, MTS' Board of Directors approved the issuance of \$400.0 million notes on the Luxembourg Stock Exchange. The notes are expected to be issued during October 2003.

Acquisitions of various companies—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

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MCT Corporation for a total of \$71.0 million. The Group agreed to purchase 43.7% stake in Uraltel 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 to 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 13, 2003, the Group's wholly owned subsidiary, Telecom-900, completed the purchase of the 43.7% and 2.95% stakes in Uraltel. The transaction increased Telecom-900's ownership in Uraltel to 99.85%. On August 26, 2003, the Group completed the acquisition of Vostok Mobile BV.

Acquisition of Sibchallenge—On August 22, 2003, MTS completed the purchase of 100.0% of Sibchallenge, a cellular operator in the Krasnoyarsk region, for cash consideration of \$45.4 million and assumed net debt of approximately \$9.4 million. Sibchallenge holds licenses to provide GSM 900/1800 and DAMPS mobile services in the Krasnoyarsk region of Siberia, the Republic of Hakasiya, and in the Taimyr Autonomous region, all which are located in the Siberian part of Russia. The purchase price allocation for the acquisition of Sibchallenge was not finalized at the date of these financial statements.

Acquisition of Tomsk Cellular Communications—In September 2003, MTS purchased 100.0% of Siberian operator Tomsk Cellular Communications ("Tomsk") for cash consideration of \$47.0 million. Tomsk operates a GSM 900/1800 network in eastern Siberia. The purchase price allocation for the acquisition of Tomsk was not finalized at the date of these financial statements.

Acquisition of minority interest in Kuban GSM—In September 2003, the Group acquired 100.0% of Kubtelesot for cash consideration of \$107.0 million. Kubtelesot owns 43.7% of CSJC Kuban GSM ("Kuban"), and the Group's purchase of this stake increased its ownership in Kuban to 100.0%. Kuban holds licenses to provide GSM 900/1800 mobile services in Adygeya Republic and Krasnodar region. The purchase price allocation for the acquisition of Kuban was not finalized at the date of these financial statements.

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REPORT OF THE STATUTORY AUDITOR

In conformity with the legal and statutory provisions, we have the honour to report on the execution, of the assignment as statutory auditor for the financial year ended December 31, 2002 entrusted to us. We have carried out our supervisory mission on the basis of article 62 of the law of August 10, 1915, as amended, which does not obligate the statutory auditor to give an opinion on the annual accounts. We therefore have not examined the annual accounts in accordance with generally accepted auditing standards.

We have ascertained that the annual accounts as at December 31, 2002, showing a balance sheet total of USD 304.128.212 and a current year's profit of USD 134.883 reflect the accounting books and vouchers which have been submitted to us.

We have no observations to formulate on the annual accounts and propose to approve them and to give discharge to the Board of Directors.

Luxembourg, October 29, 2003

By: /s/ FIDUCIAIRE CONTINENTALE S.A.

FIDUCIAIRE CONTINENTALE S.A.

Statutory Auditor

MOBILE TELESYSTEMS FINANCE S.A.
(A beneficially wholly owned subsidiary of Mobile TeleSystems OJSC)
BALANCE SHEET
AT DECEMBER 31, 2002
(Amounts in U.S. dollars, except share and per share amounts)

	December 31, 2002
CURRENT ASSETS:	
Cash and cash equivalents	\$ 815,156
Other current assets (Note 4)	964,033
Total current assets	<u>1,779,189</u>
DEBT ISSUANCE COSTS (Note 3)	2,349,023
RECEIVABLES FROM RELATED PARTIES (Note 5)	300,000,000
TOTAL ASSETS	<u><u>\$304,128,212</u></u>
CURRENT LIABILITIES:	
Income tax payable	\$ 105,109
Accounts payable	389,031
Accrued liabilities (Note 6)	913,002
Deferred income, current portion (Note 7)	1,598,034
Total current liabilities	<u>3,005,176</u>
NOTES PAYABLE (Note 8)	299,304,065
DEFERRED INCOME , net of current portion (Note 7)	1,559,088
COMMITMENTS AND CONTINGENCIES (Note 12)	
SHAREHOLDERS' EQUITY:	
Common stock (1,000 shares with a par value of \$125 authorized, issued and outstanding) (Note 9)	125,000
Results for the period	134,883
Total shareholders' equity	<u>259,883</u>
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	<u><u>\$304,128,212</u></u>

The accompanying notes to the financial statements are an integral part of these statements.

MOBILE TELESYSTEMS FINANCE S.A.
(A beneficially wholly owned subsidiary of Mobile TeleSystems OJSC)
STATEMENT OF OPERATIONS
FOR THE PERIOD FROM DECEMBER 10, 2001 (DATE OF INCORPORATION)
TO DECEMBER 31, 2002
(Amounts in U.S. dollars)

	<u>2002</u>
OPERATING EXPENSES	\$ 148,000
Operating loss	<u>(148,000)</u>
Interest income (Note 10)	34,308,054
Interest expense (Note 11)	<u>(33,967,094)</u>
Income before provision for income taxes	<u>192,960</u>
PROVISION FOR INCOME TAXES	<u>(58,077)</u>
NET INCOME	<u><u>\$ 134,883</u></u>

The accompanying notes to the financial statements are an integral part of these statements.

MOBILE TELESYSTEMS FINANCE S.A.
(A beneficially wholly owned subsidiary of Mobile TeleSystems OJSC)
NOTES TO FINANCIAL STATEMENTS
(Amounts in U.S. dollars, except if otherwise stated)

1. GENERAL

Mobile TeleSystems Finance S.A. (the “Company”) is a company incorporated under the laws of Luxembourg on December 10, 2001 under the legal form of a “Société Anonyme.” The registered office of the Company is 3 Avenue Pasteur, L-2311 Luxembourg. The Company’s operations include holding of participations directly and indirectly, in any form whatsoever, in Luxembourg and foreign companies, the acquisition by purchase, or in any other manner as well as the transfer by sale, exchange or otherwise of stock, bonds, debentures, notes and other securities of any kind, and the ownership, administration, development and management of its portfolio. The Company may also hold interest in partnerships.

The Company may borrow in any form and proceed to the issue of bonds and debentures. It may lend funds including the proceeds of such borrowings and issues to its subsidiaries, affiliated companies or any other companies. In a general fashion it may grant assistance to affiliated companies, take any controlling and supervisory measures and carry out any operation which may deem useful in accomplishment and development of its purposes.

Since the Company’s incorporation, its sole activity has been issuing of notes and loaning the gross proceeds of the notes to Mobile TeleSystems OJSC (“MTS OJSC”), the Company’s 100% beneficial shareholder that is incorporated under the laws of the Russian Federation.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Principles

The Company maintains its accounting books and records in U.S. dollars based on Luxembourg accounting regulations. The accompanying financial statements have been prepared in order to present the Company’s financial position and its results of operations in accordance with accounting principles generally accepted in Luxembourg.

Cash and cash equivalents

Cash and cash equivalents represent cash on hand, in bank accounts and in short term investments having original maturity of less than three months.

Receivable from related parties

Loans receivable from related parties are recorded at nominal value. Based on management assessment of the recoverability of the amounts, no specific bad debt provision was created at December 31, 2002.

Debt issuance costs

Legal and other direct costs incurred in connection with the issuance of debt are deferred and amortized through interest expense using the effective interest rate method over the life of the underlying debt.

MOBILE TELESYSTEMS FINANCE S.A.
(A beneficially wholly owned subsidiary of Mobile TeleSystems OJSC)
NOTES TO FINANCIAL STATEMENTS (Continued)
(Amounts in U.S. dollars, except if otherwise stated)

Notes payable

Notes payable are initially recorded at par value less any issue discount (or plus any premium). The discount or premium between issue and redemption value is amortized over the life of the underlying debt through interest expense using the effective interest rate method.

Deferred income

Fees reimbursed by MTS OJSC in connection with notes issuance costs and discounts on the issuance of debt are deferred and recognized as income over the life of the debt to match the amortization of the corresponding initial borrowing costs and the discount on issue of the debt.

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 and tax credits carry forwards using enacted tax rate expected to be in effect at the time these differences are realized. Valuation allowances are recorded for deferred tax assets for which it is not more likely that not such assets will be realized.

Interest income and interest expense

Interest income and interest expense are recorded on an accrual basis.

Foreign currency translation

The Company's functional currency is the U.S. dollar. Monetary assets and liabilities stated in currencies other than U.S. dollar, have been translated at the period end exchange 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 statements of operations.

Financial instruments

Notes payable are comprised of \$250 million and \$50 million 10.95% notes due 2004 issued in December 2001 and March 2002, respectively. At December 31, 2002, the fair value of these notes, calculated based on quoted market prices was approximately \$315 million.

The long term receivables from MTS OJSC bear a market rate of interest and management believes that the book value approximates the market value of this receivable at December 31, 2002. The fair value of financial instruments included in the current assets approximates the historical costs disclosed in the financial statements due to the short-term maturities of these instruments.

3. DEBT ISSUANCE COSTS

As of December 31, 2002, debt issuance costs are comprised of commissions and fees incurred related to the issue of the notes payable amounting to \$2,349,023 after amortization of \$1,086,016.

MOBILE TELESYSTEMS FINANCE S.A.
(A beneficially wholly owned subsidiary of Mobile TeleSystems OJSC)
NOTES TO FINANCIAL STATEMENTS (Continued)
(Amounts in U.S. dollars, except if otherwise stated)

4. OTHER CURRENT ASSETS

Other currents assets as of December 31, 2002 include accrued interest related to the loan receivable from MTS OJSC (see Note 5) of \$917,000, and deferred tax assets for the amount of \$47,033, respectively. Deferred tax assets relate to the temporary differences originating from the different accounting treatment of fees reimbursed by MTS OJSC for tax and accounting purposes.

5. RECEIVABLES FROM RELATED PARTIES

Receivables from related parties as of December 31, 2002 are comprised of loans to MTS OJSC for the amounts of \$300 million, respectively. On December 31, 2001 the Company entered into a \$250 million loan agreement with MTS OJSC that bears interest at the rate of 11.025%, payable semi-annually in arrears. On March 20, 2002, the Company entered into an additional \$50 million loan agreement with MTS OJSC that bears interest at 11.0125% payable semi-annually in arrears. Loans mature on December 21, 2004. Accrued interest on these loans at December 31, 2002 amounted to \$917,000.

For the period from December 10, 2001 (date of incorporation) to December 31, 2002 the Company received interest payments under these loan agreements of \$31,676,854.

6. ACCRUED LIABILITIES

As of December 31, 2002, accrued liabilities are comprised of accrued interest on notes payable of \$913,002.

7. DEFERRED INCOME

The Company charged \$4,800,000 to MTS OJSC to reimburse the debt issuance costs and issue discount incurred in originating the \$250 million loan described in Note 8. This income has been deferred and is recognized as interest income in the statements of operations to match the amortization of the debt issuance costs and the issue discount. As of December 31, 2002 the balance on this account is \$3,157,122, net of accumulated amortization of \$1,642,878, respectively.

8. NOTES PAYABLE

On December 21, 2001, the Company issued \$250,000,000 10.95% notes at the price of 99.254%. Proceeds received from the notes, net of underwriting discount, were \$248,135,000. Related debt issuance costs in the amount of \$2,786,105 were capitalized. On March 20, 2002, the Company issued additional \$50,000,000 10.95% notes at a price of 101.616%. Proceeds received from these notes, including the offering premium, were \$50,808,000. Related debt issuance costs in the amount of \$649,000 were capitalized.

All the notes are guaranteed by MTS OJSC and mature on December 21, 2004. The Company 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 U.S. Securities and Exchange Commission under the Securities Act of 1933.

MOBILE TELESYSTEMS FINANCE S.A.
(A beneficially wholly owned subsidiary of Mobile TeleSystems OJSC)
NOTES TO FINANCIAL STATEMENTS (Continued)
(Amounts in U.S. dollars, except if otherwise stated)

These notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, limitations on the Company, MTS OJSC's and its subsidiaries' 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 the Company 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.

9. SHAREHOLDERS' EQUITY

On December 10, 2001, the Company was incorporated with a share capital amounting to \$125,000, represented by 1,000 shares with a nominal value of \$125 each, fully subscribed and paid-up. On an annual basis, if the Company reports a profit for the year, Luxembourg law requires appropriation of an amount equal to at least 5 percent of the annual net income to a legal reserve until such reserve equals 10 percent of the issue capital. This reserve is not available for distribution. The amount of this reserve at December 31, 2002 was insignificant.

10. INTEREST INCOME

For the period from December 10, 2001 (date of incorporation) to December 31, 2002, interest income comprises of \$32,594,176, of interest income from MTS OJSC (see Note 5); interest income on bank deposits of \$71,000, \$1,642,878, relating to the recognition of deferred income (see Note 7).

11. INTEREST EXPENSE

For the period from December 10, 2001 (date of incorporation) to December 31, 2002 interest expense comprised of \$32,409,107, of interest expense, related to notes payable (see Note 8), \$1,445,987, relating to the amortization of debt issuance costs and debt issue discount and premium (see Notes 3 and 8), and \$112,000, relating to the bank commission expense.

12. COMMITMENTS AND CONTINGENCIES

In the normal course of business, the Company is exposed to various loss contingencies. At December 31, 2002 management believes the Company has no loss contingencies that will have a material adverse effect on the Company's financial position or the results of its operations.

13. SUBSEQUENT EVENTS

On January 30, 2003, the Company issued \$400.0 million 9.75% notes at par. These notes are guaranteed by MTS OJSC and mature on January 30, 2008. The Company is required to make interest payments on the notes semi-annually in arrears on January 30 and July 30 of each year, commencing on July 30, 2003. The notes are listed on the Luxembourg Stock Exchange. The proceeds were loaned to MTS OJSC.

On August 5, 2003, the Company issued \$300.0 million notes bearing interest at LIBOR + 4% (5.1% on August 5, 2003) with a 1.0% discount. The cash proceeds, net of issuance costs of approximately \$1.0 million, amounted to \$296.0 million. These notes are guaranteed by MTS OJSC and will mature on August 5, 2004. The Company is required to make interest payments on the notes quarterly in arrears on November 5, 2003, February 5, 2004, May 5, 2004 and August 5, 2004. The

MOBILE TELESYSTEMS FINANCE S.A.
(A beneficially wholly owned subsidiary of Mobile TeleSystems OJSC)
NOTES TO FINANCIAL STATEMENTS (Continued)
(Amounts in U.S. dollars, except if otherwise stated)

notes are redeemable at 100.0% of their principal amount, plus accrued interest prior to their maturity at the option of the issuer on the second and third interest payment dates and in other limited circumstances, including for tax reasons. The notes are listed on the Luxembourg Stock Exchange. The proceeds were loaned to MTS OJSC.

In September and October 2003, the Boards of Directors of MTS OJSC and the Company, respectively, approved the issuance of \$400.0 million notes on the Luxembourg Stock Exchange. The notes are expected to be issued during October 2003. The proceeds from these notes will be loaned to MTS OJSC.

ISSUER

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London E1W 1YT
England

\$400,000,000



Mobile TeleSystems Finance S.A.

**8.375% Notes
due 2010**

Guaranteed by Mobile TeleSystems OJSC

OFFERING MEMORANDUM

October 14, 2003

Joint Bookrunners

Credit Suisse First Boston

ING

Co-Managers

ABN AMRO

JPMorgan

RZB-Austria Raiffeisen Zentralbank Österreich AG

Commerzbank Securities

Merrill Lynch International

Renaissance Capital

Financial Advisor to the Guarantor

Moscow Bank of Reconstruction and Development