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

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

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## Mobile TeleSystems Finance S.A.

**\$400,000,000**

**8.00% notes due 2012**

### Guaranteed by Mobile TeleSystems OJSC

#### The Company—

- We are Mobile TeleSystems OJSC, or MTS, a leading provider of mobile cellular communications services in the Russian Federation, Ukraine and certain other CIS countries.

#### 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 January 28, 2005.

#### Maturity—

- The notes will mature at par on January 28, 2012.

#### Interest—

- The issuer will pay interest on the notes at an annual rate equal to 8.00%. The issuer will make interest payments on the notes semi-annually on January 28 and July 28 of each year, commencing on July 28, 2005. 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.

#### 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.

#### 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 in offshore transactions to non-U.S. persons 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. For a description of these and further restrictions, see “Plan of Distribution” and “Transfer Restrictions.”

#### Settlement—

- The notes will be delivered on or about January 28, 2005 through Euroclear, Clearstream or DTC, as the case may be, against payment therefor in immediately available funds. The closing date of the offering is January 28, 2005. 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: 99.736%**

*Joint Lead Managers*

**Credit Suisse First Boston**

**Goldman Sachs International**

*Co-Managers*

**CITIGROUP**

**ING Financial Markets**

**HSBC**

**Barclays Capital**

**Commerzbank Corporates & Markets**

**Bank Austria**

January 27, 2005

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## **IMPORTANT INFORMATION ABOUT THIS OFFERING MEMORANDUM**

This offering memorandum is based on information provided by us and other sources believed 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 its date. 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, Ukraine and certain other CIS countries and their economies 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.

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

#### **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.

#### **NOTICE TO U.K. INVESTORS**

This offering memorandum is only being distributed to and is only directed at (1) persons who are outside the United Kingdom or (2) investment professionals falling within Article 19(5) of the Financial Services and Markets Act 2000 (Financial Promotion) Order 2001 (the “Order”) or (3) persons 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 offering memorandum or any of its contents.

#### **NOTICE TO NEW HAMPSHIRE RESIDENTS**

NEITHER THE FACT THAT A REGISTRATION STATEMENT OR AN APPLICATION FOR A LICENSE HAS BEEN FILED UNDER CHAPTER 421-B OF THE NEW HAMPSHIRE REVISED STATUTES (“RSA 421-B”) WITH THE STATE OF NEW HAMPSHIRE NOR THE FACT THAT A SECURITY IS EFFECTIVELY REGISTERED OR A PERSON IS LICENSED IN THE STATE OF NEW HAMPSHIRE CONSTITUTES A FINDING BY THE SECRETARY OF STATE OF NEW HAMPSHIRE THAT ANY DOCUMENT FILED UNDER RSA 421-B IS TRUE, COMPLETE AND NOT MISLEADING. NEITHER ANY SUCH FACT NOR THE FACT THAT AN EXEMPTION OR EXCEPTION IS AVAILABLE FOR A SECURITY OR A TRANSACTION MEANS THAT THE SECRETARY OF STATE 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 ENFORCEMENT 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 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 any 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 Trustee on behalf 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 offering memorandum may constitute forward-looking statements within the meaning of Section 27A of the U.S. Securities Act of 1933 (the “U.S. Securities Act”) and Section 21E of the U.S. Securities Exchange Act of 1934 (the “U.S. Exchange Act”). 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.

We desire to take advantage of the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and are including this cautionary statement in connection with this safe harbor legislation. This offering memorandum 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,” “intend,” “estimate,” “forecast,” “project,” “predict,” “plan,” “will,” “may,” “should,” “could” 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 offering memorandum 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, 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 economies of Russia, Ukraine and certain other CIS countries, political stability in Russia, Ukraine and certain other CIS countries, 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 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 in this offering memorandum.



## **CURRENCIES**

In this offering memorandum, 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 “hryvnias” are to the lawful currency of Ukraine, references to “som” are to the lawful currency of Uzbekistan 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. Unless the context otherwise requires, references to "MTS," "we," "us" or "our" refer collectively to Mobile TeleSystems OJSC and its subsidiaries. "UMC" refers to Ukrainian Mobile Communications, our subsidiary in Ukraine. "MTS Belarus" refers to Mobile TeleSystems LLC, our 49%-owned affiliate in Belarus. As MTS Belarus is accounted for as an equity investment in our consolidated financial statements, our revenues do not include MTS Belarus' revenues and our subscriber data does not include its subscribers. We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States, or U.S. GAAP.*

### Our Company

We are a leading provider of mobile cellular communications services in the Russian Federation, Ukraine and certain other CIS countries, employing technology based primarily on Global System for Mobile Communications, or GSM. For the nine months ended September 30, 2004, we generated net revenues of \$2,807.3 million and had a subscriber base of 26.6 million (20.8 million in Russia, 5.5 million in Ukraine and 0.3 million in Uzbekistan) at September 30, 2004, making us the largest mobile operator in each of these three countries in terms of subscribers.

In addition to standard voice services, we offer our subscribers value-added services including voice mail, short message service, or SMS, general packet radio service, or GPRS, and various SMS- and GPRS-based information and entertainment services (including multi-media message service, or MMS). We also offer our subscribers the ability to roam automatically throughout Europe and in much of the rest of the world, and as of September 30, 2004, we had bilateral roaming agreements with 283 wireless operators in 159 countries.

We have grown rapidly since 1999 through organic growth, as well as acquisitions. The table below sets forth our total subscribers as of the end of, and net revenues for each of, the last five years and the nine months ended September 30, 2004:

Period	Subscribers <sup>(1)</sup>	Net revenues
	(in thousands)	
1999 .....	306	\$ 358,327
2000 .....	1,194	\$ 535,712
2001 .....	2,650	\$ 893,247
2002 .....	6,644	\$1,361,756
2003 .....	16,720	\$2,546,198
September 30, 2004 .....	26,633	\$2,807,338

<sup>(1)</sup> We define a subscriber as an individual or organization whose account shows chargeable activity within the previous 61 days (or 183 days in the case of the "Jeans" brand tariffs) and whose account does not have a negative balance for more than this period.

According to AC&M-Consulting, we had a leading 35% market share of total wireless subscribers in Russia at September 30, 2004. Our market share in the Moscow license area, which encompasses the City of Moscow and the Moscow region, was higher at 45%. The Moscow license area accounts for approximately 25% of our total subscriber base. In Ukraine, we had a leading 52% market share at September 30, 2004, according to AC&M-Consulting. Our subscriber base continued to grow in the fourth quarter of 2004. At December 31, 2004, we had approximately 34.2 million subscribers, of which 26.5 million were in Russia, 7.4 million were in Ukraine and 0.3 million were in Uzbekistan.

Russia is our principal market, both in terms of subscribers and revenues. At September 30, 2004, approximately 78% of our subscriber base was in Russia and approximately 21% was in Ukraine. For

the nine months ended September 30, 2004, approximately 79% of our revenues came from operations in Russia and 20.6% from operations in Ukraine.

Overall wireless penetration in Russia was at approximately 41% at September 30, 2004, and higher in Moscow at 87%, according to AC&M-Consulting. Mobile cellular penetration in Ukraine was lower than in Russia at approximately 22% at September 30, 2004, according to AC&M-Consulting. Mobile cellular penetration in Uzbekistan was at approximately 2% at September 30, 2004, according to AC&M-Consulting. The relatively low level of mobile penetration in the markets in which we operate presents us with future growth opportunities.

As of September 30, 2004, we had licenses to operate in 87 regions of Russia, including a population of approximately 142.6 million people, or approximately 98% of the country's total population. In addition, as of September 30, 2004, we had licenses to operate in the entire territory of Ukraine with a population of approximately 48 million people and in the entire territory of Uzbekistan with a population of approximately 25.2 million people. As of September 30, 2004, we had commercial operations in 63 regions of Russia, with a combined population of approximately 125.3 million people, in all of Ukraine and in selected areas of Uzbekistan. Since September 30, 2004, we expanded our presence in thirteen additional regions with a combined population of approximately 14.2 million people.

To maintain and increase our market share and brand awareness, we use a combination of print media, radio, television, direct mail and outdoor advertising, focusing on brand and image advertising, as well as on promotion of particular tariff plans. Supporting these efforts, we have developed an extensive distribution network with over 300 proprietary sales and customer service offices and an additional 27,000 points of sale operated by our dealers, as of September 30, 2004.

We seek to minimize our exposure to the credit risk of our subscribers through our advance-payment billing system, which is used by over 98% of our subscribers in Russia and approximately 80% of our subscribers in Ukraine. Under this system, our subscribers prepay for their access, usage and value-added service fees.

MTS Belarus had 0.97 million subscribers and a leading market share of 49% at September 30, 2004, according to AC&M-Consulting. The subscriber base of MTS Belarus grew to 1.2 million at December 31, 2004. Belarus, a country with a population of approximately 9.8 million, had a mobile cellular penetration rate of 20% at September 30, 2004, according to AC&M-Consulting.

### **Business Strategy**

Our primary goal is to maintain our position as a leading wireless operator in Russia and the CIS by strengthening our position across the markets in which we operate and deploying a customized approach to different customer segments. To accomplish this, we intend to implement the following strategies:

- Maintain our leading position by growing our subscriber base and focusing on the quality of our subscriber mix.
- Selectively expand our network to areas in which we do not already operate, focusing on high-density population areas and on areas along transportation routes.
- Continue to provide clearly structured tariff plans and branding propositions, as well as value-added service options, which appeal to the various groups of subscribers within our network, including SMS- and GPRS-based services.
- Continue to take advantage of our strong position in the major urban license areas, including Moscow and St. Petersburg, as a platform from which to test and launch new products and services.

- Further develop subscriber loyalty programs aimed at retaining our most valuable high-revenue subscribers.

In the past few years, we have rapidly expanded into the Russian regions and select CIS countries through launches of operations in territories in which we had licenses and through acquisitions of other mobile operators. Starting in 2003, we have become particularly focused on the integration of our existing businesses into a single company with a unified marketing approach and centralized network and operations management. We are currently working to complete the implementation of a centrally-managed corporate function to enhance performance and efficiency at all levels of our operations and simultaneously integrate our operations. In addition, we intend to continue to consolidate our ownership in regional subsidiaries by acquiring remaining minority stakes.

Our capital expenditures (consisting of purchases of property, plant and equipment and intangible assets) in 2003 and for the nine months ended September 30, 2004 were \$958.8 million and \$780.2 million, respectively, and we expect to invest approximately \$400 million in the fourth quarter of 2004 and approximately \$1.8 billion in 2005. These investments are required to support the growth of our subscriber base (*i.e.*, to improve network capacity) and to develop our network in the new regions for which we received licenses in 2003 and 2004.

We may also expand our operations into other countries of the CIS through the acquisition of existing operators or new licenses as attractive opportunities arise.

Implementation of these strategies is subject to a number of risks. See “Risk Factors” for a description of these and other risks we face.

#### **Corporate Information**

Our legal name is Mobile TeleSystems OJSC, and we have been incorporated under the laws of the Russian Federation since March 1, 2000. Our registered 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.

## 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 . . . . .	<p>\$400,000,000 aggregate principal amount of 8.00% notes due 2012.</p> <p>The notes are being offered by the initial purchasers (1) in offshore transactions to non-U.S. persons in reliance on Regulation S (“Regulation S”) under the U.S. Securities Act and (2) within the United States to “qualified institutional buyers” (“QIBs”) as defined in Rule 144A under the U.S. Securities Act (“Rule 144A”) in reliance on the exemption from registration provided by Rule 144A.</p>
Maturity Date . . . . .	January 28, 2012.
Interest . . . . .	The issuer will pay interest on the notes at an annual rate of 8.00% on January 28 and July 28 of each year. The first interest payment will be made on July 28, 2005.
Denominations . . . . .	The notes will be issued in denominations of \$2,000 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.
Guarantee . . . . .	We will fully and unconditionally guarantee 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.
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 net proceeds the issuer will receive from the offering, after deducting discounts, fees and expenses incurred in connection with the offering will be approximately \$396,428,061. The issuer will lend these proceeds to us pursuant to a loan agreement. We intend to use approximately \$70 million of the net proceeds from the offering to repay a \$140 million loan we received from Credit Suisse First Boston International in October 2004 for general corporate purposes. We intend to use the remaining net proceeds from the offering for general corporate purposes, including for potential acquisitions and for potentially increasing our interests in certain mobile cellular telecommunications providers. 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 has been made to list the notes on the Luxembourg Stock Exchange.

Trustee, Registrar, Transfer Agent  
and Principal Paying Agent . . . . . JPMorgan Chase Bank, N.A.

Luxembourg Listing Agent,  
Luxembourg Paying Agent and  
Luxembourg Transfer Agent . . . . . J.P. Morgan Bank Luxembourg S.A.



## SUMMARY FINANCIAL AND OPERATING DATA

The selected consolidated financial data for the years ended December 31, 2001, 2002 and 2003, and as of December 31, 2002 and 2003, are derived from our annual consolidated financial statements, prepared in accordance with U.S. GAAP included elsewhere in this offering memorandum. The selected consolidated financial data as of and for the nine months ended September 30, 2003 and 2004 are derived from the interim condensed consolidated financial statements, prepared in accordance with U.S. GAAP included elsewhere in this offering memorandum 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 consolidated financial data for the years ended December 31, 1999 and 2000, and as of December 31, 1999, 2000 and 2001, derived from our annual consolidated financial statements not included in this offering memorandum. Our results of operations are affected by acquisitions. Results of operations of acquired businesses are included in our consolidated financial statements from their respective dates of acquisition. The summary financial data should be read in conjunction with our consolidated financial statements included elsewhere in this offering memorandum, "Risk Factors" and "Operating and Financial Review and Prospects." Certain industry and operating data are also provided below.

	Years Ended December 31,					Nine Months Ended September 30,	
	1999	2000	2001	2002	2003	2003	2004
(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)							
<b>Consolidated statements of operations data:</b>							
<b>Net operating revenues:</b>							
Service revenues and connection fees <sup>(1)</sup> . . . . .	\$327,323	\$499,354	\$851,374	\$1,299,141	\$2,465,089	\$1,715,749	\$2,741,553
Sales of handsets and accessories . . . . .	31,004	36,358	41,873	62,615	81,109	58,748	65,785
Total net operating revenues . . . . .	358,327	535,712	893,247	1,361,756	2,546,198	1,744,497	2,807,338
<b>Operating expenses:</b>							
Cost of services, exclusive of depreciation and amortization shown separately below . . . . .	60,683	83,093	143,665	196,445	301,108	210,199	335,480
Cost of handsets and accessories, exclusive of depreciation and amortization shown separately below . . . . .	29,932	39,217	39,828	90,227	173,071	112,996	149,272
Sales and marketing expenses . . . . .	23,722	76,429	107,729	171,977	326,783	219,352	298,401
Depreciation and amortization . . . . .	53,766	87,684	133,318	209,680	415,916	288,112	450,742
Sundry operating expenses <sup>(2)</sup> . . . . .	74,612	110,242	134,598	229,056	406,722	294,015	427,260
Impairment of investment . . . . .	—	—	10,000	—	—	—	—
Net operating income . . . . .	115,612	139,047	324,109	464,371	922,598	649,823	1,146,183
Currency exchange and translation losses (gains) . .	3,238	1,066	2,264	3,474	(693)	(4,481)	(2,647)
<b>Other expenses (income):</b>							
Interest income . . . . .	(801)	(7,626)	(11,829)	(8,289)	(18,076)	(11,743)	(18,577)
Interest expenses . . . . .	11,805	11,335	6,944	4,389	106,551	70,013	78,828
Other expenses (income), net . . . . .	(829)	(502)	(2,672)	(2,454)	3,420	12,251	(22,006)
Total other expenses (income), net . . . . .	10,175	3,207	(7,557)	33,646	91,895	70,521	38,245
Income before provision for income taxes and minority interest . . . . .	102,199	134,774	329,402	427,251	831,396	584,143	1,110,585
Provision for income taxes . . . . .	18,829	51,154	98,128	110,417	242,480	160,514	269,590
Minority interest . . . . .	(2,291)	(6,428)	7,536	39,711	71,677	59,139	27,372
Net income before cumulative effect of a change in accounting principle . . . . .	85,661	90,048	223,738	277,123	517,239	364,490	813,623
Cumulative effect of a change in accounting principle, net of income taxes of \$9,644 in 2001 .	—	—	(17,909)	—	—	—	—
Net income . . . . .	<u>\$ 85,661</u>	<u>\$ 90,048</u>	<u>\$205,829</u>	<u>\$ 277,123</u>	<u>\$ 517,239</u>	<u>\$ 364,490</u>	<u>\$ 813,623</u>

	Years Ended December 31,					Nine Months Ended September 30,	
	1999	2000	2001	2002	2003	2003	2004
	(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)						
Dividends declared . . . . .	\$11,879	\$13,631	\$2,959	\$ —	\$111,355 <sup>(3)</sup>	\$111,355 <sup>(3)</sup>	\$219,950 <sup>(3)</sup>
Pro forma net income giving effect to the change in accounting principle, had it been applied retroactively . . .	78,258	93,108	223,738	277,123	517,239	364,490	813,623
Net income per share, basic and diluted . . . . .	0.05	0.05	0.10	0.14	0.26	0.18	0.41
Dividends declared per share . . . . .	0.01	0.01	—	—	0.06	0.056	0.111
Weighted average number of shares of common stock outstanding . . . . .	1,634,527,040	1,806,968,096	1,983,359,507	1,983,359,507	1,983,374,949	1,983,359,507	1,983,958,588
<b>Consolidated cash flow data:</b>							
Cash provided by operating activities . . . . .	\$116,801	\$190,914	\$338,201	\$412,772	\$965,984	\$667,766	\$1,281,221
Cash used in investing activities . . . . .	(115,184)	(423,349)	(441,523)	(697,921)	(1,910,087)	(1,315,268)	(823,271)
(of which capital expenditures) <sup>(4)</sup> . . . . .	(118,338)	(224,898)	(441,200)	(574,272)	(958,771)	(635,652)	(780,212)
Cash (used in) provided by financing activities . . . . .	(11,557)	298,543	247,592	100,817	997,545	760,699	(356,760)
<b>Consolidated balance sheet data (end of period):</b>							
Cash, cash equivalents and short-term investments . .	\$10,000	\$245,828	\$304,933	\$64,661	\$335,376	\$177,269	\$243,274
Property, plant and equipment, net . . . . .	250,270	439,307	856,056	1,344,633	2,256,076	2,068,404	2,808,573
Total assets . . . . .	682,047	1,101,332	1,727,492	2,283,296	4,225,351	3,784,956	4,865,698
Total debt (long-term and short-term) <sup>(5)</sup> . . . . .	112,123	52,773	325,840	454,485	1,660,334	1,394,413	1,487,249
Total shareholders' equity .	343,724	801,084	1,018,279	1,302,044	1,723,910	1,561,210	2,331,629
Including capital stock . . .	49,276	40,352	40,352	40,352	40,361	40,361	43,162
<b>Financial ratios (end of period):</b>							
Total debt/total capitalization <sup>(6)</sup> . . . . .	24.6%	6.2%	24.2%	25.9%	49.1%	47.2%	39.0%
<b>Industry and operating data:<sup>(7)</sup></b>							
Mobile penetration in Russia (end of period) . .	1%	2%	6%	12%	25%	21%	41%
Mobile penetration in Ukraine (end of period) .	—	—	—	—	13%	11%	22%

	Years Ended December 31,					Nine Months Ended September 30,	
	1999	2000	2001	2002	2003	2003	2004
(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)							
Subscribers in Russia (end of period, thousands) <sup>(8)</sup> . . .	306	1,194	2,650	6,644	13,370	11,344	20,842
Subscribers in Ukraine (end of period, thousands) <sup>(8)</sup> . .	—	—	—	—	3,350	2,550	5,528
Overall market share in the Moscow license area (end of period) . . . . .	40%	55%	50%	43%	43%	43%	45%
Overall market share in Russia (end of period) . . . . .	23%	35%	33%	38%	37%	37%	35%
Overall market share in Ukraine (end of period) . . . . .	—	—	—	—	51%	48%	52%
Average monthly usage per subscriber in Russia (minutes) <sup>(9)</sup> . . . . .	224	151	157	159	144	150	156
Average monthly service revenue per subscriber in Russia <sup>(10)</sup> . . . . .	\$124	\$54	\$36	\$23	\$17	\$19	\$14
Average monthly usage per subscriber in Ukraine (minutes) <sup>(9)</sup> . . . . .	—	—	—	—	97	95	123
Average monthly service revenue per subscriber in Ukraine <sup>(10)</sup> . . . . .	—	—	—	—	\$15	\$18	\$15
Subscriber acquisition costs in Russia <sup>(11)</sup> . . . . .	\$148	\$69	\$56	\$35	\$26	\$23	\$21
Subscriber acquisition costs in Ukraine <sup>(11)</sup> . . . . .	—	—	—	—	\$32	\$34	\$21
Churn in Russia <sup>(12)</sup> . . . . .	20.7%	21.6%	26.8%	33.9%	47.3%	34.9%	23.7%
Churn in Ukraine <sup>(12)</sup> . . . . .	—	—	—	—	23.8%	19.4%	16.6%

(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. Service revenues amounted to \$314.6 million, \$484.5 million, \$830.3 million, \$1,274.3 million and \$2,435.7 million for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively, and \$1,690.9 million and \$2,705.1 million for the nine months ended September 30, 2003 and 2004, respectively. Guest roaming fees included in service revenues were \$44.0 million, \$43.2 million, \$52.6 million, \$83.4 million and \$112.0 million for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively, and \$81.6 million and \$71.9 million for the nine months ended September 30, 2003 and 2004, respectively.

(2) Sundry operating expenses include taxes (other than income taxes), primarily revenue and property-based taxes, of \$15.6 million, \$26.9 million, \$25.3 million, \$39.1 million and \$40.4 million for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively, and \$28.2 million and \$29.4 million for the nine months ended September 30, 2003 and 2004, respectively.

(3) Includes dividends on treasury shares of \$0.4 million and \$1.1 million for the nine months ended September 30, 2003 and 2004, respectively.

(4) Capital expenditures include purchases of property, plant and equipment and intangible assets.

(5) Includes notes payable, bank loans, capital lease obligations and other debt.

(6) 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 5 above for the definition of "total debt."

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

(8) We define a subscriber as an individual or organization whose account shows chargeable activity within the previous 61 days (or 183 days in the case of the "Jeans" brand tariffs) and whose account does not have a negative balance for more than this period.

(9) 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 subscribers during such period and dividing by the number of months in such period. For Ukraine, the figure has been calculated based on the months of March through December 2003.

(10) Average monthly service revenue per subscriber is calculated 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. For Ukraine, the 2003 figure has been calculated based on the months of March through December 2003.

(11) Subscriber acquisition costs are calculated as total sales and marketing expenses for the period per additional subscriber. Effective January 1, 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. For Ukraine, the 2003 figure has been calculated based on the months of March through December 2003.

(12) We define churn as the total number of subscribers who cease to be a subscriber (as defined above) during the period (whether involuntarily due to non-payment or voluntarily, at such subscriber's request, including those switching to a different tariff plan), expressed as a percentage of the average number of subscribers during that period. For Ukraine, the 2003 figure has been annualized based on the months of March through December 2003.

## **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 occurs, our business, prospects, financial condition or results of operations could be materially adversely affected. In that case, the value of the notes could also decline and you could lose all or part of your investment.*

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

### **Risks Relating to Business Operations in Emerging Markets**

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

Investors in emerging markets such as the Russian Federation, Ukraine and other CIS countries should be aware that these markets are subject to greater risk than more developed markets, including in some cases significant legal, economic and political risks. Investors should also note that emerging economies such as the economies of the Russian Federation and Ukraine 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**

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

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

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

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

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

***Our controlling shareholder has the ability to control our operations and its interests may conflict with those of holders of the notes, and it may make decisions that materially adversely affect your investment.***

Sistema controls 50.6% of our shares. As a result, Sistema has the ability to implement actions requiring shareholder approval, including the election of a majority of our directors and the declaration of dividends, and has the ability to control our operations. Therefore, decisions made by Sistema will influence our business, results of operations and financial condition, and these decisions may conflict with the interests of the holders of the notes.

Sistema has outstanding a significant amount of indebtedness, including \$350.0 million of notes maturing in 2008 and \$350.0 million of notes maturing in 2011. In addition, the notes maturing in 2011 can be redeemed at the option of the noteholders in 2007. Therefore, Sistema will require significant funds to meet its obligations, which may come in part from dividends paid by its subsidiaries, including us.

Sistema voted in favor of declaring dividends of \$111.4 million in 2003 and approximately \$220.0 million in 2004. The indentures relating to our outstanding notes do not, and the indenture relating to the notes offered hereby will not, restrict our ability to pay dividends. As a result of paying dividends, our reliance on external sources of financing may increase, and our cash flow and ability to repay our debt obligations, or make capital expenditures, investments and acquisitions could be materially adversely affected.

Sistema also owns an interest in Sky Link CJSC, which operates on a CDMA-2000 standard in the Moscow and St. Petersburg and certain other license areas, but plans to develop a broader CDMA-2000 wireless network in Russia. Sky Link intends to be a niche player, targeting high-end businesses and residential customers, which could result in increased competition for us.

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

While our subscriber base and revenues are growing as we continue to grow our operations, our average monthly service revenues per subscriber are decreasing. For example, our average monthly service revenues per subscriber in Russia for 2001, 2002, 2003 and for the nine months ended September 30, 2004 was \$36, \$23, \$17 and \$14. We expect our average monthly service revenues per subscriber to continue to decrease due to tariff decreases, lower tariffs in the regions outside of the Moscow license area and the increase of mass-market subscribers as a proportion of our overall subscriber mix. See "Operating and Financial Review and Prospects." This decrease in our average monthly service revenues per subscriber may materially adversely affect our results of operations.

***We are substantially dependent on a single supplier of billing system software, which may hinder our ability to control our costs and expand our network.***

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

network. See “Business—Customer Payments and Billing” for a description of our plans to implement a new billing system.

***Our failure to implement the necessary infrastructure to manage our growth could have a material adverse 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 after such calls are made. There could be potential delays between the time that a subscriber’s balance reaches zero and the disconnection of such subscriber from 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 estimate that we incurred approximately \$16.7 million in losses during 2003 as a result of this dealer fraud. We have taken measures that we believe will 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 materially adversely affect our market share. We have also canceled our contracts with certain dealers who had the highest numbers of fraudulent accounts.

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

***If we cannot successfully develop our network or integrate our acquired businesses, we will be unable to expand our subscriber base and maintain our profitability.***

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

- extend coverage and increase the capacity of our existing network in the Moscow and regional license areas;
- further develop our operations in Ukraine and Uzbekistan and make investments in MTS Belarus; 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. Limited information regarding the markets into which we have or 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 our network through acquisitions and we may continue to engage in further acquisitions. We may not be able to integrate previous or future acquisitions successfully or operate them profitably. Such integration requires significant time and effort from our senior management, who are also responsible for managing our existing operations. Such integration may also be difficult as our technical systems may differ from those of the acquired businesses. In addition, 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 risks during the course of our expansion into countries outside of the Russian Federation. Differing cultures and more uncertain business operating environments could lead to lower profitability and higher risks to our business.

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. Telecommunications equipment used in Ukraine is also subject to obligatory certification requirements. The failure of any equipment we use to receive timely certification or re-certification could also hinder our expansion plans. 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 and strain our financial resources, restricting our ability to successfully expand our operations.***

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

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

- stringent control of network buildout, operating 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 control over financial reporting and disclosure controls and procedures; and
- hiring and training of new personnel.

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

***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 on our ability to continue to interconnect cost-effectively with the Moscow City Telephone Network, or MGTS, and other incumbent fixed-line operators in Russia, Ukrtelecom, in Ukraine, and other local, domestic and international telecommunications operators. Fees for interconnection are established by agreements with network operators and vary, depending on the network used, the nature of the call and the call destination. We have entered into interconnection agreements with several local, domestic and international telecommunications operators, including MGTS and Rostelecom in Russia and UTEL and Ukrtelecom in Ukraine. Interconnection with these operators is required to complete calls originating on our network but terminating outside of it and to complete calls to our subscribers originating outside of our network.



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

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

***Governmental regulation of our interconnect rates in Ukraine could adversely affect our results of operations.***

Under the Ukrainian Telecommunications Law adopted in November 2003, the National Commission for the Regulation of Communications, or the NCRC, commencing January 1, 2005, is entitled to regulate the tariffs for public telecommunications services rendered by fixed line operators, whereas the mobile cellular operators (including UMC) are entitled to set their retail tariffs and negotiate interconnect rates with other operators. However, the NCRC would be entitled to regulate the interconnect rates of any mobile cellular operator declared a "dominant market force" by the Antimonopoly Committee of Ukraine, or the AMC. Government regulation of our interconnect rates could cause our interconnect revenues to decrease or be limited, which could have a material adverse effect on our results of operations.

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

***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 constrained and our ability to expand limited, resulting in a loss of market share and lower revenues.***

There is a limited number of frequencies available for wireless operators in each of the regions in which 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, frequency may not 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 availability of frequencies in the GSM 900 MHz band in Ukraine is limited by the fact that the Ukrainian military has a number of frequencies for its exclusive use. While future capacity constraints could be reduced by an increase in the GSM frequencies allocated to us, including additional frequencies in the GSM 1800 MHz band, we may not be awarded some or any of the remaining GSM spectrum. In addition, the Ukrainian government is currently delaying the allocation of new frequencies to wireless communications operators in Ukraine which, in turn, may constrain 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 adverse 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 Information Technologies and Communications, informing us of the cancellation of the approval the State Service for Communication Control had given it in May 2000 for certain frequencies within the 900 MHz band in order to install base stations with restricted emanation, which 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 Information Technologies and Communications, halted the implementation of this letter on September 14, 2000, and the Ministry of Information Technologies and Communications reinstated these frequency allocations to us on November 14, 2000, such future attempts may 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 such allocations may not be renewed in a timely manner or at all. If our frequencies are revoked or we are unable to renew our frequency allocations, our network capacity would be constrained and our ability to expand limited, resulting in a loss of market share and lower revenues.

***Because we lack a comprehensive back-up system for our network and insurance for our computer systems, a network or computer systems failure could prevent us from operating our business and lead to a loss of subscribers, damage to our reputation and violations of the terms of our licenses and subscriber contracts.***

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 was unable to function, significant disruptions to our systems would occur, including our inability to provide services. Disruptions in our services occurred in the Moscow license area on August 3, 2000, December 15, 2000, January 23, 2001 and May 30, 2003, and in the Kiev license area on August 31, 2004 and September 1-2, 2004. See “Regulation—Regulation in Ukraine—Competition” for a description of the recommendation issued by the AMC to UMC following the Kiev area disruptions. These types of disruptions may recur, which could lead to a loss of subscribers, damage to our reputation, penalties and violations of the terms of our licenses and subscriber contracts.

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, viruses 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 material adverse effect on our business.

***Failure to fulfill the terms of our licenses, including the payment of license contributions, could result in their suspension or termination, which could have a material adverse effect on our business and results of operations.***

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.

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 \$103.6 million as of September 30, 2004. 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 and most contain further requirements as to network capacity and territorial coverage to be reached by specified dates.

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

***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 or our company could negatively affect this brand image, which could lead to loss of market share and revenues.

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

The Ministry of Information Technologies and Communications has previously stated that it expected to announce the procedures for the award of licenses for UMTS wireless services during 2002, and then during 2003. To date, however, no procedures have been announced. Depending upon the procedures adopted, 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 or Ukraine (although we do not believe that the award of UMTS licenses in Ukraine is imminent) would hinder us from competing effectively with operators who are able to provide these services and limit our ability to expand our services, which could have a material adverse effect on our prospects, business and results of operations.

In addition, we employ technology based primarily on the Global System for Mobile Communications, or GSM, standard. The UMTS standard is significantly superior to existing second-generation standards such as GSM. The adoption of UMTS may consequently increase the competition we face. The technology we currently use may become obsolete or uncompetitive and, if we are not able to develop a strategy compatible with this or any other new technology, 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.

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

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

Our licenses expire in various years from 2005 to 2016 and may be renewed in Russia, Ukraine and Uzbekistan upon application to the Federal Service for Supervision in the Area of Communications and the NCRC, respectively. From time to time, as required, we also apply for the re-issuance of licenses prior to their expiration.

Governmental officials have broad discretion in deciding whether to renew a license, and may not renew our licenses after expiration. If our licenses are renewed, they may be renewed with additional obligations, including payment obligations. Failure to renew our licenses or to receive renewed licenses

with similar terms to our existing licenses could significantly diminish our service area, which could have a material adverse effect on our business and results of operations.

***We engage in transactions with related parties, which may present conflicts of interest, potentially resulting in the conclusion of transactions on terms not determined by market forces.***

We have purchased interests in various mobile telecommunications companies from Sistema and entered into arrangements with affiliates of Sistema for advertising (Maxima), interconnection services (MTT) and insurance services (Rosno). In addition, we have entered into interconnection and telephone numbering capacity purchase agreements with MGTS, Comstar and MTU-Inform, which are subsidiaries of Sistema, as well as office leases with MGTS and an agreement to purchase a new billing system from Strom Telecom, which is also a subsidiary of Sistema. Furthermore, we have entered into a number of arrangements with T-Mobile and its affiliates, including 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 and a wholly-owned subsidiary of Sistema. These transactions may present conflicts of interest, potentially resulting in the conclusion of transactions on terms not determined by market forces.

***If the Federal Antimonopoly Service 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, which could have a material adverse effect on our business and results of operations.***

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

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

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

We own less than 100% of the equity in some of our subsidiaries, with the remaining equity balance being held by minority shareholders. These subsidiaries have in the past carried out, and continue to carry out, numerous transactions with us and our other subsidiaries, which may be considered “interested party transactions” under Russian law, requiring approval by disinterested directors, disinterested independent directors or disinterested shareholders. See “Certain Transactions with Related Parties.” These transactions have not always been properly approved and, therefore, may be challenged by minority shareholders. In addition, Russian law requires a three-quarters majority vote

of the holders of voting stock present at a shareholders' meeting to approve certain transactions, including, for example, charter amendments, major transactions involving assets in excess of 50% of the assets of the company, repurchase by the company of shares and share issuances. In some cases, minority shareholders may not approve interested party transactions requiring their approval or other transactions requiring supermajority approval. In the event these minority shareholders were to successfully challenge past interested party transactions, or do not approve interested party or other transactions in the future, we could be limited in our operational flexibility and our results of operations could be materially adversely affected.

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

In January 2003, we discovered that part of 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 and other personal information of approximately five million of our subscribers. This database is currently being sold in Russia. In addition, in May 2003, certain subscriber databases of several operators in the North-West region, including those of MTS, MegaFon, Delta Telecom and two other operators, were stolen and are currently being sold.

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

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

### **Risks Relating to Our Financial Condition**

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

We have a substantial amount of outstanding indebtedness, primarily consisting of the obligations we entered into in connection with our notes and bank loans. As of September 30, 2004, our consolidated total debt, including capital lease obligations, was approximately \$1,487.2 million, and we have signed several agreements for additional financing for an aggregate amount of \$478.5 million since September 30, 2004. We have approximately \$375.5 million in notes and bank loans that are due by September 30, 2005.

Our ability to service, repay and refinance our indebtedness 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 may not be able to generate sufficient cash flow or access international capital markets or incur additional indebtedness to enable us to service or repay our indebtedness or to fund our other



liquidity needs. We may be required to refinance all or a portion of our indebtedness on or before maturity, sell assets, reduce or delay capital expenditures or seek additional capital. We cannot assure you that any refinancing or additional financing would be available on commercially reasonable terms or at all, or whether our assets could be sold, or if sold, whether the proceeds therefrom would be sufficient to meet our debt service obligations. Our inability to generate sufficient cash flow to satisfy our debt service obligations, or to refinance debt on commercially reasonable terms, would materially adversely affect our business, financial condition, results of operations and prospects. See “Operating and Financial Review and Prospects—Liquidity and Capital Resources.”

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

We will need to make significant capital expenditures, particularly in connection with the development, construction and maintenance of, and the purchasing of software for, our GSM network. We spent approximately \$441.2 million in 2001, approximately \$574.3 million in 2002, approximately \$958.8 million in 2003 and expect to spend approximately \$1.8 billion in 2004 for the fulfillment of our capital spending plans. 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 financings and cash flow from our operations may not be sufficient to meet our planned needs in the event of various unanticipated potential developments, including the following:

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

To meet our financing requirements, we may need to attract additional equity or debt financing. Russian companies are limited in their ability to issue shares in the form of ADSs or other depository receipts due to new Russian securities regulations that came into force in 2003 providing that no more than 40% of a Russian company's shares may be circulated abroad through sponsored depository receipt programs. Although as of December 31, 2004, our ADR program accounted for 21.77% of our outstanding shares, we expect that the ADR program will be close to its 40% limit when and if the GDRs recently placed by T-Mobile are converted into ADRs. We will thus be unable to raise additional equity financing through depository receipt programs. Moreover, the Russian securities regulatory authority may reduce the 40% limit in the future. If we cannot obtain adequate funds to satisfy our capital requirements, we may need to limit our operations significantly, which could have a material adverse effect on our business, prospects and results of operations.

In addition, from time to time, we may merge our subsidiaries into us for operational reasons. Under Russian law, such merger would be considered a reorganization and we would be required to notify our creditors of this reorganization. Russian law also provides that, for a period of 30 days after notice, these creditors would have a right to accelerate our debts and demand reimbursement for

applicable losses. In the event that we elect to undertake any such merger and all or part of our debt is accelerated, we may not have the ability to raise the funds necessary for repayment and our business and financial condition could be materially adversely affected. On November 9, 2004, our general meeting of shareholders approved a merger of seven of our wholly-owned subsidiaries into us. The term for notifying our creditors has not yet commenced. We do not, however, expect a substantial portion of our indebtedness to be accelerated.

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

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

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

***Inflation could increase our costs and adversely affect our results of operations.***

The Russian economy has been characterized by high rates of inflation. In 2003, the inflation rate of 12%, combined with the nominal appreciation of the ruble, resulted in the appreciation of the ruble against the U.S. dollar in real terms. For the first nine months of 2004, the rate of inflation in Russia was 8.5%. As we tend to experience inflation-driven increases in certain of our costs, including salaries and rents, which are sensitive to rises in the general price level in Russia, our costs in U.S. dollar terms will rise. In this situation, due to competitive pressures, we may not be able to raise the prices we charge for our products and services sufficiently to preserve operating margins.

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

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

A new framework law on exchange controls took effect on June 18, 2004. This law empowers the government and the Central Bank of Russia to further regulate and restrict currency control matters, including operations involving foreign securities and foreign currency borrowings by Russian companies. The new law also abolishes the need for companies to obtain transaction-specific licenses from the Central Bank of Russia (except for opening bank accounts outside Russia), envisaging instead the implementation of generally applicable restrictions on currency operations. As the evolving regulatory



regime is new and untested, it is unclear whether it will be more or less restrictive than the prior laws and regulations it has replaced.

***Vaguely drafted Russian transfer pricing rules and lack of reliable pricing information subject us to the risks of additional costs and penalties.***

Russian transfer pricing rules entered into force in 1999, giving Russian tax authorities the right to control prices for transactions between related entities and certain other types of transactions between independent parties, such as foreign trade transactions or transactions with significant price fluctuations. The Russian transfer pricing rules are vaguely drafted, leaving wide scope for interpretation by Russian tax authorities and arbitration courts and their use in politically motivated investigations and prosecutions. We believe that the prices used by our group are market prices and, therefore, comply with the requirements of Russian tax law on transfer pricing. However, due to the uncertainties in interpretation of transfer pricing legislation, the tax authorities may challenge our prices and propose adjustments. If such price adjustments are upheld by the Russian arbitration courts and implemented, our 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 would have an adverse impact on our financial condition and results of operations. Although Ukraine has reformed its transfer pricing rules, similar concerns with interpretation and enforcement by the Ukrainian tax authorities exist.

***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 Central Bank of Russia restrict investments by Russian companies outside Russia and in most hard-currency-denominated instruments in Russia, and there are only a limited number of ruble-denominated instruments in which we may invest our excess cash. 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 10% of those earnings into rubles within seven days of receipt, although Russian legislation allows the Central Bank of Russia to decrease this conversion requirement or increase it up to 30%. For example, we earned around \$53 million, \$83 million, \$112 million and \$72 million in foreign currency in 2001, 2002, 2003 and the first nine months of 2004, respectively, primarily from our 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 foreign currency in Russia could increase our costs when making payments in foreign currency to suppliers and creditors and could cause us to default on our obligations to them.***

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

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

***Indentures relating to our notes and our controlling shareholder Sistema's notes contain, and our syndicated loan agreement contains, restrictive covenants, which limit our ability to incur debt and to engage in various activities.***

The indentures relating to our outstanding notes contain, and the indenture relating to the notes offered hereby will contain, covenants limiting our ability to incur debt, create liens on our properties and enter into sale and lease-back transactions. The indentures also contain covenants limiting our ability to merge or consolidate with another person or convey our properties and assets to another person, 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. Our syndicated loan facility contains similar and other covenants. Failure to comply with these covenants could cause a default and result in the debt becoming immediately due and payable, which would materially adversely affect our business, financial condition and results of operations.

In addition, Sistema, which controls 50.6% of our shares and consolidates our results in its financial statements, is subject to various covenants in the indentures related to its \$350.0 million in aggregate principal amount of notes due 2008 and \$350.0 million in aggregate principal amount of notes due 2011, which impose restrictions on Sistema and its restricted subsidiaries (including us) with respect to, *inter alia*, incurrence of indebtedness, creation of liens and disposal of assets. In these indentures, Sistema undertakes that it will not, and will not permit its restricted subsidiaries (including us) to, incur indebtedness unless a certain debt/EBITDA (as defined therein) ratio is met. In addition to us, Sistema has other businesses that require capital and, therefore, the consolidated Sistema group's capacity to incur indebtedness otherwise available to us could be diverted to its other businesses. Sistema may also enter into other agreements in the future that may further restrict it and its restricted subsidiaries (including us) from engaging in these and other activities. We expect Sistema to exercise its control over us in order for Sistema, as a consolidated group, to meet its covenants, which could materially limit our ability to conduct our operations, including the implementation of our business strategy.

***If a change in control occurs, our noteholders and other debt holders may require us to redeem notes or other debt, which could have a material adverse effect on our financial condition and results of operations.***

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

- Any person acquires beneficial ownership of 50% or more of the total voting power of all shares of our common stock; provided that the following transactions would not be deemed to result in a change in control:
  - 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
  - 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.

Our syndicated loan facility contains a similar change of control provision.

If a change in control occurs, and our noteholders and other debt holders exercise their right to require us to redeem all of their notes or debt, such event could have a material adverse effect on our financial condition and results of operations.

### **Risks Relating to Our Industry**

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

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

*A merger between our two largest competitors would result in a change in our relative market share in the Russian mobile communications market.*

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

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

We operate in an uncertain regulatory environment. The legal framework with respect to the provision of telecommunication services in Russia and Ukraine and in other areas in which we may operate in the future is not well developed, and a number of conflicting laws, decrees and regulations apply to the telecommunications sector. Moreover, regulation is conducted largely through the issuance of licenses and instructions, and governmental officials have a high degree of discretion. In this environment, political influence or manipulation could be used to affect regulatory, tax and other decisions against us on the basis of other than legal considerations. For example, Russian government authorities investigated Vimpelcom in late 2003 on grounds that it was illegally operating in Moscow pursuant to a license issued to its wholly-owned subsidiary rather than to Vimpelcom itself. In addition, some of our competitors may receive preferential treatment from the government, potentially giving them a substantial advantage over us. For example, according to press reports, MegaFon and Kyivstar, our competitors in Russia and Ukraine, respectively, received preferential treatment in regulatory matters in the past.

***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, applicable regulations require that agreements for the provision of telecommunications services must be concluded and performed only by the licensee. This requirement has been an important factor in our recent acquisitions. As we are unable to buy licenses, we must instead purchase the company holding the license. We must also continue to operate through such company in its license area by entering into agency, lease, services and similar agreements.

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

Additionally, Russian law requires that, in the event of a merger, a license held by either of the merging entities must be reissued to the successor entity, rather than simply transferred. We intend to continue to merge with our wholly-owned subsidiaries as part of our efforts to integrate our networks; however, a 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.

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, nation-wide licensee in the event that such a license was granted.

***If we are found to have a dominant position in our markets, the government may regulate our tariffs and restrict our operations.***

Under Russian legislation, the Federal Antimonopoly Service may categorize a company as a dominant force in a market. Current Russian legislation does not clearly define “market” in terms of the types of services or the geographic area. As of September 30, 2004, MTS OJSC and our subsidiaries CJSC Kuban-GSM, Tomsk Cellular Communications LLC, CJSC Siberian Cellular System-900 and CJSC UDN 900 are categorized as companies with a market share exceeding 35%. This classification, in turn, gives the Federal Antimonopoly Service the power to impose certain restrictions on the businesses of those entities.

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

If we or any of our subsidiaries were classified as a dominant market force or as having a dominant position in the market, the imposition of government-determined tariffs could result in competitive disadvantages, and our business and results of operations could be materially adversely affected. Additionally, restrictions on expansion or government-mandated withdrawal from regions or markets could reduce our subscriber base and prevent us from implementing our business strategy.

Moreover, we could be required to make additional license applications at an additional unexpected cost.

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

Due to the recent growth in fixed and wireless telephone use in Moscow, the city's "095" code has reached numbering capacity limits and an additional code or codes are expected to be introduced in the future. Calls between a new code and another code will require callers to dial through "8," the long distance dialing prefix, which is also used by our "federal" number subscribers. The overtaxing of these long distance lines may inconvenience 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 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, decrease our access to base station sites, diminish subscriber usage and hinder access to additional financing.***

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

***Computer viruses may harm or disrupt our network.***

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

## **Risks Relating to the Russian Federation and Ukraine**

### **Economic Risks**

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

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

- significant declines in gross domestic product;
- hyperinflation;
- an unstable currency;

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

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

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

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

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

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

Recently, there has been a rapid increase in lending by Russian banks, which many believe has been accompanied by a deterioration in the credit quality of the borrowers. In addition, a robust domestic corporate debt market is leading to Russian banks increasingly holding large amounts of



Russian corporate ruble bonds in their portfolios, which is further deteriorating the risk profile of Russian bank assets. The serious deficiencies in the Russian banking sector, combined with the deterioration in the credit portfolios of Russian banks, may result in the banking sector being more susceptible to market downturns or economic slowdowns, including due to Russian corporate defaults that may occur during any such market downturn or economic slowdown. In addition, the Central Bank of Russia has recently revoked the licenses of certain Russian banks, which resulted in market rumors about additional bank closures and many depositors withdrawing their savings. If a banking crisis were to occur, Russian companies would be subject to severe liquidity constraints due to the limited supply of domestic savings and the withdrawal of foreign funding sources that would occur during such a crisis.

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

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

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

The deterioration of physical infrastructure in Russia and Ukraine harms the national economies, disrupts the transportation of goods and supplies, adds costs to doing business in these countries and can interrupt business operations. These difficulties can impact us directly; for example, 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 materially adversely affect the Russian and Ukrainian economies and our business.***

The Russian and Ukrainian economies are vulnerable to market downturns and economic slowdowns elsewhere in the world. As has happened in the past, financial problems or an increase in the perceived risks associated with investing in emerging economies could dampen foreign investment in Russia and Ukraine and Russian and Ukrainian businesses could face severe liquidity constraints, further adversely affecting their economies. Additionally, because Russia produces and exports large amounts of oil, the Russian economy is especially vulnerable to the price of oil on the world market and a decline in the price of oil could slow or disrupt the Russian economy. Recent military conflicts and international terrorist activity have also significantly impacted oil and gas prices, and pose additional risks to the Russian economy. Russia and Ukraine are also major producers and exporters of metal products and their economies are vulnerable to world commodity prices and the imposition of



tariffs and/or antidumping measures by the United States, the European Union or by other principal export markets.

### **Political and Social Risks**

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

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

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

Similarly to Russia, Ukraine has experienced political instability since its independence in 1991, having seen nine changes in prime minister since 1991. The various state authorities, and the relations between them, as well as the Ukrainian government's policies and the political leaders who formulate and implement them, are subject to rapid change. For example, following the presidential elections in November 2004, mass demonstrations and strikes took place throughout Ukraine to protest the election process and results. While tensions in Ukraine appear to have subsided following the invalidation of the November election results and the new presidential election held on December 26, 2004, the long-term effects of these events and policy direction of the new government are not yet known.

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

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

The Russian Federation is a federation of 89 sub-federal political units, consisting of republics, territories, regions, cities of federal importance and autonomous regions and districts. The delineation of authority and jurisdiction among the members of the Russian Federation and the federal government is, in many instances, unclear and remains contested. Lack of consensus between the federal

government and local or regional authorities often results in the enactment of conflicting legislation at various levels and may lead to further political instability. In particular, conflicting laws have been enacted in the areas of privatization, land legislation and licensing. Some of these laws and governmental and administrative decisions implementing them, as well as certain transactions consummated pursuant to them, have in the past been challenged in the courts, and such challenges may occur in the future. This lack of consensus hinders our long-term planning efforts and creates uncertainties in our operating environment, both of which may prevent us from effectively and efficiently implementing our business strategy.

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

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

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

The political and economic changes in Russia and Ukraine in recent years have resulted in significant dislocations of authority. The local and international press have reported that significant 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 the commercial interests of the government officials or certain individuals. Additionally, published reports indicate that a significant number of Russian and Ukrainian media regularly publish slanted articles in return for payment. The depredations of organized or other crime, demands of corrupt officials or claims that we have been involved in official corruption may in the future bring negative publicity, could disrupt our ability to conduct our business effectively and could thus materially adversely affect our financial condition and results of operations.

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

The failure of the government and many private enterprises to pay full salaries on a regular basis and the failure of salaries and benefits generally to keep pace with the rapidly increasing cost of living

have led in the past, and could lead in the future, to labor and social unrest. For example, in 1998, miners in several regions of Russia, demanding payment of overdue wages, resorted to strikes which included blocking major railroads. More recently, mass protests and strikes erupted across Ukraine following the country's presidential election in November 2004. Such labor and social unrest may have political, social and economic consequences, such as increased support for a renewal of centralized authority; increased nationalism, with restrictions on foreign involvement in the economies of Russia and Ukraine; and increased violence. An occurrence of any of the foregoing events could restrict our operations and lead to the loss of revenue, materially adversely affecting our operations.

***Major changes in Ukraine-Russia relations may adversely affect our business.***

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

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

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

**Legal Risks**

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

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

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

Additionally, several fundamental laws have only recently become effective. The recent nature of much of Russian and Ukrainian legislation, the lack of consensus about the scope, content and pace of

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

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

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

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

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

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

In addition, in 2003 and 2004, the Ministry for Taxes and Levies has aggressively cracked down on certain Russian companies' use of tax-optimization schemes, and press reports have speculated that these enforcement actions have been selective and politically motivated. For example, in June 2004, a Russian court granted the tax authorities' claim against Yukos for payment of more than \$3 billion in back taxes. In addition, more than \$4 billion in back taxes were assessed against Yukos in September 2004. Similarly, in March 2004, oil company Sibneft was assessed over \$1 billion in back taxes. 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.

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

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

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

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

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

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

The Civil Code of the Russian Federation dated January 26, 1996, or the Civil Code, and the Federal Law on Joint Stock Companies of December 26, 1995, or the Federal Law on Joint Stock Companies, generally provide that shareholders in a Russian joint stock company are not liable for the obligations of the joint stock company and bear only the risk of loss of their investment. This may not be the case, however, when one person is capable of determining decisions made by another person or entity. The person or entity capable of determining such decisions is deemed an "effective parent." The person whose decisions are capable of being so determined is deemed an "effective subsidiary." 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 ability to determine decisions of the effective subsidiary arises. For example, this liability could arise through ownership of voting securities or by contract. In these instances, other shareholders of the effective subsidiary may claim compensation for the effective subsidiary's losses from the effective parent which caused the effective subsidiary to take action or fail to take action knowing that such action or failure to take action would result in losses. Accordingly, we could be liable in some cases for the debts of our consolidated subsidiaries. This liability could have a material adverse effect on our business, results of operations and financial condition.

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

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

- decisions with respect to a reorganization;
- the approval by shareholders of a "major transaction," which, in general terms, is a transaction involving property worth more than 50% of the gross book value of our assets calculated according to 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 MTS OJSC's net assets calculated in accordance with Russian accounting standards at the time the matter at issue is voted upon, could have a material adverse effect on our results of operations and financial condition.

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

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

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

The new Federal Law on Communications came into force on January 1, 2004. Among other things, this law provides for the establishment of a "universal services reserve fund" for the purpose of supporting communications companies operating in less developed regions of Russia. This reserve fund will be funded by a levy imposed on all communication services providers, including us. The Ministry of Communications has proposed setting the levy at 1.5%. However, the amount of this levy, the procedure of its collection and procedures for distribution from this reserve fund are still subject to

approval by the federal government. This additional levy will increase our costs and may materially adversely affect our financial condition and results of operations.

In addition, the new Ukrainian Law on Telecommunications also came into force on January 1, 2004. However, regulations implementing the new law have not yet been promulgated and certain regulatory bodies established by the new law have not yet commenced their regulatory functions. For example, the regulatory body tasked with regulating the telecommunications industry and issuing telecommunications licenses has yet to be formed, and no other regulatory authority has been designated under the law to perform these functions. In addition, the new Ukrainian Law on Telecommunications, among other things, may require companies with a dominant position in the telecommunications market to develop public telecommunications services if directed to do so by the regulatory authorities. See “Regulation—Regulation in Ukraine—Competition.” As UMC’s estimated market share in mobile telecommunication services in Ukraine is over 50%, implementation of the new law may materially 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 tax, or VAT;
- excise taxes and import duties;
- unified social tax; and
- property tax.

The tax environment in Russia has historically been complicated by the fact that various authorities have often issued contradictory pieces of tax legislation. For example, tax laws are unclear with respect to the deductibility of certain expenses and at times we have taken a position that may be considered aggressive by tax authorities, but that we consider to be in compliance with current law. Prior to 2003, 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—Regulation in the Russian Federation—Licensing of Telecommunications Services and Radio Frequency Allocation.” This uncertainty potentially exposes us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could result in a greater than expected tax burden and the suspension or termination of our telecommunications licenses.

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

In practice, the Russian tax authorities often interpret the tax laws in a way that rarely favors taxpayers, who often have to resort to court proceedings to defend their position against the tax authorities. Differing interpretations of tax regulations exist both among and within government ministries and organizations at the federal, regional and local levels, creating uncertainties and inconsistent enforcement. Tax declarations, together with related documentation such as customs declarations, are subject to review and investigation by a number of authorities, each of which may



impose fines, penalties and interest charges. Generally, taxpayers are subject to inspection for a period of three calendar years of their activities which immediately preceded the year in which the audit is carried out. As previous audits do not exclude subsequent claims relating to the audited period, the statute of limitations is not entirely effective. In addition, in some instances, new tax regulations have been given retroactive effect. Recently, the Constitutional Court of the Russian Federation ruled that VAT paid on a commercial enterprise's purchases, or input VAT, cannot be offset against VAT collected from sales to the extent that the input VAT was incurred on items purchased with borrowed funds.

Moreover, financial 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 of another entity in our group. In addition, payments of intercompany dividends are subject to a withholding tax of 9% to 15%, though this tax does not apply to dividends paid out further up the ownership chain once they have already been taxed at the lower level.

The foregoing conditions create tax risks in Russia that are more significant than typically found in countries with more developed tax systems, imposing additional burdens and costs on our operations, including management resources. In addition to our substantial tax burden, these risks and uncertainties complicate our tax planning and related business decisions, potentially exposing us to significant fines and penalties and enforcement measures despite our best efforts at compliance, and could materially adversely affect our business and the value of the notes.

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

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

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

***We face similar risks in other countries of the CIS.***

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

## **Risks Relating to the 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 notes offered hereby. Although application has been made to list the notes on the Luxembourg Stock Exchange, we cannot assure you 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.

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

We operate a significant portion of our business through our 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 relating to the notes offered hereby, as well as other outstanding notes, restricts our and our subsidiaries' ability to incur debt, we or our subsidiaries may incur substantial additional indebtedness. As of September 30, 2004, our subsidiaries had total outstanding obligations that effectively rank senior to the notes of \$486.1 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 taxation 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 in Russia 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 tax gross-up provisions are enforceable in Russia.

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 at the Option of the Issuer for Tax Reasons."

***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—EU Savings Directive.” 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 the 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 the Notes—Redemption at the Option of the Issuer for Tax Reasons.”

***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. 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 may be substantially less complete or researched than those of Western countries. Official statistics may also be produced on different bases than those used in Western countries. Any discussion of matters relating to Russia in this 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 in connection with their misuse of economic data.

***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 ordinary 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 Article 3 of 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 December 31, 2003	At September 30, 2004
	(Amounts in thousands)	
<b>Indebtedness:</b>		
\$250,000,000 10.95% notes due 2004 (issued in December 2001) <sup>(1)</sup> . . . .	\$ 249,332	\$ 249,862
\$50,000,000 10.95% notes due 2004 (issued in March 2002) <sup>(1)</sup> . . . . .	50,308	50,066
\$400,000,000 9.75% notes due 2008 (issued in January 2003) . . . . .	400,000	400,000
\$300,000,000 floating rate notes due 2004 (issued in August 2003) <sup>(2)</sup> . .	298,196	—
\$400,000,000 8.375% notes due 2010 (issued in October 2003) . . . . .	400,000	400,000
Total indebtedness . . . . .	<u>\$1,397,836</u>	<u>\$1,099,928</u>
<b>Shareholders' equity:</b>		
Share capital (issued and fully paid) 1,000 shares of par value \$125 . .	\$ 125	\$ 125
Retained earnings . . . . .	644	1,026
Total shareholders' equity . . . . .	<u>769</u>	<u>1,151</u>
Total capitalization <sup>(3)</sup> . . . . .	<u>\$1,398,605</u>	<u>\$1,101,079</u>

<sup>(1)</sup> These notes were redeemed in December 2004.

<sup>(2)</sup> These notes were redeemed in May 2004.

<sup>(3)</sup> In October 2004, the issuer entered into a loan agreement with Credit Suisse First Boston for \$140.0 million. For a description of this loan, see "Operating and Financial Review and Prospects—Liquidity and Capital Resources—Recent Financing Activities—Credit Suisse First Boston Loan."

The issuer had no other securities outstanding as of the dates indicated. Other than as set forth above, there has been no material change in the capitalization of the issuer since September 30, 2004.

## 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 issuances of the notes as set forth in the table above and 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; Boris Podolski, company director, residing in the Russian Federation; and Andrey Vinogradov, company director, residing in the Russian Federation.

The business address of each director of the issuer is 4 Marksistaya Street, Moscow 109147, Russian Federation.

## **USE OF PROCEEDS**

The net proceeds the issuer will receive from the offering, after deducting discounts, fees and expenses incurred in connection with the offering will be approximately \$396,428,061. The issuer will lend these proceeds to us pursuant to a loan agreement. We intend to use approximately \$70 million of the net proceeds from the offering to repay a \$140 million loan we received from Credit Suisse First Boston International in October 2004 for general corporate purposes. We intend to use the remaining net proceeds from the offering for general corporate purposes, including for (i) potential acquisitions of mobile cellular telecommunications providers in various regions of the Russian Federation and countries of the CIS and (ii) potentially increasing our interests in certain mobile cellular telecommunications providers through the acquisition of minority stakes. Any acquisitions that occur could be material. We can give no assurance that the acquisitions will be completed on favorable terms, or at all.

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 short-term debt and total capitalization at September 30, 2004, on a historical basis and as adjusted to give effect to the offering. For further information regarding our financial condition, see our consolidated financial statements and “Operating and Financial Review and Prospects.”

	September 30, 2004	
	Historical	As Adjusted
	(Amounts in thousands)	
<b>Short-term debt:</b>		
Capital lease obligations . . . . .	\$ 7,653	\$ 7,653
Bank loans and other debt . . . . .	75,592	75,592
\$250,000,000 10.95% notes due 2004 (issued in December 2001) <sup>(1)</sup> . . . . .	249,862	249,862
\$50,000,000 10.95% notes due 2004 (issued in March 2002) <sup>(1)</sup> . . . . .	50,066	50,066
Total short-term debt . . . . .	<u>\$ 383,173</u>	<u>\$ 383,173</u>
<b>Long-term debt:</b>		
Capital lease obligations . . . . .	\$ 5,061	\$ 5,061
Bank loans and other debt . . . . .	299,015	299,015
\$400,000,000 9.75% notes due 2008 (issued in January 2003) . . . . .	400,000	400,000
\$400,000,000 8.375% notes due 2010 (issued in October 2003) . . . . .	400,000	400,000
\$400,000,000 8.00% notes due 2012 . . . . .	—	400,000
Total long-term debt . . . . .	<u>1,104,076</u>	<u>1,504,076</u>
Total debt <sup>(2)</sup> . . . . .	<u>\$1,487,249</u>	<u>\$1,887,249</u>
<b>Shareholders' equity:</b>		
Common stock, 0.1 ruble par value per share (2,096,975,792 shares authorized; 1,993,326,138 issued; 1,986,124,030 shares outstanding) <sup>(3)</sup> . . . . .	\$ 50,558	\$ 50,558
Treasury stock (7,202,108 shares) . . . . .	(7,396)	(7,396)
Additional paid-in capital . . . . .	563,791	563,791
Unearned compensation . . . . .	(2,147)	(2,147)
Shareholder receivable . . . . .	(21,423)	(21,423)
Accumulated other comprehensive income . . . . .	8,925	8,925
Retained earnings . . . . .	<u>1,739,321</u>	<u>1,739,321</u>
Total shareholders' equity . . . . .	<u>2,331,629</u>	<u>2,331,629</u>
Total capitalization <sup>(4)</sup> . . . . .	<u>\$3,818,878</u>	<u>\$4,218,878</u>

<sup>(1)</sup> These notes were redeemed in December 2004.

<sup>(2)</sup> We incurred additional debt after September 30, 2004. See Note 11 to our interim condensed consolidated financial statements and “Operating and Financial Review and Prospects—Liquidity and Capital Resources—Recent Financing Activities” for further details.

<sup>(3)</sup> All issued shares are fully paid.

<sup>(4)</sup> Except as disclosed above, there have been no material changes in our capitalization since September 30, 2004.

## SELECTED CONSOLIDATED FINANCIAL AND OPERATING DATA

The selected consolidated financial data for the years ended December 31, 2001, 2002 and 2003, and as of December 31, 2002 and 2003, are derived from our annual consolidated financial statements, prepared in accordance with U.S. GAAP included elsewhere in this offering memorandum. The selected consolidated financial data as of and for the nine months ended September 30, 2003 and 2004 are derived from the interim condensed consolidated financial statements, prepared in accordance with U.S. GAAP included elsewhere in this offering memorandum 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 consolidated financial data for the years ended December 31, 1999 and 2000, and as of December 31, 1999, 2000 and 2001, derived from our annual consolidated financial statements not included in this offering memorandum. Our results of operations are affected by acquisitions. Results of operations of acquired businesses are included in our consolidated financial statements from their respective dates of acquisition. The summary financial data should be read in conjunction with our consolidated financial statements, "Risk Factors" and "Operating and Financial Review and Prospects." Certain industry and operating data are also provided below.

	Years Ended December 31,					Nine Months Ended September 30,	
	1999	2000	2001	2002	2003	2003	2004
(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)							
<b>Consolidated statements of operations data:</b>							
<b>Net operating revenues:</b>							
Service revenues and connection fees <sup>(1)</sup> . . . . .	\$327,323	\$499,354	\$851,374	\$1,299,141	\$2,465,089	\$1,715,749	\$2,741,553
Sales of handsets and accessories . . . . .	31,004	36,358	41,873	62,615	81,109	58,748	65,785
Total net operating revenues . . . . .	358,327	535,712	893,247	1,361,756	2,546,198	1,744,497	2,807,338
<b>Operating expenses:</b>							
Cost of services, exclusive of depreciation and amortization shown separately below . . . . .	60,683	83,093	143,665	196,445	301,108	210,199	335,480
Cost of handsets and accessories, exclusive of depreciation and amortization shown separately below . . . . .	29,932	39,217	39,828	90,227	173,071	112,996	149,272
Sales and marketing expenses . . . . .	23,722	76,429	107,729	171,977	326,783	219,352	298,401
Depreciation and amortization . . . . .	53,766	87,684	133,318	209,680	415,916	288,112	450,742
Sundry operating expenses <sup>(2)</sup> . . . . .	74,612	110,242	134,598	229,056	406,722	294,015	427,260
Impairment of investment . . . . .	—	—	10,000	—	—	—	—
Net operating income . . . . .	115,612	139,047	324,109	464,371	922,598	649,823	1,146,183
Currency exchange and translation losses (gains) . .	3,238	1,066	2,264	3,474	(693)	(4,481)	(2,647)
<b>Other expenses (income):</b>							
Interest income . . . . .	(801)	(7,626)	(11,829)	(8,289)	(18,076)	(11,743)	(18,577)
Interest expenses . . . . .	11,805	11,335	6,944	4,389	106,551	70,013	78,828
Other expenses (income), net . . . . .	(829)	(502)	(2,672)	(2,454)	3,420	12,251	(22,006)
Total other expenses (income), net . . . . .	10,175	3,207	(7,557)	33,646	91,895	70,521	38,245
Income before provision for income taxes and minority interest . . . . .	102,199	134,774	329,402	427,251	831,396	584,143	1,110,585
Provision for income taxes . . . . .	18,829	51,154	98,128	110,417	242,480	160,514	269,590
Minority interest . . . . .	(2,291)	(6,428)	7,536	39,711	71,677	59,139	27,372
Net income before cumulative effect of a change in accounting principle . . . . .	85,661	90,048	223,738	277,123	517,239	364,490	813,623
Cumulative effect of a change in accounting principle, net of income taxes of \$9,644 in 2001 .	—	—	(17,909)	—	—	—	—
Net income . . . . .	<u>\$ 85,661</u>	<u>\$ 90,048</u>	<u>\$205,829</u>	<u>\$ 277,123</u>	<u>\$ 517,239</u>	<u>\$ 364,490</u>	<u>\$ 813,623</u>

	Years Ended December 31,					Nine Months Ended September 30,	
	1999	2000	2001	2002	2003	2003	2004
	(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)						
Dividends declared . . . . .	\$11,879	\$13,631	\$2,959	\$ —	\$111,355 <sup>(3)</sup>	\$111,355 <sup>(3)</sup>	\$219,950 <sup>(3)</sup>
Pro forma net income giving effect to the change in accounting principle, had it been applied retroactively . . .	78,258	93,108	223,738	277,123	517,239	364,490	813,623
Net income per share, basic and diluted . . . . .	0.05	0.05	0.10	0.14	0.26	0.18	0.41
Dividends declared per share . . . . .	0.01	0.01	—	—	0.06	0.056	0.111
Weighted average number of shares of common stock outstanding . . . . .	1,634,527,040	1,806,968,096	1,983,359,507	1,983,359,507	1,983,374,949	1,983,359,507	1,983,958,588
<b>Consolidated cash flow data:</b>							
Cash provided by operating activities . . . . .	\$116,801	\$190,914	\$338,201	\$412,772	\$965,984	\$667,766	\$1,281,221
Cash used in investing activities . . . . . (of which capital expenditures) <sup>(4)</sup> . . . . .	(115,184)	(423,349)	(441,523)	(697,921)	(1,910,087)	(1,315,268)	(823,271)
Cash (used in) provided by financing activities . . . . .	(11,557)	298,543	247,592	100,817	997,545	760,699	(356,760)
<b>Consolidated balance sheet data (end of period):</b>							
Cash, cash equivalents and short-term investments . .	\$10,000	\$245,828	\$304,933	\$64,661	\$335,376	\$177,269	\$243,274
Property, plant and equipment, net . . . . .	250,270	439,307	856,056	1,344,633	2,256,076	2,068,404	2,808,573
Total assets . . . . .	682,047	1,101,332	1,727,492	2,283,296	4,225,351	3,784,956	4,865,698
Total debt (long-term and short-term) <sup>(5)</sup> . . . . .	112,123	52,773	325,840	454,485	1,660,334	1,394,413	1,487,249
Total shareholders' equity .	343,724	801,084	1,018,279	1,302,044	1,723,910	1,561,210	2,331,629
Including capital stock . . .	49,276	40,352	40,352	40,352	40,361	40,361	43,162
<b>Financial ratios (end of period):</b>							
Total debt/total capitalization <sup>(6)</sup> . . . . .	24.6%	6.2%	24.2%	25.9%	49.1%	47.2%	39.0%
<b>Industry and operating data:<sup>(7)</sup></b>							
Mobile penetration in Russia (end of period) . .	1%	2%	6%	12%	25%	21%	41%
Mobile penetration in Ukraine (end of period) .	—	—	—	—	13%	11%	22%

	Years Ended December 31,					Nine Months Ended September 30,	
	1999	2000	2001	2002	2003	2003	2004
(Amounts in thousands, except share and per share amounts, industry and operating data and ratios)							
Subscribers in Russia (end of period, thousands) <sup>(8)</sup> . . .	306	1,194	2,650	6,644	13,370	11,344	20,842
Subscribers in Ukraine (end of period, thousands) <sup>(8)</sup> . .	—	—	—	—	3,350	2,550	5,528
Overall market share in the Moscow license area (end of period) . . . . .	40%	55%	50%	43%	43%	43%	45%
Overall market share in Russia (end of period) . . . . .	23%	35%	33%	38%	37%	37%	35%
Overall market share in Ukraine (end of period) . . . . .	—	—	—	—	51%	48%	52%
Average monthly usage per subscriber in Russia (minutes) <sup>(9)</sup> . . . . .	224	151	157	159	144	150	156
Average monthly service revenue per subscriber in Russia <sup>(10)</sup> . . . . .	\$124	\$54	\$36	\$23	\$17	\$19	\$14
Average monthly usage per subscriber in Ukraine (minutes) <sup>(9)</sup> . . . . .	—	—	—	—	97	95	123
Average monthly service revenue per subscriber in Ukraine <sup>(10)</sup> . . . . .	—	—	—	—	\$15	\$18	\$15
Subscriber acquisition costs in Russia <sup>(11)</sup> . . . . .	\$148	\$69	\$56	\$35	\$26	\$23	\$21
Subscriber acquisition costs in Ukraine <sup>(11)</sup> . . . . .	—	—	—	—	\$32	\$34	\$21
Churn in Russia <sup>(12)</sup> . . . . .	20.7%	21.6%	26.8%	33.9%	47.3%	34.9%	23.7%
Churn in Ukraine <sup>(12)</sup> . . . . .	—	—	—	—	23.8%	19.4%	16.6%

(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. Service revenues amounted to \$314.6 million, \$484.5 million, \$830.3 million, \$1,274.3 million and \$2,435.7 million for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively, and \$1,690.9 million and \$2,705.1 million for the nine months ended September 30, 2003 and 2004, respectively. Guest roaming fees included in service revenues were \$44.0 million, \$43.2 million, \$52.6 million, \$83.4 million and \$112.0 million for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively, and \$81.6 million and \$71.9 million for the nine months ended September 30, 2003 and 2004, respectively.

(2) Sundry operating expenses include taxes (other than income taxes), primarily revenue and property-based taxes, of \$15.6 million, \$26.9 million, \$25.3 million, \$39.1 million and \$40.4 million for the years ended December 31, 1999, 2000, 2001, 2002 and 2003, respectively, and \$28.2 million and \$29.4 million for the nine months ended September 30, 2003 and 2004, respectively.

(3) Includes dividends on treasury shares of \$0.4 million and \$1.1 million for the nine months ended September 30, 2003 and 2004, respectively.

(4) Capital expenditures include purchases of property, plant and equipment and intangible assets.

(5) Includes notes payable, bank loans, capital lease obligations and other debt.

(6) 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 5 above for the definition of "total debt."

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

(8) We define a subscriber as an individual or organization whose account shows chargeable activity within the previous 61 days (or 183 days in the case of the "Jeans" brand tariffs) and whose account does not have a negative balance for more than this period.

(9) 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 subscribers during such period and dividing by the number of months in such period. For Ukraine, the figure has been calculated based on the months of March through December 2003.

(10) Average monthly service revenue per subscriber is calculated 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. For Ukraine, the 2003 figure has been calculated based on the months of March through December 2003.

(11) Subscriber acquisition costs are calculated as total sales and marketing expenses for the period per additional subscriber. Effective January 1, 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. For Ukraine, the 2003 figure has been calculated based on the months of March through December 2003.

(12) We define churn as the total number of subscribers who cease to be a subscriber (as defined above) during the period (whether involuntarily due to non-payment or voluntarily, at such subscriber's request, including those switching to a different tariff plan), expressed as a percentage of the average number of subscribers during that period. For Ukraine, the 2003 figure has been annualized based on the months of March through December 2003.

## OPERATING AND FINANCIAL REVIEW AND PROSPECTS

*The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements, related notes and other financial information. This section contains forward-looking statements that involve risk and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements as a result of various factors, including those described under “Risk Factors” and “Cautionary Statement Regarding Forward-Looking Statements.” Our consolidated financial statements have been prepared in accordance with U.S. GAAP.*

### Overview

We are the largest mobile operator in Russia and Ukraine in terms of subscribers. Revenues for the nine months ended September 30, 2004 were \$2,807.3 million, an increase of 58.2% from the nine months ended September 30, 2003. Net income for the nine months ended September 30, 2004 was \$813.6 million, up 123.2% from the nine months ended September 30, 2003. At September 30, 2004, we had a subscriber base of 26.6 million (20.8 million in Russia, 5.5 million in Ukraine and 0.3 million in Uzbekistan).

Our revenues have increased through organic growth, as well as through acquisitions. During March to July 2003, we acquired 100% of UMC, a mobile operator in Ukraine, for approximately \$378.3 million in cash and assumed debt of UMC in the amount of \$62.0 million. UMC's results of operations have been included in our consolidated financial statements beginning March 1, 2003. For the nine months ended September 30, 2003 and 2004, UMC accounted for approximately 14.2% and 20.6%, respectively of our net revenues. We acquired a 74% stake in Uzdunrobita in August 2004, and Uzdunrobita's results of operations have been included in our interim condensed consolidated financial statements beginning August 1, 2004. For the period from August to September 2004, Uzdunrobita had net revenues of \$10.1 million. We spent \$75.9 million, \$143.4 million, \$667.2 million and \$172.2 million in cash (net of cash acquired) in 2001, 2002 and 2003 and in the nine months ended September 30, 2004, respectively, to acquire businesses. In addition, in September 2004, we spent another \$63.0 million to exercise our call option and acquire the remaining shares of TAIF Telecom (see Note 2 to our interim condensed consolidated financial statements).

We require significant funds to support our subscriber growth, primarily for increasing network capacity and developing networks in new license areas. Our cash outlays for capital expenditures (consisting of purchases of property, plant and equipment and intangible assets) in 2001, 2002 and 2003 and in the nine months ended September 30, 2004 were \$441.2 million, \$574.3 million, \$958.8 million and \$780.2 million, respectively. We have financed our cash requirements through our operating cash flows and borrowings. Net cash provided by operating activities in 2001, 2002 and 2003 and in the nine months ended September 30, 2004 was \$338.2 million, \$412.8 million, \$966.0 million and \$1,281.2 million, respectively. Over the last few years, we have raised a total of \$1.4 billion million through five U.S. dollar-denominated unsecured notes offerings in international capital markets. In July 2004, a syndicate of international banks made available to us an unsecured loan facility in an aggregate amount of \$500.0 million, which is repayable in three years. In September 2004, this syndicated loan facility was increased to \$600.0 million of which we have drawn \$200.0 million as of September 30, 2004. As of September 30, 2004, we had indebtedness of approximately \$1.49 billion, and our interest expense for the nine months ended September 30, 2004 was \$78.8 million, net of amounts capitalized.

We hold a 49% equity investment in a mobile operator in Belarus, MTS Belarus, which had 0.97 million subscribers as of September 30, 2004. MTS Belarus is an equity investment, and its results are not consolidated in our financial statements. The remaining stake in MTS Belarus is owned by a Belarus state-owned enterprise.

## Segments

We have several operating segments corresponding to separate legal entities within our group. For reporting purposes, we group them as follows: (1) our company, Mobile TeleSystems OJSC, or MTS OJSC, which holds licenses for and operates in the Moscow license area and a number of areas outside of Moscow; (2) our subsidiary, Telecom XXI, which holds licenses for and operates in St. Petersburg and a number of areas in northwest Russia; (3) our subsidiary, UMC, which holds licenses for and operates in Ukraine; and (4) several other smaller subsidiaries, which hold licenses for and operate in the different regions of Russia and our newly acquired subsidiary, Uzdunrobita, which holds licenses for and operates in Uzbekistan, which we call “Other regions.” See Note 10 to our interim condensed consolidated financial statements for segment information.

## Subscriber Data

The following table shows our subscribers by country as of the dates indicated.

	At December 31,			At September 30,	
	2001	2002	2003	2003	2004
	(in thousands)				
<b>Subscribers<sup>(1)</sup></b>					
Russia, including: . . . . .	2,650	6,644	13,370	11,344	20,842
MTS OJSC . . . . .	2,275	3,746	6,529	6,036	11,146
Moscow license area . . . . .	2,035	3,082	4,936	4,488	6,697
Telecom XXI . . . . .	—	854	1,666	1,438	2,320
Other Russian regions . . . . .	375	2,044	5,175	3,870	7,376
Ukraine (UMC) . . . . .	—	—	3,350	2,550	5,528
Uzbekistan (Uzdunrobita) . . . . .	—	—	—	—	263
Total consolidated . . . . .	<u>2,650</u>	<u>6,644</u>	<u>16,720</u>	<u>13,894</u>	<u>26,633</u>
MTS Belarus (unconsolidated) . . . . .	—	43	465	309	970

<sup>(1)</sup> We define a subscriber as an individual or organization whose account shows chargeable activity within the previous 61 days (or 183 days in the case of the “Jeans” brand tariffs) and whose account does not have a negative balance for more than this period.

We had approximately 20.8 million subscribers in Russia at September 30, 2004 of which 6.7 million were in the Moscow license area that encompasses the City of Moscow and the Moscow region. According to AC&M-Consulting, approximately 25% of all mobile cellular subscribers in Russia reside in the Moscow license area, where penetration stood at approximately 87% as of September 30, 2004. Penetration in all of Russia was lower, at approximately 41%, according to AC&M-Consulting. Our subscribers in Russia outside of the Moscow license area totaled approximately 14.1 million as of September 30, 2004. According to AC&M-Consulting, as of September 30, 2004, we had a leading 35% market share of total mobile cellular subscribers in Russia. Our market share in the Moscow license area was higher at 45% as of September 30, 2004, according to AC&M-Consulting. We had approximately 5.5 million subscribers in Ukraine as of September 30, 2004 and, according to AC&M-Consulting, a 52% market share of total mobile cellular subscribers in Ukraine. In addition, we had approximately 0.3 million subscribers in Uzbekistan, representing a 51% market share, according to AC&M-Consulting.

We consider subscribers who are disconnected from our network, whether involuntarily due to non-payment or voluntarily, at such subscribers’ request (including those switching to a different tariff plan), and subscribers who do not use chargeable services for more than 61 days in any given period as churned subscribers (or 183 days in the case of our “Jeans” brand tariffs). 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 Russian and Ukrainian subscriber churn for the periods indicated.

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003 <sup>(1)</sup>	2004 <sup>(1)</sup>
<b>Subscriber Churn</b>					
Russia . . . . .	26.8%	33.9%	47.3%	34.9%	23.7%
Ukraine . . . . .	—	—	23.8% <sup>(2)</sup>	19.4% <sup>(3)</sup>	16.6%

<sup>(1)</sup> Nine-month data not comparable to annual data.

<sup>(2)</sup> Calculated based on the months of March through December 2003.

<sup>(3)</sup> Calculated based on the months of March through September 2003.

The churn rate is highly dependent on competition in our license areas and those subscribers who migrate as a result of such competition. The decrease in our churn rate during the first nine months of 2004 occurred mainly due to successful marketing initiatives, focused on customer loyalty.

While our subscribers and revenues have been growing, our average monthly service revenue per subscriber has 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 our average monthly service revenue per subscriber and average monthly minutes of use per Russian and Ukrainian subscriber for the periods indicated.

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
<b>Average monthly service revenue per subscriber</b>					
Russia . . . . .	\$ 36	\$ 23	\$ 17	\$ 18	\$ 14
Ukraine . . . . .	—	—	\$ 15 <sup>(1)</sup>	\$ 16 <sup>(2)</sup>	\$ 14
<b>Average monthly minutes of use per subscriber</b>					
Russia . . . . .	\$157	\$159	\$144	\$151	\$157
Ukraine . . . . .	—	—	\$ 97 <sup>(1)</sup>	\$ 95 <sup>(2)</sup>	\$123

<sup>(1)</sup> Calculated based on the months of March through December 2003.

<sup>(2)</sup> Calculated based on the months of March through September 2003.

Average monthly service revenue per subscriber for Russia decreased from \$23 for the year ended December 31, 2002 to \$17 for the year ended December 31, 2003 and from \$18 for the nine months ended September 30, 2003 to \$14 for the nine months ended September 30, 2004. We expect a continued decline in average monthly service revenue per subscriber due to tariff decreases and the increasing ratio of mass-market subscribers with lower average monthly service revenue per subscriber in our subscriber mix. Average monthly minutes of use per subscriber is increasing due to tariff decreases and other general factors resulting in increased mobile use. See “Risk Factors—Risks Relating to Our Business—Increased competition and a more diverse subscriber base have resulted in decreasing average monthly service revenues per subscriber, which may materially adversely affect our results of operations.”



The following table shows the mix between Jeans and non-Jeans subscribers for Russia and Ukraine for the periods indicated. The “Jeans” brand tariffs were introduced in November 2002. For a description of our Jeans and SIM-SIM brands, see “Business—Tariffs.”

	At December 31,			At September 30,	
	2001	2002	2003	2003	2004
<b>Russia</b>					
Jeans . . . . .	—	3%	44%	25%	71%
Non-Jeans . . . . .	100%	97%	56%	75%	29%
<b>Ukraine</b>					
Jeans (including SIM-SIM) . . . . .	—	—	79%	76%	83%
Non-Jeans . . . . .	—	—	21%	24%	17%

## Revenues

Our principal sources of revenue are:

- service revenues, including usage fees, monthly subscription fees, roaming and value-added service fees, and connection fees; and
- revenues from sales of 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 in Russia, while in Ukraine there have been cases where governmental authorities imposed restrictions on our tariffs. For example, in April 2004 we reduced some of our tariffs in Ukraine due to these restrictions.

### Service Revenues and Connection Fees

*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, our “Jeans” tariff subscribers receive all incoming calls from certain other mobile providers free of charge.

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 as a percentage of total net revenues were 69.3% in 2001, 67.3% in 2002, 71.7% in 2003, 72.2% and 80.8% in the nine months ended September 30, 2003 and 2004, respectively. The further development of our “Jeans” tariff, which has no monthly subscription fee, will support growth of the usage fees as a percentage of total revenues. 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 as a percentage of our total net revenues represented 16.9% in 2001, 18.2% in 2002, 17.9% in 2003, 18.4% and 12.7% in the nine months ended September 30, 2003 and 2004, respectively.

The main reason for the decline of the monthly subscription fees as a percentage of total net revenues is a decrease in the share of subscribers with a monthly subscription fee in the subscriber mix. 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 6.7% of our total net revenues in 2001, 6.7% in 2002, 6.0% in 2003, 4.6% and 2.6% in the nine months ended September 30, 2003 and 2004, 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. In addition, roaming tariffs between mobile operators have a tendency to decrease relative to the increase of total number of mobile users.

We offer our subscribers an array of value-added services, including SMS, call forwarding, call waiting, call barring, call identification, voice mail, itemized billing and content-based services. For the years ended December 31, 2002 and 2003 and the nine months ended September 30, 2003 and 2004 monthly average SMS usage was 10, 16, 13 and 21 text messages sent per subscriber in Russia, respectively. These services have historically comprised less than 10% 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 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 the initial connection to our network and sign-up for value-added services. We defer connection fees and recognize them as revenues over the estimated average subscriber life as described in Note 1 to our interim condensed consolidated financial statements. Connection fees represented 2.3% of our total net revenues in 2001, 1.8% in 2002, 1.2% in 2003, 1.4% and 1.3% in the nine months ended September 30, 2003 and 2004, respectively. We expect connection fee revenues to remain at a low level as a percentage of total net revenues.

#### **Sales of Handsets and Accessories**

We sell handsets and accessories directly to subscribers in our sales offices and also to dealers for further resale. Since 1998, we have offered subscribers primarily 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 4.7% of our total net revenue in 2001, 4.6% in 2002, 3.2% in 2003, 3.3% and 2.3% in the nine months ended September 30, 2003 and 2004, respectively. Our average selling price of handsets declined significantly between 2000 and 2003 and continued to decline in the nine months ended September 30, 2004. We generally do not subsidize handset sales in Russia, but in Ukraine, we subsidize handsets for contract subscribers. See “—Expenses—Cost of Handsets and Accessories” below.

We expect the demand for our handsets and accessories to continue to decrease due to the availability of cheaper “grey” market handsets entering the market. In addition, many new subscribers already own handsets, either purchased on the grey market or because they are churn clients from other operators. We expect 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.

## Expenses

Our principal expenses are:

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

### Cost of Services

*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.

### Cost of Handsets and Accessories

This type of expense includes primarily the cost of handsets and accessories sold to dealers and subscribers, and the cost of SIM cards provided to our customers. 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 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 Ukraine, we subsidize handsets for contract subscribers. In the nine months ended September 30, 2003 and 2004, we provided net handset subsidies in Ukraine for a total cost of \$28.1 million and \$36.0 million, respectively, which are reported as loss on sales of handsets. However, we do not subsidize handset sales in Russia.

Generally, we provide SIM cards to our customers free of charge. Cost of SIM cards used amounted to \$13.4 million in 2001, \$26.3 million in 2002, \$68.3 million in 2003, \$39.0 million and \$56.1 million in the nine months ended September 30, 2003 and 2004, respectively. The growth of SIM cards expense in the nine months ended September 30, 2004 was primarily the result of an increase in subscribers and internal churn within our subscriber base.

### **Sales and Marketing Expenses**

Our sales and marketing expenses primarily consist of:

- dealer commissions on new connections and advances collection from subscribers; 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 in our license areas and are expected to increase as subscriber numbers and market competition increase. In addition, we expect these costs to increase as we further develop our brand and introduce value-added services.

Prior to February 1, 2004, in Russia, we paid the full amount of commission when a dealer activated a subscriber's contract. If such subscriber's usage of our voice and non-voice services over the following six-month period amounted to less than the amount of the dealer's commission, the dealer was required to reimburse the difference to us. Commencing on February 1, 2004, dealer commission contracts have been gradually migrated to a new payment scheme. Specifically, we have begun linking commissions payable to a dealer on a monthly basis to the amount of revenues we receive during the twelve-month period from the date a subscriber is activated by such dealer. In addition, we have established caps or a maximum commission amount for our dealers. We believe that the new method for paying commissions to dealers provides dealers with greater incentives to renew subscriptions, reduces the risk of dealer fraud and improves our cash-flow management.

### **General and Administrative Expenses**

Our general and administrative expenses consist primarily of:

- employee salaries and bonuses;
- social contributions payable to the government;
- taxes other than income taxes, *e.g.*, taxes based on sales and property taxes;
- office maintenance expenses;
- provision for doubtful accounts;
- network repair and maintenance; and
- rent.

Total general and administrative 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—Customer Payments and Billing." However, our general and administrative expenses for the year ended December 31, 2003 included \$32.6 million of provision expense in comparison with \$7.0 million of provision expense incurred in 2002 mainly due to dealer and subscriber fraud discovered in the first quarter of 2003 for the amount of \$16.7 million. Our general and administrative expenses for the nine months ended September 30, 2004 included \$17.4 million of bad debt expense compared to \$28.7 million of bad debt expense in the nine months ended September 30, 2003 also mainly due to the fraud that occurred in 2003, as described above. See

“Risk Factors—Risks Relating to Our Business—Our failure to implement the necessary infrastructure to manage our growth could have a material adverse effect on our business and results of operations.”

We measure subscriber acquisition costs, or SAC, to monitor the cost-effectiveness of our sales and marketing. We define SAC as total sales and marketing expenses for the period per additional subscriber. The following table shows SAC by segment for the periods indicated:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
<b>Subscriber Acquisition Costs (SAC)</b>					
Russia . . . . .	\$ 56	\$ 35	\$ 26	\$ 26	\$ 22
MTS OJSC . . . . .	\$ 65	\$ 48	\$ 32	\$ 31	\$ 26
Telecom XXI . . . . .	—	\$ 24	\$ 22	\$ 22	\$ 22
UMC . . . . .	—	—	\$ 32 <sup>(1)</sup>	\$ 37 <sup>(2)</sup>	\$ 21
Other regions . . . . .	\$ 22	\$ 18	\$ 17	\$ 18	\$ 15

<sup>(1)</sup> Calculated based on the months of March through December 2003.

<sup>(2)</sup> Calculated based on the months of March through September 2003.

### **Depreciation of Property, Network Equipment and Amortization of Intangibles**

We expect depreciation expense, which is principally associated with the depreciation of network equipment, to continue to increase in line with our network development program and the buildout 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 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. At that date, we reclassified the carrying value of goodwill of \$22.0 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 in the nine months ended September 30, 2004 on our research and development activities.

### **Interest Expense**

We expect interest expense to continue to increase, which is principally associated with external debt incurred to finance our network development program and the buildout associated with our regional license areas.

### **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 and the nine

months ended September 30, 2004, these expenses were computed according to several special deductibility regulations. These regulations combined 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 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 2001, our statutory income tax rate in Russia was 35%. Effective January 1, 2002, the statutory income tax rate was reduced to 24%. As the result of this reduction, we recognized a net deferred tax benefit of approximately \$22.0 million in 2001.

In 2003, the statutory income tax rate in Ukraine was 30%. From January 1, 2004, the Ukrainian statutory income tax rate changed to 25% as a result of changes in legislation. As the result of this reduction, we recognized a net deferred tax expense of approximately \$4.8 million in 2003.

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.

## **Acquisitions**

Our results of operations for the periods presented are significantly affected by acquisitions. Results of operations of acquired businesses are included in our consolidated financial statements for the periods after their respective dates of acquisition.



Below is the list of our major acquisitions during 2001, 2002 and 2003 and in the nine months ended September 30, 2004.

<u>Company</u>	<u>License area</u>	<u>Date of acquisition</u>	<u>Stake acquired</u>	<u>Purchase price*</u> (in millions)
<b>2001</b>				
Telecom XXI	10 regions in northwest Russia, including St. Petersburg	May 2001	100.0%	\$ 49.7
Telecom-900	Controlling stake in 3 regional operators: (1) 60% of FECS-900 (several regions in the Far East of Russia); (2) 53% of Uratel (Ural region); and (3) 51% of SCS-900 (several regions in the Siberian part of Russia)	August 2001	81.0%	26.8
				<b>\$ 76.5</b>
<b>2002</b>				
Kuban-GSM	Krasnodar region	March 2002	51.0%	\$ 71.4
Kuban-GSM	Krasnodar region	October 2002	1.7%	5.0
BM-Telecom	Bashkortostan Republic	May 2002	100.0%	41.0
MTS-Barnaul	Altai region	July 2002	100.0%	2.4
Dontelecom	Rostov region	October 2002	100.0%	22.5
BIT	4 regions in the Far East of Russia	October 2002	100.0%	0.9
Telecom-900	See above	November 2002	19.0%	6.9
				<b>\$150.1</b>
<b>2003</b>				
UMC	Ukraine	March 2003	57.7%	\$199.0
UMC	Ukraine	June 2003	26.0%	87.6
UMC	Ukraine	July 2003	16.3%	91.7
TAIF Telcom	Tatarstan Republic and Volga region	April 2003	51.0%	61.0
TAIF Telcom	Tatarstan Republic and Volga region	May 2003	1.7%	2.3
Sibchallenge	Krasnoyarsk region	August 2003	100.0%	45.5
Vostok Mobile BV	50% stake in Primtelefon (several regions in the Far East of Russia)	August 2003	100.0%	29.0
Uraltel	Ural region	August 2003	46.7%	35.7
TSS	Eastern Siberia	September 2003	100.0%	47.0
Kuban-GSM	Krasnodar region	September 2003	47.3%	107.0
				<b>\$705.8</b>
<b>Nine Months Ended September 30, 2004</b>				
SCS-900	Several regions in the Siberian part of Russia	March 2004	11.0%	\$ 8.5
FECS-900	Several regions in the Far East of Russia	April 2004	40.0%	8.3
MSS	Eastern Siberia	April 2004	7.5%	2.2
Primtelefon	Several regions in the Far East of Russia	June 2004	50.0%	31.0
UDN-900	Udmurtiya Republic	July 2004	49.0%	6.4
Volgograd Mobile	Volga region	August 2004	50.0%	2.9
Astrakhan Mobile	Volga region	August 2004	50.0%	1.1
Uzdunrobita	Uzbekistan	August 2004	74.0%	121.0
				<b>\$181.4</b>

\* Excluding acquisition-related costs and debt assumed.

See also Note 11 to our interim condensed consolidated financial statements for additional acquisitions since September 30, 2004.

## Results of Operations

The following table sets forth selected financial information by reportable segment.

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
<b>Revenues</b>					
MTS OJSC . . . . .	\$831,857	\$1,044,877	\$1,471,198	\$1,065,798	\$1,544,845
Telecom XXI . . . . .	—	79,166	210,460	147,498	219,799
UMC . . . . .	—	—	394,038	251,549	586,445
Other regions . . . . .	64,780	291,143	601,171	402,654	723,826
Eliminations <sup>(1)</sup> . . . . .	(3,390)	(53,430)	(130,669)	(93,002)	(267,577)
Revenues as reported . . . . .	<u>\$893,247</u>	<u>\$1,361,756</u>	<u>\$2,546,198</u>	<u>\$1,774,497</u>	<u>\$2,807,338</u>
<b>Costs of services and cost of handsets and accessories, exclusive of depreciation and amortization shown separately below</b>					
MTS OJSC . . . . .	\$168,323	\$ 235,957	\$ 315,021	\$ 228,885	\$ 401,314
Telecom XXI . . . . .	—	18,415	33,348	23,555	32,293
UMC . . . . .	—	—	94,959	57,275	150,571
Other regions . . . . .	17,144	75,467	141,765	93,069	148,814
Eliminations <sup>(1)</sup> . . . . .	(1,974)	(43,168)	(110,914)	(79,589)	(248,240)
Cost of services and cost of handsets and accessories as reported . . . . .	<u>\$183,493</u>	<u>\$ 286,672</u>	<u>\$ 474,179</u>	<u>\$ 323,195</u>	<u>\$ 484,752</u>
<b>Sundry operating expenses<sup>(2)</sup></b>					
MTS OJSC . . . . .	\$121,055	\$ 173,377	\$ 241,069	\$ 184,672	\$ 224,396
Telecom XXI . . . . .	—	18,894	28,071	20,580	33,333
UMC . . . . .	—	—	50,192	32,723	55,992
Other regions . . . . .	13,543	39,213	88,074	56,736	116,774
Eliminations <sup>(1)</sup> . . . . .	—	(2,428)	(684)	(696)	(3,235)
Sundry operating expenses as reported . . . . .	<u>\$134,598</u>	<u>\$ 229,056</u>	<u>\$ 406,722</u>	<u>\$ 294,015</u>	<u>\$ 427,260</u>
<b>Sales and marketing expenses</b>					
MTS OJSC . . . . .	\$102,806	\$ 125,841	\$ 187,325	\$ 130,400	\$ 161,417
Telecom XXI . . . . .	—	22,183	31,627	21,759	28,727
UMC . . . . .	—	—	50,791	30,635	51,899
Other regions . . . . .	5,516	27,599	58,672	38,180	63,884
Eliminations <sup>(1)</sup> . . . . .	(593)	(3,646)	(1,632)	(1,622)	(7,526)
Sales and marketing expenses as reported . . . . .	<u>\$107,729</u>	<u>\$ 171,977</u>	<u>\$ 326,783</u>	<u>\$ 219,352</u>	<u>\$ 298,401</u>
<b>Depreciation and amortization</b>					
MTS OJSC . . . . .	\$114,923	\$ 144,004	\$ 199,946	\$ 140,541	\$ 178,003
Telecom XXI . . . . .	—	17,343	36,782	25,669	35,143
UMC . . . . .	—	—	66,392	45,437	82,221
Other regions . . . . .	18,395	48,333	114,484	78,101	157,670
Eliminations <sup>(1)</sup> . . . . .	—	—	(1,688)	(1,636)	(2,295)
Depreciation and amortization as reported . . . . .	<u>\$133,318</u>	<u>\$ 209,680</u>	<u>\$ 415,916</u>	<u>\$ 288,112</u>	<u>\$ 450,742</u>
<b>Operating Income</b>					
MTS OJSC . . . . .	\$316,894	\$ 365,698	\$ 527,837	\$ 381,300	\$ 579,715
Telecom XXI . . . . .	—	2,331	80,632	55,935	90,303
UMC . . . . .	—	—	131,704	85,478	245,762
Other regions . . . . .	8,039	100,531	198,176	136,568	236,684
Eliminations <sup>(1)</sup> . . . . .	(824)	4,189	(15,751)	(9,458)	(6,281)
Operating income as reported . . . . .	<u>\$324,109</u>	<u>\$ 464,371</u>	<u>\$ 922,598</u>	<u>\$ 649,823</u>	<u>\$1,146,183</u>

(1) Represents the elimination of intercompany sales, sundry 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.

(2) For the purposes of this analysis “Sundry operating expenses” consists of general and administrative expenses and other operating expenses.

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

### **Revenues and cost of services and cost of handsets and accessories**

*Consolidated revenues* for the nine months ended September 30, 2004 increased by \$1,032.8 million, or 58.2%, to \$2,807.3 million from \$1,774.5 million for the nine months ended September 30, 2003. This increase was primarily due to the significant growth in our subscriber base from 13.9 million as of September 30, 2003 to 26.6 million as of September 30, 2004. As of September 30, 2003, UMC had 2.6 million subscribers, which grew to 5.5 million subscribers as of September 30, 2004. A portion of the growth in the subscriber base was due to acquisitions during the nine months ended September 30, 2004, including Uzdunrobita with 0.3 million subscribers and Primtelefon with 0.2 million subscribers. The growth was also attributable to our sales and marketing efforts and the expansion of our network, as well as improving general economic conditions and income levels in Russia and Ukraine. The increase in revenues from subscriber growth was partially offset by a decrease in tariffs in the Moscow and other highly competitive license areas, 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 by 22% from \$18 per subscriber for the nine months ended September 30, 2003 to \$14 for the nine months ended September 30, 2004.

For the nine months ended September 30, 2004, service revenues and connection fees increased by \$1,025.9 million, or 59.8%, to \$2,741.6 million compared to \$1,715.7 million for the nine months ended September 30, 2003 due to the growth in the number of our subscribers, as explained above. Revenues from sales of handsets and accessories increased by \$7.1 million, or 12.1%, for the nine months ended September 30, 2004 compared to the nine months ended September 30, 2003, due to growth of handsets sale activity. This growth was partially offset by a decline in the average selling price of handsets.

*Consolidated cost of services and cost of handsets and accessories* for the nine months ended September 30, 2004 increased by 50.0% to \$484.8 million from \$323.2 million for the nine months ended September 30, 2003. The increase in costs was primarily attributable to subscriber growth and related growth of traffic related expenses and cost of handsets and accessories sold. For the nine months ended September 30, 2004, interconnection and line rental expenses grew to \$241.7 million from \$127.3 million for the nine months ended September 30, 2003 and roaming expenses grew to \$93.8 million from \$82.9 million, respectively. For the nine months ended September 30, 2004, cost of handsets and accessories sold, including SIM cards provided to customers, grew to \$149.3 million from \$113.0 million for the nine months ended September 30, 2003.

*Consolidated gross margin* was \$2,322.6 million, or 82.7% of consolidated revenues for the nine months ended September 30, 2004, compared to \$1,451.3 million, or 81.8% of consolidated revenues for the nine months ended September 30, 2003. This increase in our consolidated gross margin percentage 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 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 nine months ended September 30, 2004 increased by 44.9% to \$1,544.8 million from \$1,065.8 million for the nine months ended September 30, 2003. Our subscriber base in the MTS OJSC license areas increased by 85% from 6.0 million as of September 30, 2003 to 11.1 million as of September 30, 2004. The effect on revenues of the increase in our subscriber base was partially offset by a decrease in the average selling prices of handsets and accessories, a decrease in

tariffs in the Moscow license area and an increase of mass-market subscribers share in our subscriber mix.

*MTS OJSC cost of services and cost of handsets and accessories* for the nine months ended September 30, 2004 increased by 75.3% to \$401.3 million from \$228.9 million for the nine months ended September 30, 2003. The growth occurred as a result of \$32.7 million and \$69.2 million increases in roaming expenses and cost of handsets and accessories, respectively. This was primarily driven by an increase in the number of subscribers and related growth of roaming traffic and cost of handsets and accessories sold. Roaming expenses increased to \$126.6 million, or 8.2% of segment revenues, for the nine months ended September 30, 2004 from \$93.9 million, or 8.8% of segment revenues, for the nine months ended September 30, 2003. Cost of handsets and accessories increased to \$133.2 million, or 8.6% of segment revenues, for the nine months ended September 30, 2004 from \$64.0 million, or 6.0% of segment revenues, for the nine months ended September 30, 2003.

*MTS OJSC gross margin* increased by 36.6% to \$1,143.5 million in the nine months ended September 30, 2004 from \$836.9 million in the nine months ended September 30, 2003. MTS OJSC's gross margin percentage decreased to 74.0% in the nine months ended September 30, 2004 from 78.5% in the nine months ended September 30, 2003. The main reason for the decrease in the gross margin by 4.5% was the significant growth in sales of equipment and handsets from MTS OJSC to subsidiaries. MTS OJSC charges minimal mark-up, ranging from 3% to 7%, on these sales. The effect of these transactions is eliminated in the consolidated financial statements.

*Telecom XXI revenues* for the nine months ended September 30, 2004 increased by 49.0% to \$219.8 million from \$147.5 million for the nine months ended September 30, 2003. Our subscriber base in the Telecom XXI license areas increased by 64.3% from 1.4 million as of September 30, 2003 to 2.3 million as of September 30, 2004. The growth of subscribers in percentage terms is higher than the growth of revenues mainly because the newly acquired subscribers have lower average monthly service revenue per subscriber compared to subscribers already connected to our network. This trend is typical when expanding subscriber base in a competitive environment.

*Telecom XXI cost of services and cost of handsets and accessories* for the nine months ended September 30, 2004 increased by 37.9% to \$32.4 million from \$23.5 million for the nine months ended September 30, 2003. This was primarily due to \$5.7 million and \$5.5 million increases in interconnection and line rental expenses and roaming expenses, respectively. Interconnection and line rental expenses increased to \$11.6 million, or 5.3% of segment revenues, in the nine months ended September 30, 2004 from \$5.9 million, or 4.0% of segment revenues, in the nine months ended September 30, 2003 mainly due to an increase of the number of base stations in use and overall growth in traffic on the network. Roaming expenses increased to \$14.7 million, or 6.7% of segment revenues, for the nine months ended September 30, 2004 from \$9.2 million, or 6.2% of segment revenues, for the nine months ended September 30, 2003 mainly due to subscriber growth and related traffic expenses.

*Telecom XXI gross margin* increased by 51.1% to \$187.4 million in the nine months ended September 30, 2004 from \$124.0 million in the nine months ended September 30, 2003. Telecom XXI gross margin percentage increased to 85.3% in the nine months ended September 30, 2004 from 84.1% in the nine months ended September 30, 2003. This increase is primarily the result of continued expansion of the network in 2004 and the related economies of scale effect.

*UMC revenues* for the nine months ended September 30, 2004 were \$586.4 million, while for the nine months ended September 30, 2003, \$251.5 million of UMC's revenues were consolidated with our results (representing revenues from the date of our acquisition of UMC in March 2003 to September 30, 2003). Growth in sales revenues occurred mainly due to an increase in UMC's subscriber base from 2.6 million, as of September 30, 2003, to 5.5 million, as of September 30, 2004.

*UMC cost of services and cost of handsets and accessories* for the nine months ended September 30, 2004 and for the period from March 1, 2003 to September 30, 2003 were \$150.5 million and \$57.3 million, respectively. The growth was mainly due to the increase in UMC's subscriber base.

*UMC gross margin* for the nine months ended September 30, 2004 grew to \$435.9 million from \$194.2 million for the period from March 1, 2003 to September 30, 2003. As a percentage of total revenues, gross margin decreased to 74.3% in nine months ended September 30, 2004, from 77.2% in same period in 2003. This decrease gross margin was mainly due to the introduction in September 2003 of the calling party pays scheme. Under this scheme, starting from September 2003, UMC pays termination fees to other mobile operators for calls initiated by its subscribers. During the nine months ended September 30, 2004, this scheme had a full effect on financial results, while during the same period in 2003, only the month of September was included.

*Other regions revenues* for the nine months ended September 30, 2004 increased by 79.8% to \$723.9 million from \$402.7 million for the nine months ended September 30, 2003. Our subscriber base in these regions increased by 89.7% from 3.9 million as of September 30, 2003 to 7.4 million as of September 30, 2004, which is the result of our expansion into the regions both through organic growth and acquisitions. As of September 30, 2004, we had commenced commercial operations in 63 regions of Russia, compared to 57 as of September 30, 2003. The growth of subscribers in percentage terms is higher than revenue growth mainly due to the fact that newly acquired subscribers have lower average monthly service revenue per subscriber compared to subscribers already connected to our network. This is a usual trend for expanding subscribers base in the competitive environment

*Other regions cost of services and cost of handsets and accessories* for the nine months ended September 30, 2004 increased by 59.8% to \$148.8 million from \$93.1 million for the nine months ended September 30, 2003 due to subscriber growth and related traffic expenses.

*Other regions gross margin* increased by \$265.5 million, or 85.8%, from \$575.1 million in the nine months ended September 30, 2003 to \$309.6 million in the nine months ended September 30, 2004, primarily due to the increase in the number of subscribers. Our gross margin percentage for the other regions segment increased to 79.4% in the nine months ended September 30, 2004 from 76.9% in the nine months ended September 30, 2003, which can be explained by the same factors discussed above with respect to the increase in the consolidated gross margin.

### **Sundry operating expenses**

*Consolidated sundry operating expenses* for the nine months ended September 30, 2004 increased by 45.3% to \$427.3 million from \$294.0 million for the nine months ended September 30, 2003. The increase in sundry operating expenses was largely attributable to the subscriber growth and the acquisition of UMC, which together contributed \$56.0 million to consolidated sundry operating expenses for the nine months ended September 30, 2004 after intercompany elimination. For the nine months ended September 30, 2003, only seven months of UMC's operations were consolidated, contributing \$32.7 million to sundry operating expenses in that period. In the nine months ended September 30, 2004, salary expenses and related social contributions increased by \$75.0 million due to an increase in personnel. In addition, network repair and maintenance expenses increased by \$23.3 million in the nine months ended September 30, 2004 due to the expansion and aging of our network, as compared to the same period in 2003. Generally, sundry operating expenses as a percentage of net revenues decreased to 15.2% for the nine months ended September 30, 2004 from 16.6% in the nine months ended September 30, 2003 due to economies of scale.

*MTS OJSC sundry operating expenses* for the nine months ended September 30, 2004 increased by 21.5% to \$224.4 million from \$184.7 million for the nine months ended September 30, 2003. The major reason for this growth was an increase in salaries, bonuses and related social contributions for additional personnel of \$39.9 million. Sundry operating expenses as a percentage of segment revenues



decreased to 14.5% for the nine months ended September 30, 2004 from 17.3% for the nine months ended September 30, 2003. This decrease was mainly due to a reduction in the bad debt provision expense from \$25.2 million for the nine months of 2003, or 2.4% of segment revenue, to \$9.6 million for the nine months of 2004, or 0.6% of segment revenue. The higher expense in the first nine months of 2003 was related to the dealer and subscriber fraud discovered in March 2003, as discussed above.

*Telecom XXI sundry operating expenses* for the nine months ended September 30, 2004 increased by 61.7% to \$33.3 million from \$20.6 million for the nine months ended September 30, 2003. The most significant increases were in the areas of salaries and related social contributions for additional personnel of \$4.6 million and repair and maintenance of \$4.6 million. The increases were primarily the result of the general expansion of our network in the region. Sundry operating expenses as a percentage of segment revenues increased to 15.2% for the nine months ended September 30, 2004, as compared to 14.0% for the nine months ended September 30, 2003. The main reason for this increase was one-off repair expenses incurred during the nine months ended September 30, 2004.

*UMC sundry operating expenses* for the nine months ended September 30, 2004 were \$56.0 million, or 9.5% of segment revenues, while for the nine months ended September 30, 2003 these expenses were \$32.7 million, or 13% of segment revenue. The increase in such expenses in absolute terms during the first nine months of 2004 was the result of an overall increase in UMC's activity. The main reason for the decrease in sundry operating expenses as a percentage of segment revenues was the economies of scale we achieved related to salary and repair and maintenance expenses.

*Other regions sundry operating expenses* for the nine months ended September 30, 2004 increased by 106.0% to \$116.8 million from \$56.7 million for the nine months ended September 30, 2003. The most significant increases were in the areas of salaries and related social contributions for additional personnel of \$24.2 million and repair and maintenance expenses for the expanded network of \$12.7 million. Sundry operating expenses as a percentage of segment revenues increased to 16.1% for the nine months ended September 30, 2004, as compared to 14.1% for the nine months ended September 30, 2003 due to higher expenses in connection with our continuing expansion into the regions.

### **Sales and marketing expenses**

*Consolidated sales and marketing expenses* for the nine months ended September 30, 2004 increased by 36.0% to \$298.4 million from \$219.4 million for the nine months ended September 30, 2003. The increase in sales and marketing expenses was largely related to our strategy to develop our subscriber base through organic growth. The components of growth in sales and marketing expenses were an increase of \$49.4 million in commissions to dealers and an increase of \$29.6 million in advertising and promotion expenses. The increase in commissions to dealers was primarily due to an increase in the volume of sales through dealers. The increase in advertising and promotion expenses related to increased overall marketing efforts and relatively higher costs of television commercials. Sales and marketing expenses as a percentage of net revenues decreased to 10.6% for the nine months ended September 30, 2004 from 12.4% for the nine months ended September 30, 2003. The main reason for this decrease was the introduction in Russia of the new dealers' commission scheme in 2004, described above, which resulted in a decrease in dealers' commissions as a percentage of revenues from 8.5% to 7.1%.

*MTS OJSC sales and marketing expenses* for the nine months ended September 30, 2004 increased by 23.8% to \$161.4 million from \$130.4 million for the nine months ended September 30, 2003. Sales and marketing expenses as a percentage of segment revenues decreased to 10.4% for the nine months ended September 30, 2004 from 12.2% for the nine months ended September 30, 2003. MTS OJSC has traditionally incurred consolidated costs of national TV advertising campaigns, which have experienced significant inflation in the last few years. MTS does not allocate a portion of these advertising costs to Telecom XXI and other Russian regions segments even though sales in these regions benefit from this



national advertising. The main reason for the decrease in sales and marketing expenses as a percentage of segment revenues was the introduction of the new dealer commission scheme in 2004, which resulted in a decrease in dealers' commissions as a percentage of revenues from 8.2% to 6.6%.

*Telecom XXI sales and marketing expenses* for the nine months ended September 30, 2004 increased by 31.7% to \$28.7 million from \$21.8 million for the nine months ended September 30, 2003, as a result of the expansion of the operations into regions other than St. Petersburg and an increase in dealers' commissions due to general growth of sales volume through dealers. Sales and marketing expenses as a percentage of segment revenues decreased to 13.1% for the nine months ended September 30, 2004 from 14.8% for the nine months ended September 30, 2003. The main reason for this decrease was a decrease of the dealer commissions as a percentage of segment revenues from 11.3% to 10.2% for the nine months ended September 30, 2003 and 2004, respectively, which was primarily due to the introduction of the new dealer commission scheme in 2004, described above. In addition, in the third quarter of 2003, we introduced our Jeans tariff in the region, which became popular and has lower commission fees than our contract tariff plans.

*UMC sales and marketing expenses* for the nine months ended September 30, 2004 were \$51.9 million, or 8.9% of segment revenues, while for nine months ended September 30, 2003 these expenses were \$30.6 million, or 12.2% of segment revenue. Absolute growth in these expenses for the nine months ended September 30, 2004 occurred due to overall growth of UMC's activity. The decrease in sales and marketing expenses as a percentage of segment revenue was caused by two factors: decrease in advertising and promotion expenses from 5.0% to 2.6% of segment revenue due to extensive advertising campaigns organized in the third quarter of 2003 related to the Jeans tariff launch and decrease in dealers' commissions from 7.2% to 6.2% of segment revenue due to a change in the commission scheme in December 2003 (commission is calculated based on revenue received from subscribers contracted by the dealer).

*Other regions sales and marketing expenses* for the nine months ended September 30, 2004 increased by 67.3% to \$63.9 million from \$38.2 million for the nine months ended September 30, 2003, as a result of our expansion of the existing regional operations. Sales and marketing expenses as a percentage of segment revenues decreased to 8.8% for the nine months ended September 30, 2004, from 9.5% for the nine months ended September 30, 2003. The main reason for this decrease was a decrease in dealers' commissions expense as a percentage of segment revenues from 7.3% to 6.5% due to several factors: expansion of our own distribution network in some regions (*i.e.*, more new subscription are made in our own sales offices and no commission is paid to dealers) and a decrease in the dealers' commissions tariffs in several regions.

#### **Depreciation and amortization expenses**

*Consolidated depreciation and amortization* of property, network equipment, telephone numbering capacity, license costs and other intangible assets for the nine months ended September 30, 2004 increased by 56.4% to \$450.7 million from \$288.1 million for the nine months ended September 30, 2003. Depreciation and amortization expenses as a percentage of net revenues remained stable at 16.1% for the nine months ended September 30, 2004, as compared to 16.2% for the nine months ended September 30, 2003.

*MTS OJSC depreciation and amortization* for the nine months ended September 30, 2004 increased by 26.7% to \$178.0 million from \$140.5 million for the nine months ended September 30, 2003, but declined as a percentage of segment revenues to 11.5% for the nine months ended September 30, 2004 from 13.2% for the nine months ended September 30, 2003 mainly due to expansion of our subscriber base in our existing network.

*Telecom XXI depreciation and amortization* for the nine months ended September 30, 2004 increased by 36.6% to \$35.1 million from \$25.7 million for the nine months ended September 30, 2003 and decreased as a percentage of segment revenues to 16.0% from 17.4%. This decrease is due to

revenue growth outpacing depreciation expense growth as Telecom XXI's commercial operations are firmly established and extensive network build-up in the initial years of operations (2002-2003) is no longer being carried out.

*UMC depreciation and amortization* for the nine months ended September 30, 2004 was \$82.2 million, or 14.0% of segment revenues, while for the nine months ended September 30, 2003 depreciation and amortization was \$45.4 million, or 18.1% of segment revenues. Absolute growth of depreciation and amortization expense was mainly due to the continued buildout of UMC's network in Ukraine. The decrease in depreciation and amortization expense as a percentage of segment revenues was mainly due to the effect of economies of scale.

*Other regions depreciation and amortization* for the nine months ended September 30, 2004 increased by 101.9% to \$157.7 million from \$78.1 million for the nine months ended September 30, 2003 and increased as a percentage of segment revenues to 21.8% from 19.4%. The increase in the depreciation and amortization expense was driven by two factors: the continued buildout of our network in the regions and assets acquired through acquisitions.

### **Operating Income**

*Consolidated operating income* for the nine months ended September 30, 2004 increased by 76.4% to \$1,146.2 million, including \$245.8 million of UMC's results after intercompany elimination for the nine months ending September 30, 2004 from \$649.8 million for the nine months ended September 30, 2003, of which \$85.5 million was contributed by UMC. Operating income as a percentage of net revenues was at 40.8% for the nine months ended September 30, 2004 and 36.6% for the nine months ended September 30, 2003. The main reasons for the increase in operating income as a percentage of revenues were the relative decreases as a percentage of revenues of the sales and marketing expenses and sundry operating expenses.

*MTS OJSC operating income* for the nine months ended September 30, 2004 increased by 52.0% to \$579.7 million from \$381.3 million for the nine months ended September 30, 2003 and remained relatively stable as a percentage of segment revenues at 37.5% for the nine months ended September 30, 2004, as compared to 35.8% for the nine months ended September 30, 2003.

*Telecom XXI operating income* for the nine months ended September 30, 2004 increased by 61.5% to \$90.3 million, or 41.1% of segment revenues, from \$55.9 million, or 37.9% of segment revenues, for the nine months ended September 30, 2003. Telecom XXI experienced higher profitability as large start-up expenses incurred in 2002 resulted in revenue growth in 2003, a trend which continued in 2004.

*UMC operating income* for the nine months ended September 30, 2004 was \$245.8 million, or 41.9% of segment revenues, while for nine months ended September 30, 2003 operating income was \$85.5 million, or 34.0% of segment revenues. Absolute growth of operating income primarily was the result of the overall growth in UMC's subscriber base and the continued buildout of its network. In addition, for nine months ended September 30, 2003, only seven months of UMC's operations were consolidated into our results, as we did not acquire a controlling stake in UMC until March 2003. Growth of operating income as a percentage of segment revenues occurred mainly due to a decrease in expenses realized through economies of scale and the growth in UMC's subscriber base.

*Other regions operating income* for the nine months ended September 30, 2004 increased by 73.3% to \$236.7 million, or 32.7% of segment revenues, from \$136.6 million, or 33.9% of segment revenues, for the nine months ended September 30, 2003. The growth in operating income of the other regions segment occurred due to overall organic and acquisitional growth of the regional business (growth of subscriber base and revenues), followed by respective growth of cost of services and operating expenses.

### **Currency exchange and translation gain**

*Consolidated currency exchange and translation gain* for the nine months ended September 30, 2004 was \$2.6 million, compared to \$4.8 million for the nine months ended September 30, 2003. We conduct our operations primarily within the Russian Federation and Ukraine. We are subject to currency fluctuations, including U.S. dollar versus ruble/hryvnia and U.S. dollar versus euro. See “Risk Factors—Risks Relating to Our Financial Condition—Continued or increased limitations on the conversion of rubles to foreign currency in Russia could increase our costs when making payments in foreign currency to suppliers and creditors and could cause us to default on our obligations to them.” and “—Quantitative and Qualitative Disclosures about Market Risk—Foreign Currency Risk.”

### **Interest expense**

*Consolidated interest expense* for the nine months ended September 30, 2004 increased by 12.6% to \$78.8 million from \$70.0 million for the nine months ended September 30, 2003, primarily as the result of additional interest expense incurred in conjunction with our \$300.0 million notes issued in August 2003 and \$400.0 million notes issued in October 2003.

### **Other income**

*Consolidated other income/(expense)* for the nine months ended September 30, 2004 increased to a gain of \$22.0 million from a loss of \$12.3 million incurred for the nine months ended September 30, 2003. The main reason for this change relates to the significant growth in profitability of MTS Belarus. During the nine months ended September 30, 2003, \$2.0 million of MTS Belarus’ loss was included in our results, while for the nine months ended September 30, 2004, \$15.7 million of income was included in our results.

### **Provision for income taxes**

*Consolidated provision for income taxes* for the nine months ended September 30, 2004 increased by 68.0% to \$269.6 million from \$160.5 million for the nine months ended September 30, 2003. The effective tax rate decreased to 24.3% in the nine months ended September 30, 2004 from 27.5% in the nine months ended September 30, 2003 mainly as a result of an increase in deductible foreign currency exchange losses for purposes of our statutory accounts and a decrease in the statutory tax rate in Ukraine from 30% in 2003 to 25% in 2004.

### **Minority interest**

*Minority interest* for the nine months ended September 30, 2004 decreased by \$31.7 million to \$27.4 million from \$59.1 million for the nine months ended September 30, 2003 as a result of purchases of additional stakes from minority shareholders in regional companies, the major ones being FECS-900, Uraltel and SCS-900.

### **Net income**

*Net income* for the nine months ended September 30, 2004 increased by \$449.1 million, or 123.2%, to \$813.6 million, compared to \$364.5 million for the nine months ended September 30, 2003, due to overall growth of our operations and the factors discussed above. Net income as a percentage of revenues was 29.0% in the nine months ended September 30, 2004 and 20.5% in the nine months ended September 30, 2003. The main reason for the increase in net income as a percentage of revenues was the relative decrease as a percentage of revenues in the following items: sales and marketing expenses, sundry operating expenses, interest expense, other expense and minority interest.

## **Year Ended December 31, 2003 compared to Year Ended December 31, 2002**

### **Revenues and cost of services and products**

*Consolidated revenues* for the year ended December 31, 2003 increased by \$1,184.4 million, or 87.0%, to \$2,546.2 million from \$1,361.8 million for the year ended December 31, 2002. This increase was primarily due to the significant growth in our subscriber base from 6.64 million as of December 31, 2002 to 16.72 million as of December 31, 2003. A portion of the growth in the subscriber base was due to acquisitions during 2003, including UMC. At the time of acquisition, UMC had 1.8 million subscribers, which grew to 3.4 million subscribers as of the end of the year. The increase in revenues from subscriber growth 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 26% from \$23 per subscriber for the year ended December 31, 2002 to \$17 for the year ended December 31, 2003. Our sales and marketing effort and the expansion of our network, as well as improving general economic conditions and income levels in Russia and Ukraine were primarily responsible for the growth in our subscriber base.

For the year ended December 31, 2003, service revenues increased by \$1,161.4 million, or 91.1%, to \$2,435.7 million compared to \$1,274.3 million for the year ended December 31, 2002 due to the growth in the number of our subscribers, as explained above. Connection fees increased by only \$4.5 million, or 18.2%, compared to the year ended December 31, 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 \$18.5 million, or 29.5%, for the year ended December 31, 2003, compared to the year ended December 31, 2002 due to subscriber growth in 2003, although not as fast as subscriber growth because the average selling price of handsets declined as many of our subscribers already own handsets.

*Consolidated cost of services and cost of handsets and accessories* for the year ended December 31, 2003 increased by 65.4% to \$474.2 million from \$286.7 million for the year ended December 31, 2002. The increase in costs was primarily attributable to subscriber growth and related growth of traffic related expenses and cost of equipment sold, as well as the inclusion of ten months of UMC's results, which added \$94.1 million to consolidated cost of services and products after intercompany eliminations.

*Consolidated gross margin* was 81.4% for the year ended December 31, 2003 compared to 78.9% for the year ended December 31, 2002. We believe that this 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 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 year ended December 31, 2003 increased by 40.8% to \$1,471.2 million from \$1,044.9 million for the year ended December 31, 2002. Our subscriber base in the MTS OJSC license areas increased by 74.3% from 3.7 million as of December 31, 2002 to 6.5 million as of December 31, 2003. The increase in the 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 cost of handsets and accessories* for the year ended December 31, 2003 increased by 33.5% to \$315.0 million from \$236.0 million for the year ended December 31, 2002. This was primarily due to the \$37.8 million and \$27.6 million increases in roaming expenses and cost of handsets and accessories, respectively, resulting from an increase in the number of subscribers and related growth of roaming traffic and cost of equipment sold. Roaming expenses increased to \$126.7 million, or 8.6% of segment revenues, for the year ended December 31, 2003 from \$88.9 million,

or 8.5% of segment revenues, for the year ended December 31, 2002. Cost of handsets and accessories increased to \$89.8 million, or 6.1% of segment revenues, for the year ended December 31, 2003 from \$62.2 million, or 6.0% of segment revenues, for the year ended December 31, 2002.

*MTS OJSC gross margin* increased by 42.9% to \$1,156.2 million in 2003 from \$808.9 million in 2002. MTS OJSC's gross margin percentage increased to 78.6% in 2003 from 77.4% in 2002, which can be explained by the same factors discussed above with respect to the increase in the consolidated gross margin.

*Telecom XXI revenues* for the year ended December 31, 2003 increased by 165.8% to \$210.5 million from \$79.2 million for the year ended December 31, 2002, which was Telecom XXI's first year of operations. Our subscriber base in the Telecom XXI license areas increased by 95.1% from 0.9 million as of December 31, 2002 to 1.7 million as of December 31, 2003. We also increased our tariffs in 2003.

*Telecom XXI cost of services and cost of handsets and accessories* for the year ended December 31, 2003 increased by 81.0% to \$33.3 million from \$18.4 million for the year ended December 31, 2002. This was primarily due to the \$8.5 million and \$7.5 million increases in interconnection and line rental expenses and roaming expenses, respectively. Interconnection and line rental expenses increased to \$14.0 million, or 6.7% of segment revenues, in 2003 from \$5.5 million, or 6.9% of segment revenues, in 2002 mainly due to an increase in the number of base stations in use. Roaming expenses increased to \$12.5 million, or 5.9% of segment revenues, for the year ended December 31, 2003 from \$5.0 million, or 6.3% of segment revenues, for the year ended December 31, 2002 mainly due to subscriber growth and related traffic expenses.

*Telecom XXI gross margin* increased by 191.3% to \$177.1 million in 2003 from \$60.8 million in 2002. Telecom XXI gross margin percentage increased to 84.2% in 2003 from 76.7% in 2002, which can be explained primarily by the increase in tariffs discussed above.

*UMC revenues* for the year ended December 31, 2003, were \$394.0 million.

*UMC cost of services and products* for the year ended December 31, 2003 was \$95.0 million, resulting in a gross margin of \$299.0 million.

*UMC gross margin percentage* was 75.9% in 2003.

*Other regions revenues* for the year ended December 31, 2003 increased by 106.5% to \$601.2 million from \$291.1 million for the year ended December 31, 2002. Our subscriber base in the other regions segment increased by 153.2% from 2.0 million as of December 31, 2002 to 5.2 million as of December 31, 2003, consistent with our expansion into the regions.

*Other regions cost of services and cost of handsets and accessories* for the year ended December 31, 2003 increased by 87.8% to \$141.8 million from \$75.5 million for the year ended December 31, 2002 due to subscriber growth and related growth of traffic related expenses.

*Other regions gross margin* increased by \$243.7 million, or 113.0%, from \$215.7 million in 2002 to \$459.4 million in 2003, primarily due to the increase in the number of subscribers. Our gross margin percentage for the other regions segment increased to 76.4% in 2003 from 74.1% in 2002, which can be explained by the same factors discussed above with respect to the increase in the consolidated gross margin.

### **Sundry operating expenses**

*Consolidated sundry operating expenses* for the year ended December 31, 2003 increased by 77.5% to \$406.7 million from \$229.1 million for the year ended December 31, 2002. The increase in sundry operating expenses was largely attributable to subscriber growth and the acquisition of UMC, which contributed \$50.2 million to consolidated sundry operating expenses for the year ended December 31, 2003 after intercompany elimination. In 2003, we experienced an increase of \$72.1 million in salaries and related social contributions for additional personnel and an increase in network repair and



maintenance expenses of \$19.0 million due to the expansion and aging of our network, as compared to the prior period. Our operating expenses for the year ended December 31, 2003 also included a \$16.7 million provision related to dealer and subscriber fraud. See “Risk Factors—Risks Relating to Our Business—Our failure to implement the necessary infrastructure to manage our growth could have a material adverse effect on our business and results of operations.” Operating expenses as a percentage of net revenues were, however, relatively stable at 16.0% and 16.8% for the year ended December 31, 2003 and 2002, respectively.

*MTS OJSC sundry operating expenses* for the year ended December 31, 2003 increased by 39.0% to \$241.1 million from \$173.4 million for the year ended December 31, 2002. The most significant increases were in the areas of bad debt, mainly related to dealer and subscriber fraud as discussed above (\$16.7 million), and salaries and related social contributions for additional personnel (\$28.6 million). Sundry operating expenses as a percentage of segment revenues remained relatively stable at 16.4% for the year ended December 31, 2003, as compared to 16.6% for the year ended December 31, 2002.

*Telecom XXI sundry operating expenses* for the year ended December 31, 2003 increased by 48.7% to \$28.1 million from \$18.9 million for the year ended December 31, 2002. The most significant increases were in the areas of salaries and related social contributions for additional personnel (\$5.3 million). Sundry operating expenses as a percentage of segment revenues decreased to 13.3% for the year ended December 31, 2003, as compared to 20.8% for the year ended December 31, 2002 mainly due to the fact that 2002 was the first year of the commercial operations and we incurred more start-up operating expenses in that period.

*UMC sundry operating expenses* for the year ended December 31, 2003 were \$50.2 million, or 12.7% of segment revenues.

*Other regions sundry operating expenses* for the year ended December 31, 2003 increased by 124.7% to \$88.1 million from \$39.2 million for the year ended December 31, 2002. The most significant increases were in the areas of salaries and related social contributions for additional personnel (\$21.3 million) and repair and maintenance expenses for expanded network (\$4.6 million). Sundry operating expenses as a percentage of segment revenues increased to 14.7% for the year ended December 31, 2003, as compared to 13.5% for the year ended December 31, 2002, primarily due to increased expenses incurred in connection with our continuing expansion into the regions.

### **Sales and marketing expenses**

*Consolidated sales and marketing expenses* for the year ended December 31, 2003 increased by 90.0% to \$326.8 million from \$172.0 million for the year ended December 31, 2002. The increase in sales and marketing expenses was largely related to subscriber growth and the acquisition of UMC, which contributed \$50.8 million to the consolidated sales and marketing expenses for the year ended December 31, 2003. The components of growth in sales and marketing expenses were an increase of \$101.4 million in commissions paid to dealers and an increase of \$57.0 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 separate marketing effort for the “Jeans” brand, which was launched in November 2002, increased overall marketing efforts and higher costs of television commercials. Sales and marketing expenses as a percentage of net revenues remained relatively stable at 12.8% for the year ended December 31, 2003, as compared to 12.6% for the year ended December 31, 2002.

*MTS OJSC sales and marketing expenses* for the year ended December 30, 2003 increased by 48.9% to \$187.3 million from \$125.8 million for the year ended December 31, 2002. Sales and marketing expenses as a percentage of segment revenues increased to 12.7% for the year ended December 31, 2003 from 12.0% for the year ended December 31, 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 has experienced significant inflation in the last year. We do not allocate a portion of these television advertising costs to the Telecom XXI and other regions segments even though sales in these regions benefit from this national advertising.

*Telecom XXI sales and marketing expenses* for the year ended December 31, 2003 increased by 42.3% to \$31.6 million from \$22.2 million for the year ended December 31, 2002, as a result of the expansion of the operations into regions other than St. Petersburg and an increase in dealers’ commission due to general growth of sales volume through dealers. Sales and marketing expenses as a percentage of segment revenues decreased to 15.0% for the year ended December 31, 2003 from 28.0% for the year ended December 31, 2002 mainly due to the start-up advertising campaign in 2002, the first year of commercial operations of Telecom XXI.

*UMC sales and marketing expenses* for the year ended December 31, 2003 were \$50.8 million, or 12.9% of segment revenues.

*Other regions sales and marketing expenses* for the year ended December 31, 2003 increased by 112.7% to \$58.7 million from \$27.6 million for the year ended December 31, 2002, as a result of our acquisitions during 2002 and 2003 and the expansion of the existing regional operations. Sales and marketing expenses as a percentage of segment revenues remained stable at 9.8% for the year ended December 31, 2003, as compared to 9.5% for the year ended December 31, 2002.

#### **Depreciation and amortization expenses**

*Consolidated depreciation and amortization* of property, network equipment, telephone numbering capacity, license costs and other intangible assets for the year ended December 31, 2003 increased by 98.3% to \$415.9 million from \$209.7 million for the year ended December 31, 2002. Depreciation and amortization expenses as a percentage of net revenues increased to 16.3% for the year ended December 31, 2003 from 15.4% for the year ended December 31, 2002. This increase was attributable to the increased asset base resulting from our continuing expansion of our network, especially with respect to Telecom XXI, and acquisitions of regional operations in Russia and the amortization of license costs, acquired customer base and tangible assets of UMC, which contributed \$66.4 million to consolidated depreciation and amortization during 2003.

*MTS OJSC depreciation and amortization* for the year ended December 31, 2003 increased by 38.8% to \$199.9 million from \$144.0 million for the year ended December 31, 2002 but remained relatively stable as a percentage of segment revenues at 13.6% for the year ended December 31, 2003, as compared to 13.8% for the year ended December 31, 2002.

*Telecom XXI depreciation and amortization* for the year ended December 31, 2003 increased by 112.7% to \$36.8 million from \$17.3 million for the year ended December 31, 2002 and decreased as a percentage of segment revenues to 17.5% from 21.8%. This decrease is explained by the fact that 2002 was the first year of Telecom XXI commercial operations and therefore revenues were lower in 2002 compared to 2003 although extensive capital investments into network build-up resulted in a high depreciation expense in both years.

*UMC depreciation and amortization* for the year ended December 31, 2003, was \$66.4 million, or 16.9% of segment revenues.

*Other regions depreciation and amortization* for the year ended December 31, 2003 increased by 137.1% to \$114.5 million from \$48.3 million for the year ended December 31, 2002 and increased as a percentage of segment revenues to 19.0% from 16.6%. The increase in the depreciation and amortization expense is associated with assets of acquired businesses and amortization of license costs recognized in the acquisitions of Kuban-GSM, Dontelecom, BM-Telecom, TAIF Telcom and other regional operators.

## **Operating Income**

*Consolidated operating income* for the year ended December 31, 2003 increased by 98.7% to \$922.6 million, including \$127.6 million of UMC's result after intercompany elimination for ten months ending December 31, 2003 from \$464.4 million for the year ended December 31, 2002. Operating income as a percentage of net revenues was at 36.2% for the year ended December 31, 2003 and 34.1% for the year ended December 31, 2002.

*MTS OJSC operating income* for the year ended December 31, 2003 increased by 44.3% to \$527.8 million from \$365.7 million for the year ended December 31, 2002 and remained relatively stable as a percentage of segment revenues at 35.9% for the year ended December 31, 2003, as compared to 35.0% for the year ended December 31, 2002.

*Telecom XXI operating income* for the year ended December 31, 2003 increased to \$80.6 million, or 38.3% of segment revenues, from \$2.3 million, or 2.9% of segment revenues, for the year ended December 31, 2002. Telecom XXI experienced higher profitability as large start-up expenses incurred in 2002 resulted in revenue growth in 2003 and due to higher tariffs that were implemented in 2003.

*UMC operating income* for the year ended December 31, 2003, was \$131.7 million, or 33.4% of segment revenues.

*Other regions operating income* for the year ended December 31, 2003 increased by 97.2% to \$198.2 million, or 33.0% of segment revenues, from \$100.5 million, or 34.5% of segment revenues, for the year ended December 31, 2002. The growth in operating income of the other regions segment occurred due to overall organic and acquisitional growth of the regional business (growth of subscriber base and revenues), followed by respective growth of cost of services and operating expenses.

## **Currency exchange and translation gain**

*Consolidated currency exchange and translation gain* for the year ended December 31, 2003 was \$0.7 million, compared to a \$3.5 million loss for the year ended December 31, 2002. We conduct our operations primarily within the Russian Federation and Ukraine. We are subject to currency fluctuations, including U.S. dollar versus ruble/hryvnia and U.S. dollar versus euro. See "Risk Factors—Risks Relating to Our Financial Condition—Devaluation of the ruble against the U.S. dollar could increase our costs and reduce our revenues" and "—Quantitative and Qualitative Disclosures about Market Risks—Foreign Currency Risk."

## **Interest expense**

*Consolidated interest expense* for the year ended December 31, 2003 increased by 140.1% to \$106.6 million from \$44.4 million for the year ended December 31, 2002 primarily as the result of interest expense related to our \$400.0 million notes issuances in January 2003, \$300.0 million notes issuances in August 2003, and \$400.0 million notes issuances in October 2003. In addition, debt assumed in our acquisitions of UMC, TAIF Telcom, Sibchallenge and TSS in 2003 amounted to \$88.3 million.

## **Provision for income taxes**

*Consolidated provision for income taxes* for the year ended December 31, 2003 increased by 119.7% to \$242.5 million from \$110.4 million for the year ended December 31, 2002. The effective tax rate increased to 29.2% in 2003 from 25.8% in 2002 as a result of the UMC acquisition in 2003 (in Ukraine the tax rate was 30% in 2003) and a lower level of non-deductible expenses for the year ended December 31, 2003. In addition, the deferred income tax benefit increased by \$24.0 million to \$43.0 million for the year ended December 31, 2003 from \$19.0 million for the year ended

December 31, 2002 as a result of the increase in the amortization of licenses and other intangible assets of the regional operators acquired during 2002 and 2003.

#### **Minority interest**

Minority interest for the year ended December 31, 2003 increased by \$32.0 million to \$71.7 million from \$39.7 million for the year ended December 31, 2002 as a result of growth in net income of regional operators, including \$23.4 million for Kuban-GSM, \$17.0 million for Telecom-900 and \$13.1 million for Recom, and due to regional operators acquired in 2003, including \$3.6 million for TAIF Telcom and \$10.6 million for UMC for the period prior to the purchase of 100% of UMC in July 2003.

#### **Net income**

*Net income* for the year ended December 31, 2003 increased by \$240.1 million, or 86.6%, to \$517.2 million, compared to \$277.1 million for the year ended December 31, 2002, due to overall growth of our operations and the factors discussed above. Net income as a percentage of revenues was 20.3% in 2002 and 2003.

### **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 by 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 2.7 million as of December 31, 2001 to 6.6 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 by 36.4% from \$36 per subscriber in 2001 to \$23 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 cost of handsets and accessories* for the year ended December 31, 2002 increased by 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 by 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 cost of handsets and accessories* for the year ended December 31, 2002 increased by 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 handsets and accessories 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 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 by 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.

*Other regions (including Telecom XXI) revenues* for the year ended December 31, 2002 increased by 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 other regions segment 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.

*Other regions (including Telecom XXI) cost of services and cost of handsets and accessories* for the year ended December 31, 2002 increased by 449.1% to \$93.9 million from \$17.1 million for the year ended December 31, 2001 due to subscriber growth.

*Other regions (including Telecom XXI) gross margin* increased by \$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 by Telecom XXI in St. Petersburg in the end of 2001. Our gross margin percentage for the other regions segment 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.

### **Sundry operating expenses**

*Consolidated sundry operating expenses* for the year ended December 31, 2002 increased by 70.2% to \$229.1 million from \$134.6 million for the year ended December 31, 2001. Sundry operating expenses as a percentage of net revenues increased to 16.8% for the year ended December 31, 2002, as compared to 15.1% for the year ended December 31, 2001. The increase in sundry 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 sundry operating expenses* for the year ended December 31, 2002 increased by 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. Sundry operating expenses as a percentage of segment revenues increased to 16.6% for the year ended December 31, 2002, as compared to 14.6% for the year ended December 31, 2001.

*Other regions (including Telecom XXI) sundry operating expenses* for the year ended December 31, 2002 increased by 330.4% to \$58.1 million from \$13.5 million for the year ended December 31, 2001. Sundry operating expenses as a percentage of segment revenues decreased to 15.7% for the year ended December 31, 2002, as 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 sundry operating expenses to revenues.

### **Sales and marketing expenses**

*Consolidated sales and marketing expenses* for the year ended December 31, 2002 increased by 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 by 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.

*Other regions (including Telecom XXI) 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 by 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 by 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.

*Other regions (including Telecom XXI) depreciation and amortization* for the year ended December 31, 2002 increased by 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 20 to our annual 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 by 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 by 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.

*Other regions (including Telecom XXI) 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 other regions segment 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.

### **Currency exchange and translation losses**

*Consolidated currency exchange and translation losses* 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—Continued or increased limitations on the conversion of rubles to foreign currency in Russia could increase our costs when making payments in foreign currency to suppliers and creditors and could cause us to default on our obligations to them” 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 \$250.0 million and \$50.0 million notes issuances in December 2001 and March 2002, respectively, as well as 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 by 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.

### **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. See Note 3 to our annual consolidated financial statements.

### **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.

### **Liquidity and Capital Resources**

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. Since that time, we have accessed the international capital markets through the sale of unsecured notes five times in an aggregate principal amount of \$1.4 billion, with \$1.1 billion of such amount being raised in 2003. In July 2004, a syndicate of international banks made available to us an unsecured loan facility in an aggregate amount of \$500.0 million, which is payable in three years. In September 2004, this syndicated loan facility was increased to \$600.0 million of which we have drawn \$200.0 million as of September 30, 2004. As of September 30, 2004, we had indebtedness of approximately \$1,487.2 million, of which \$12.7 million was capital lease obligations. See Note 6 to our interim condensed consolidated financial statements for a description of our indebtedness.

### **Capital Requirements**

We need capital to finance the following:

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

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

Our cash outlays for capital expenditures in 2001, 2002, 2003 and the nine months ended September 30, 2004 were \$441.2 million, \$574.3 million, \$958.8 million and \$780.2 million, respectively. 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. Historically, a significant portion of our capital expenditures have been related to the installation and build out of our GSM network and expansion into new license areas. We expect that capital expenditures will remain a large portion of our cash outflows in connection with the continued installation and build out of our network. We expect our capital expenditures in 2005 to be at least comparable with or higher than our capital expenditures in 2004. These investments are required to support the growth of our subscriber base (*i.e.*, to improve network capacity) and to develop our network in the new regions for which we received licenses in late 2003. Our actual capital expenditures may vary significantly from our estimates.

In addition to capital expenditures, we spent \$75.9 million, \$143.4 million, \$667.2 million and \$172.2 million in 2001, 2002, 2003 and the nine months ended September 30, 2004, respectively to acquire businesses. In addition, in September 2004, we spent another \$63.0 million to exercise our call option and acquire the remaining stake in TAIF Telecom (see Note 2 to our interim condensed consolidated financial statements). We may continue to expand our business through acquisitions. Our cash requirement relating to potential acquisitions can vary significantly based on market opportunities.

We expect to refinance our existing debt when it becomes due. In May 2004, we retired \$300 million in principal amount of our Floating Rate Notes due August 2004 with the proceeds of a \$200.0 million short-term bridge loan from Credit Suisse First Boston International and operating cash flows. This \$200.0 million bridge loan was repaid from our operating cash flows and drawings on the syndicated loan facility described above. In December 2004, we repaid our 10.95% notes due 2004 in principal amount of \$300.0 million from further drawings on the syndicated loan facility.

Sistema, which controls over 50% of our shares and consolidates our results in its financial statements, has a significant amount of outstanding debt and requires funds for debt service. These funds may come in part from dividends paid by its subsidiaries, including us. On June 30, 2003, our shareholders approved cash dividends totaling \$111.4 million (including dividends on treasury shares of \$0.4 million), which have been fully paid. On June 26, 2004, our shareholders approved cash dividends in the amount \$220.0 million (including dividends on treasury shares of \$1.1 million), which have also been fully paid. We generally intend to finance our dividend requirements through operating cash flows, and accordingly, our payment of dividends may make us more reliant on external sources of capital to finance our capital expenditures and acquisitions.

We expect that we will also need to incur certain expenditures and devote significant management resources over the next two years in relation to our system of internal controls to ensure our compliance with certain provisions of the Sarbanes Oxley Act of 2002 that will apply to us starting from the fiscal year ending December 31, 2005.

In addition, we are in the process of implementing an enterprise resource planning system that will require additional expenditures and devotion of significant management resources.

### **Capital Resources**

We plan to finance our capital requirements through a mix of operating cash flows and financing activities, as described above. Our major sources of cash have been cash provided by operations and the proceeds of our U.S. dollar-denominated notes issuances. We expect that these sources will continue to be our principal sources of cash in the future. We do not depend on off-balance sheet financing arrangements.

The availability of financing is influenced by many factors, including our profitability, operating cash flows, debt levels, credit ratings, contractual restrictions and market conditions. We cannot assure you that we will be able to continue to obtain large amounts of financing in the future, through note offerings or otherwise.

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

<u>Indebtedness</u>	<u>Currency</u>	<u>Annual interest rate (Actual rate at September 30, 2004)</u>	<u>Amount (in thousands)</u>
9.75% notes due 2008 . . . . .	USD	9.75%	\$ 400,000
8.375% notes due 2010 . . . . .	USD	8.375%	400,000
10.95% notes due 2004 . . . . .	USD	10.95%	299,928
Syndicated loan . . . . .	USD	LIBOR + 2.50% (4.70%)	200,000
Hermes Credit Facility . . . . .	EUR	EURIBOR + 0.65% (2.86%)	56,578
ING Bank (Eurasia) . . . . .	USD	LIBOR + 2.25%–4.15% (4.27%–6.17%)	53,333
HSBC . . . . .	USD	LIBOR + 2.75% (4.66%)	20,000
Ericsson . . . . .	USD	LIBOR + 4% (6.02%)	17,100
Dresdner Bank . . . . .	USD	LIBOR + 3.35% (5.37%)	10,000
Nordea Bank Sweden . . . . .	USD	LIBOR + 0.40% (2.60%)	8,124
West LB . . . . .	EUR	EURIBOR + 2% (4.21%)	5,039
Other ruble-denominated debt . . . .	RUR	15.0%–16.5%	1,946
KFW . . . . .	EUR	EURIBOR + 0.95% (3.16%)	1,338
Other USD-denominated debt . . . .	USD	LIBOR + 1.15%–6.55% (3.17%–8.57%)	1,149
Total debt . . . . .			\$1,474,535
Less current portion . . . . .			375,520
Total long-term debt . . . . .			<u>\$1,099,015</u>

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

<u>Payments due in the year ended September 30,</u>	<u>Amount (in thousands)</u>
2005 . . . . .	\$ 375,520
2006 . . . . .	60,847
2007 . . . . .	219,266
2008 . . . . .	412,573
2009 . . . . .	6,329
Thereafter . . . . .	400,000
	<u>\$1,474,535</u>

In addition, we had capital lease obligations in the amount of \$12.7 million and \$16.8 million as of September 30, 2004 and December 31, 2003, respectively. The terms of our material debt obligations and capital lease obligations are described in Notes 6 and 7, respectively, to our interim condensed consolidated financial statements.

Our ability to incur further indebtedness is limited by the covenants in our outstanding notes, including the notes offered hereby, including a debt/cash flow incurrence test and restrictions on our ability to grant liens on our properties and to enter into sale and lease-back transactions. See “Description of the Notes.” Our syndicated loan facility contains similar and other covenants, including debt/EBITDA and EBITDA/interest expense maintenance covenants. In addition, Sistema, which controls 50.6% of our shares and consolidates our results in its financial statements, is subject to various covenants in the indentures relating to its notes (in the aggregate principal amount of \$700 million), which impose restrictions on Sistema and its restricted subsidiaries (including us) with respect to, among others, incurrence of indebtedness and liens. See “Risk Factors—Risks Relating to Our Business—Indentures relating to our notes and our controlling shareholder Sistema’s notes

contain, and our syndicated loan agreement contains, restrictive covenants, which limit our ability to incur debt and to engage in various activities.”

### **Recent Financing Activities**

Since September 30, 2004, we have incurred the following indebtedness:

#### ***New credit facility***

In October 2004, we obtained two committed credit facilities in an aggregate amount of approximately \$121.0 million to finance further expansion of our network. These funds will be used to purchase telecommunication equipment and software from Siemens AG and Alcatel SEL AG for the technical upgrade and expansion of our network. The arrangers and lenders of the credit facility are HSBC Bank plc and ING BHF-BANK AG. Euler Hermes Kreditversicherungs-AG, the German credit export agency, is providing export credit cover in respect to both facilities. The facilities mature in approximately nine years and bears interest at a rate of LIBOR plus 0.425% (effective rate 2.65% for October 2004) per annum.

#### ***EBRD loan***

In December 2004, we signed an agreement with EBRD for \$150.0 million loan. The loan has a term of seven years repayable from December 15, 2005 on a biannual basis in equal installments. The loan bears interest at a rate of LIBOR plus 3.1% per annum (effective rate 5.81% as of December 15, 2004). The proceeds of the loan will be used by to finance regional expansion in Russia.

#### ***ABN AMRO loan***

In November 2004, we signed a loan agreement with ABN AMRO Bank N.V. (Stockholm branch) for two loans of \$56.6 million and €8.4 million. These funds will be used to purchase telecommunications equipment from Ericsson AB for expansion of our network. The loans are payable on a biannual basis in equal installments over nine years and bear interest at a rate of USD LIBOR/ EURIBOR plus 0.35% per annum (effective rate 2.76/2.52% for November 2004).

#### ***Credit Suisse First Boston loan***

In October 2004, MTS Finance signed a loan agreement with Credit Suisse First Boston for \$140.0 million. These funds will be used for general corporate purposes. The loan is payable in two installments of \$70 million each due three and six months after the draw date, respectively (*i.e.*, in January and April 2005). The loan bears interest at a rate of LIBOR plus 2.20% (4.44% at September 30, 2004). The loan is fully and unconditionally guaranteed by us.

A summary of our cash flows follows and cash outlays for capital expenditures and acquisitions of subsidiaries:

	Year Ended December 31,			Nine Months Ended September 30,	
	2001	2002	2003	2003	2004
	(in thousands)				
<b>Cash flows:</b>					
Net cash provided by operating activities . . . . .	\$ 338,201	\$ 412,772	\$ 965,984	\$ 667,766	\$1,281,221
Net cash used in investing activities . .	(441,523)	(697,921)	(1,910,087)	(1,315,268)	(823,271)
Net cash provided/(used) by financing activities . . . . .	247,592	100,817	997,545	760,699	(356,760)
Net increase/(decrease) in cash . . . . .	\$ 143,801	\$(184,968)	\$ 55,715	\$ 112,608	\$ 102,168
<b>Cash outlays for:</b>					
Capital expenditures <sup>(1)</sup> . . . . .	\$(441,200)	\$(574,272)	\$ (958,771)	\$ (635,652)	\$ (780,212)
Acquisition of subsidiaries, net of cash acquired . . . . .	\$ (75,858)	\$(143,396)	\$ (667,206)	\$ (629,306)	\$ (172,202)

<sup>(1)</sup> Includes acquisitions of property, plant and equipment and intangible assets.

For the nine months ended September 30, 2004, net cash provided by operating activities was \$1,281.2 million, an increase of 91.9% from the nine months ended September 30, 2003. The increase was primarily attributable to an increase in net revenues from subscribers, which was a result of an increase in our subscriber base and a significant decrease of the VAT receivable balance.

Net cash used in investing activities in the nine months ended September 30, 2004 was \$823.3 million, a decrease of 37.4% from the nine months ended September 30, 2003. This decrease is the result of several factors, including a decrease in cash spent for the business acquisitions from \$629.3 million in the nine months ended September 30, 2003 to \$172.2 million in the nine months ended September 30, 2004 and net cash inflow resulting from disposals of short-term investments, *i.e.*, matured bank deposits of \$194.4 million during the nine months ended September 30, 2004. These factors were partially offset by an increase in cash spent on acquisition of property, plant and equipment and intangible assets from \$635.7 million for the nine months ended September 30, 2003 to \$780.2 million for the same period in 2004.

Net cash used in financing activities in the nine months ended September 30, 2004 was \$356.8 million. In May 2004, we retired \$300.0 million in principal amount of our Floating Rate Notes due 2004 from the proceeds of a \$200.0 million short-term bridge loan and our operating cash flows. We paid dividends in the total amount of \$166.9 million during the nine months ended September 30, 2004, which also included dividends paid to minority shareholders of certain of our subsidiaries.

In 2003, net cash provided by operating activities was \$966.0 million, an increase of 134.0% from the year ended December 31, 2002. The increase was primarily attributable to an increase in net revenues from subscribers, which was a result of an increase in our subscriber base.

Net cash used in investing activities in 2003 was \$1,910.1 million, of which \$958.8 million related to the purchase of property, plant and equipment and intangible assets; \$330.6 million were used to acquire the 100.0% stake in UMC; \$107.0 million were used to acquire the 47.3% stake in Kuban-GSM to obtain 100% control over it; \$62.9 million were used to acquire 52.7% of the common shares and 50% of the preferred shares of TAIF Telcom; \$47.0 million were used to acquire the 100.0% stake in Sibchallenge; and \$188.7 million were used for other acquisitions of stakes in regional operators and advances to our affiliates, primarily to MTS Belarus. See “Business—History” and “—Expansion.” We financed our acquisitions of UMC, Kuban-GSM, TAIF Telcom and other regional operators primarily

from the proceeds of \$400 million of 9.75% notes due 2008 (issued in January 2003), \$300 million of Floating Rate Notes due 2004 (issued in August 2003) and \$400 million of 8.375% notes due 2010 (issued in October 2003).

Net cash provided by financing activities in 2003 was \$997.5 million. Net proceeds from the notes offerings during 2003 were \$1,087.4 million, which were used for, in addition to the acquisitions listed above, purchase of network equipment and intangible assets and advances to affiliates. We paid dividends in the total amount of \$110.9 million during 2003, which also included dividends paid to minority shareholders of our certain of our subsidiaries.

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 \$574.3 million related to purchases of property, plant and equipment and intangible assets. Net cash provided by financing activities was \$100.8 million, of which \$50.8 million related to the proceeds from the 10.95% notes due 2004 (issued in March 2002) and \$52.9 million was 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 \$441.2 million related to purchases of property, plant and equipment and intangible assets. Net cash provided by financing activities was \$247.6 million, which was primarily from the issuance of 10.95% notes due 2004 (issued in December 2001). This was offset by repayment of certain debt obligations.

### **Liquidity**

As of September 30, 2004 and December 31, 2003, we had total cash and cash equivalents of \$192.5 million (\$108.9 million in rubles, \$21.3 million in U.S. dollars, \$54.8 million in Ukrainian hryvnias and \$7.5 million in other currencies) and \$90.4 million (\$60.8 million in rubles, \$21.0 million in U.S. dollars and \$8.6 million in other currencies), respectively. In addition, as of September 30, 2004, we had short-term investments of \$50.7 million in U.S. dollar-denominated instruments at the Moscow Bank of Reconstruction and Development (MBRD), a related party. As of September 30, 2004, we had unused availability under our credit facilities to draw another \$420.0 million.

For details of external financing refer to Note 6 to our interim condensed consolidated financial statements. For subsequent events related to our external financing, refer to Note 11 to our interim condensed consolidated financial statements.

As of September 30, 2004, we had a working capital deficit of \$327.8 million compared to a deficit of \$457.5 million as of December 31, 2003. The decrease in working capital deficit was primarily attributable to the repayment in May 2004 of \$300.0 million of floating rate notes issued in August 2003. No significant changes in the balance of total current assets occurred as of September 30, 2004, compared to December 31, 2003. In December 2004, we repaid our 10.95% notes due 2004 in principal amount of \$300 million from drawings on the syndicated loan facility described above, which significantly improved our working capital position as the notes were included in short-term liabilities. We expect to repay all long-term debts as they become due from our operating cash flows or through re-financings. We believe that our working capital is sufficient for our present and future requirements.

As of December 31, 2003, we had a working capital deficit of \$457.5 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 inclusion of \$300.0 million 10.95% notes due 2004 previously classified as long-term debt into current liabilities as of December 31, 2003 (these notes were repaid in December 2004), and the issuance of \$300 million of Floating Rate Notes due 2004 (which were paid in May 2004). Cash and cash equivalents increased by \$55.7 million to \$90.4 million at December 31, 2003. Short-term investments held at MBRD increased by \$215.0 million at December 31, 2003. Accrued expenses and other current liabilities increased by \$174.5 million to \$387.8 million primarily due to first-time inclusion of respective balances of UMC as a result of its acquisition in 2003. We also experienced a \$76.9 million increase in subscriber prepayments and deposits as a result of growth in the subscriber base.

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 from issuance of 10.95% notes due 2004 (issued in December 2001) 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.

Because most of our operating subsidiaries are incorporated in Russia, their ability to pay dividends to us is limited by provisions of Russian law. For example, Russian law requires that, among other things, dividends can only be paid in an amount not exceeding net profits as determined under Russian accounting standards. In addition, dividends may only be paid if the value of the company's net assets is not less than the sum of the company's charter capital, the company's reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred stock of the company, if any, as determined under Russian accounting standards.

## **Inflation**

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

<u>Year</u>	<u>Inflation rate</u>
1999 .....	36.5%
2000 .....	20.2%
2001 .....	18.6%
2002 .....	15.1%
2003 .....	12.0%
First nine months of 2004 .....	8.5%

The Ukrainian economy has been characterized by varying rates of inflation:

<u>Year</u>	<u>Inflation rate</u>
1999 .....	19.2%
2000 .....	25.8%
2001 .....	6.1%
2002 .....	(0.6)%
2003 .....	8.2%
First nine months of 2004 .....	5.6%

In most of the regions in which we operate, except for Ukraine (UMC) and Krasnodar region (Kuban-GSM), we denominate our tariffs in units linked to the U.S. dollar. While a majority 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 and Ukraine. When, however, the rate of inflation exceeds the rate of devaluation, this results in real appreciation of the local currency versus the U.S. dollar, as was the case with the ruble in 2003. Moreover, in 2003 and

2004, the ruble appreciated in nominal terms against the U.S. dollar, which combined with the rate of inflation in Russia, resulted in a real appreciation of the ruble against the U.S. dollar. 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 and Ukraine combined with the nominal appreciation of the ruble against the U.S. dollar could significantly increase our costs and materially adversely affect its results of operations.

## Credit Rating Discussion

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

Our credit ratings as of the date of this offering memorandum are as follows:

<u>Rating Agency</u>	<u>Long-Term Debt Rating</u>	<u>Outlook/Watch</u>
Moody's <sup>(1)</sup> . . . . .	Ba3	Stable
Standard & Poor's <sup>(2)</sup> . . . . .	BB-	Watch/Negative

<sup>(1)</sup> Rated on December 10, 2001.

<sup>(2)</sup> Rated on April 28, 2004, outlook revised on December 17, 2004.

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

## Critical Accounting Policies

Critical accounting policies are those policies that require the application of management's most challenging, subjective or complex judgments, often as a result of the need to make estimates about the effect of matters that are inherently uncertain and may change in subsequent periods. Critical accounting policies involve judgments and uncertainties that are sufficiently sensitive to result in materially different results under different assumptions and conditions. We believe that our most critical accounting policies are those described below. For a detailed discussion of these and other accounting policies, see our consolidated financial statements.

### Revenue Recognition

Revenues are recognized on an accrual basis, when services are actually provided or title to equipment passes to customer, regardless of when the resulting monetary or financial flow occurs.

We categorizes the revenue sources in the statements of operations as follows:

- Service revenues and connection fees: (a) subscription fees, (b) usage fees, (c) value added service fees, (d) roaming fees charged to other operators for guest roamers utilizing our network and (e) connection fees;
- Sales of handsets and accessories.

We defer initial connection fees paid by subscribers for the first time activation of network service, as well as one time activation fees received for connection to various value-added services. These fees are recognized as revenue over the estimated average subscriber life. We periodically evaluate actual

churn of our subscribers and adjust our estimates of average subscriber lives accordingly. For example, effective January 1, 2004 we have changed our estimates of average subscriber lives which increased our income for the nine months ended September 30, 2004 by \$8.5 million. If we change our estimates of the average subscribers life in the future, the amounts of connection fees and amortization of the acquired customer base we recognize in income would change accordingly.

### **Management estimates**

The preparation of our consolidated financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses for the reporting period. Actual results could differ from those estimates. Examples of significant estimates include the provision for doubtful accounts and valuation allowance on deferred tax assets.

### **License Costs**

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

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

### **Useful Lives of Property Plant and Equipment**

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

### **Impairment of Long-lived Assets**

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

### **Translation Methodology**

We use the U.S. dollar as the functional currency for us and most of our subsidiaries because the majority of our and their revenues, costs, property, plant and equipment and intangible assets purchases and debt are either priced, incurred, payable or otherwise measured in U.S. dollars. Each of the legal entities domiciled in Russia, Ukraine, Uzbekistan and Belarus maintains its records and prepares its financial statements in the local currency, either the Russian ruble, the Ukrainian hryvnia, the Uzbek som or the Belarusian ruble, in accordance with the requirements of local statutory accounting and tax legislation.

Translation (re-measurement) of financial statements denominated in local currencies into U.S. dollars has been performed in accordance with the provisions of SFAS No. 52 "Foreign Currency Translation."

For our subsidiaries where the functional currency is the U.S. dollar, monetary assets and liabilities have been translated at the period-end exchange rates. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows have been translated at historical rates. Translation differences resulting from the use of these rates have been accounted for as foreign currency exchange gains and losses in our consolidated statements of operations.

For UMC and Kuban-GSM, where the functional currency is the local currency, the Ukrainian hryvnia and the Russian ruble, respectively, all year-end balance sheet items have been translated into U.S. dollars at the period-end exchange rate. Revenues and expenses have been translated at the period-average exchange rate. In addition, a "new cost basis" for all non-monetary assets of Kuban-GSM has been established as of January 1, 2003, when the Russian economy ceased to be considered hyperinflationary. A cumulative translation adjustment, related to the translation of UMC and Kuban-GSM, in the amount of \$8.9 million, net of income taxes, was reported as accumulated other comprehensive income in our interim condensed consolidated balance sheet.

### **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. We have recorded 100% valuation allowance against tax loss carryforwards.

### **New Accounting Pronouncements**

In December 2004, the Financial Accounting Standards Board ("FASB") issued SFAS No. 123R, "Share-Based Payment," a revision of SFAS No. 123, "Accounting for Stock-Based Compensation." SFAS No. 123R supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and requires all entities to recognize compensation cost in an amount equal to the fair value of share-based payments granted to employees. That cost will be recognized over the period during which an employee is required to provide service in exchange for an award of equity instruments. SFAS No.123R is effective for interim periods beginning after June 15, 2005, at which time

companies can select whether they will apply the standard retroactively by restating their historical financial statements or prospectively for new stock-based compensation arrangements and the unvested portion of existing arrangements. We are evaluating whether the adoption of SFAS No. 123R will have a material impact on our financial position and results of operations.

In September 2004, the Emerging Issues Task Force (“EITF”) issued a final consensus on EITF Issue No. 04-1, “Accounting for Preexisting Relationships between the Parties to a Business Combination.” In this issue the EITF reached a consensus that a business combination between two parties having a preexisting relationship is a multiple-element transaction with one element being the business combination and the other element being the settlement of the preexisting relationship. This Issue requires certain additional disclosures for business combinations between parties with a preexisting relationship. EITF Issue No. 04-1 is effective for reporting periods beginning after October 13, 2004. We do not anticipate that the adoption of EITF Issue No. 04-1 will have a material impact on our financial position or results of operations.

At the September 2004 meeting of the EITF, the Commission staff announced that companies must use the direct value method to determine the fair value of their intangible assets acquired in business combinations completed after September 29, 2004.

Historically, we used the residual method to determine the fair value of telecommunication licenses acquired in business combinations, except for the purchase of Uzdunrobita, where the fair value of licenses acquired was determined using the direct method. Under the new accounting guidance, we will use the direct method to measure the fair value of licenses acquired in our future business combinations. We do not anticipate the impact from the adoption of the above Commission guidance to be material to our consolidated financial results or financial position.

In July 2004, the EITF issued No. 02-14, “Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock.” A consensus was reached regarding an investor that has the ability to exercise significant influence over the operating and financial policies of the investee. This type of investor should apply the equity method of accounting only when it has an investment(s) in common stock and/or an investment that is in-substance common stock. The EITF also reached a consensus on the definition of in-substance common stock and related guidance. The guidance of this EITF issue is effective for reporting periods beginning after September 15, 2004. We are currently evaluating the impact of this pronouncement on our financial position and results of operations.

In December 2003, FASB issued a revision to Interpretation No. 46, “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51” (“FIN 46R” or the “Interpretation”). FIN 46R clarifies the application of ARB No. 51, “Consolidated Financial Statements,” to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities (“VIEs”), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity’s expected losses, receive a majority of the entity’s expected residual returns, or both.

Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. We adopted the requirements of the Interpretation in the first quarter of 2004. As we were not a primary beneficiary of any VIE during 2004, the adoption of FIN 46R did not have a material effect on our financial position or the results of operations.

## **Trend Information**

### **Sales**

In 2003, our revenues increased 87.0% from \$1,361.8 million to \$2,546.2 million. Our subscriber base increased to 16.7 million subscribers as of December 31, 2003 from 6.6 million as of December 31, 2002, or by 153.0%. Our revenues for the nine months ended September 30, 2004 grew by 58.2% to \$2,807.3 million in comparison to \$1,774.5 million for the nine months ended September 30, 2003. Our subscriber base increased from 13.9 million subscribers as of September 30, 2003 to 26.6 million as of September 30, 2004, or by 91.4%. Average monthly service revenue per subscriber in Russia fell from \$23 in 2002 to \$17 in 2003 due to the introduction of lower tariffs in the Moscow license area and generally lower tariffs in regions, as well as penetration to mass-market. This trend continued in the nine months ended September 30, 2004 as average monthly service revenue per subscriber in Russia decreased to \$14 for the nine months ended September 30, 2004. In 2003 and in the nine months ended September 30, 2004, more than half of our subscriber growth occurred outside of the Moscow license area. However, as a result of competition and the tariff structure in the Russian regions outside of the Moscow license area, average monthly service revenue per subscriber in the Russian regions remains lower than in the Moscow license area (though costs are generally lower there, as well). See “Risk Factors—Risks Relating to Our Business—Increased competition and a more diverse subscriber base have resulted in decreasing average monthly service revenues per subscriber, which may materially 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 experienced subscriber growth from 1.7 million subscribers at December 31, 2002 to 3.4 million subscribers at December 31, 2003 and 5.5 million at September 30, 2004, and we expect this trend to continue, assuming the Ukrainian economy continues to grow. Average monthly service revenue per subscriber grew in 2004 as a result of an extensive marketing campaign focused on subscribers with higher than average usage rates.

### **Churn**

Our subscriber churn in Russia increased from 33.9% in 2002 to 47.3% in 2003. We believe this trend reversed in the nine months ended September 30, 2004 as a result of our marketing initiatives, targeted to raise subscriber loyalty. Our subscriber churn for the nine months ended September 30, 2004 was 23.7%, as compared to 34.9% for the same period in 2003. Although our subscriber churn in Russia decreased for the nine months ended September 30, 2004, we believe that subscriber churn is highly dependent on competition and the 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. The other reasons for increases in subscriber churn are the absence of service contracts with subscribers in Russia that contain minimal periods of usage and the absence of connection fees, which generally prevent a subscriber’s early churn. In order to decrease subscriber churn, in 2004, we launched a new marketing campaign that provides a 15% discount for services rendered to certain contract subscribers if they do not terminate their contracts within one year of activation. Churn, as we use it, includes internal churn within our subscriber base, *i.e.*, our subscribers switching between different tariff plans we offer. Internal churn increased following the launch in November 2002 of the “Jeans” tariff plan. See “—Subscriber Data” above.



## Off-balance Sheet Arrangements

### Obligations under guarantee contracts

As of September 30, 2004 and 2003 and as of December 31, 2003 and 2002, our off-balance sheet arrangements consisted of debt guarantees issued to related parties as follows:

	Guaranteed amount outstanding at September 30, 2004	Guaranteed amount outstanding at December 31, 2003      2002	
		(in millions)	
Invest-Svyaz-Holding . . . . .	\$21.6	\$21.6	\$7.0
MTS Belarus . . . . .	25.0	14.5	—
Total . . . . .	<u>\$46.6</u>	<u>\$36.1</u>	<u>\$7.0</u>

We issued guarantees to various financial institutions on behalf of Invest-Svyaz-Holding, or ISH, our shareholder and a wholly-owned subsidiary of Sistema. ISH's primary business is leasing various types of telecommunications and other assets to us. See Note 9 to our interim condensed consolidated financial statements. We classify these leases as capital leases in our consolidated financial statements and the present value of future lease payments is reflected as a liability in our consolidated balance sheet.

We issued financial guarantees on behalf of MTS Belarus, our equity investee to assist it with its financing needs. See Note 9 to our interim condensed consolidated financial statements. Under each of the guarantees outstanding as of September 30, 2004, we could be required to compensate financial institutions in the event of the borrower's default. We are currently not aware of any events, and do not anticipate that any event will occur, that would cause a default of the borrowers and, therefore, require us to fulfill our obligations to make payments under these guarantees. These guarantees are not reflected in our consolidated balance sheet due to the insignificance of their fair values.

### Obligations under derivative contracts

In connection with our acquisition of 51% of the common shares and 50% of the preferred shares of TAIF Telecom in April 2003, we entered into call and put option agreements with shareholders of TAIF Telecom to acquire the remaining 49% of the common shares and 50% of the preferred shares of TAIF Telecom. The exercise periods for the call option on the common shares was 48 months from the acquisition date and for the put option on the common shares was 36 months following an 18-month period after the acquisition date. The call and put option agreements for the common shares stipulated a minimum purchase price of \$49.0 million plus 8% per annum commencing from the acquisition date. The exercise periods for the call option on the preferred shares was 48 months following a 24-month period after the acquisition date and for the put option on the preferred shares was a 24-month period from the acquisition date. The call and put option agreements for the preferred shares stipulated a minimum purchase price of \$10.0 million plus 8% per annum commencing from the acquisition date. The option was valued at \$6.5 million as of September 30, 2004. We exercised our call option to acquire remaining shares in September 2004 and completed the acquisition in October 2004.

In connection with our acquisition of 74% of the shares in Uzdurobita in August 2004, we entered into call and put option agreements with the existing shareholders of the company to acquire the remaining 26% of the shares. See Note 2 to our interim condensed consolidated financial statements. The exercise period for the option is 48 months from the acquisition date. The call and put option agreements stipulate a minimum purchase price of \$37.7 million plus 5% per annum

commencing from the acquisition date. The fair value of the put option was approximately \$3.6 million as of September 30, 2004.

### Tabular Disclosure of Contractual Obligations

We have various contractual obligations and commercial commitments to make future payments, including debt agreements, lease obligations and certain committed obligations. The following table summarizes our future obligations (including interest) under these contracts due by the periods indicated as of September 30, 2004:

	2005	2006– 2007	2008– 2009	2010– thereafter	Total
<b>Contractual Obligations:</b>					
Notes payable . . . . .	\$299,928	\$ —	\$400,000	\$400,000	\$1,099,928
Bank loans . . . . .	75,592	280,113	18,902	—	374,607
Capital leases . . . . .	10,226	5,658	133	262	16,279
Operating leases and service agreements . . . .	58,468	28,412	15,980	21,436	124,296
<b>Committed Investments:<sup>(1)</sup></b>					
Purchases of property, plant and equipment . .	331,018	—	—	—	331,018
<b>Total . . . . .</b>	<u>\$775,232</u>	<u>\$314,183</u>	<u>\$435,015</u>	<u>\$421,698</u>	<u>\$1,946,128</u>

<sup>(1)</sup> Under non-binding purchase commitments.

In addition, as of September 30, 2004, we had guaranteed indebtedness of related parties not reflected in our financial statements, due to the insignificance of its fair value, under which we could be potentially liable for \$46.6 million. See Note 9 to our interim condensed consolidated financial statements.

The terms of our current licenses provide for payments to be made to finance telecommunications infrastructure improvements, which in the aggregate could total approximately \$103.6 million as of September 30, 2004, which are not reflected in our financial statements. See Note 9 to our interim condensed consolidated financial statements. See also “—Obligations under derivative contracts” for additional discussion.

### 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.

#### Interest Rate Risk

We are exposed to variability in cash flow risk related to our variable interest rate debt and exposed to fair value risk related to our fixed-rate notes. As of September 30, 2004, approximately \$372.7 million, or 25.1% of our total indebtedness, including capital leases, was variable interest rate debt, while \$1,114.5 million, or 74.9% of our total indebtedness, including capital leases, was fixed interest rate debt. In December 2004, we entered into two interest rate swap agreements with respect to \$250.0 million of variable-rate indebtedness. See Note 11 to our interim condensed consolidated financial statements for further details. We continue to consider other financial instruments available to us on the market to mitigate exposure to variability in the interest rates.

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

**Contractual Maturity Date as of September 30, 2004**

Bank	Currency							Annual interest rate (Actual interest rate at December 31, 2003)
		2005	2006	2007	2008	2009	Total	
(amounts in thousands of U.S. dollars)								
Syndicated loan . . .	USD	\$ —	\$ —	\$200,000	\$ —	\$ —	\$200,000	LIBOR + 2.50% (4.70%)
HECF (Hermes Credit Facility) . .	EUR	12,573	12,573	12,573	12,573	6,286	56,578	EURIBOR + 0.65% (2.86%)
ING Bank Eurasia .	USD	26,667	26,666	—	—	—	53,333	LIBOR + 2.25%–4.15% (4.27%–6.17%)
HSBC . . . . .	USD	10,000	10,000	—	—	—	20,000	LIBOR + 2.75% (4.66%)
Ericsson . . . . .	USD	10,800	6,300	—	—	—	17,100	LIBOR + 4% (6.02%)
Dresdner Bank . . .	USD	10,000	—	—	—	—	10,000	LIBOR + 3.35% (5.37%)
Nordea Bank Sweden . . . . .	USD	3,250	3,250	1,624	—	—	8,124	LIBOR + 0.4% (2.60%)
WestLB . . . . .	EUR	—	—	5,039	—	—	5,039	EURIBOR +2% (4.21%)
KFW . . . . .	EUR	1,338	—	—	—	—	1,338	EURIBOR + 0.95% (3.16%)
Other loans . . . . .	USD	639	479	31	—	—	1,149	LIBOR + 1.15%–6.55% (3.17%–8.57%)
Total variable debt . .		<u>\$75,267</u>	<u>\$59,268</u>	<u>\$219,267</u>	<u>\$12,573</u>	<u>\$6,286</u>	<u>\$372,661</u>	
Weighted average interest rate . . . .		5.04	4.95	4.56	2.86	2.86	4.63	

We would experience an additional interest expense of approximately \$3.7 million on an annual basis as a result of a hypothetical increase in the LIBOR/EURIBOR by 1% over the current rate as of September 30, 2004. The fair value of our publicly traded fixed-rate long-term notes as of September 30, 2004 ranged from 100.3% to 106.0% of the notional amount. As of September 30, 2004, the difference between the carrying value and the fair value of other fixed rate debt was immaterial and the majority of capital lease obligations is current. For details of our fixed-rate debt, refer to Note 6 to our interim condensed consolidated financial statements. The fair value of variable rate debt is equivalent to carrying value.

**Foreign Currency Risk**

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 Central Bank of Russia. 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 <sup>(1)</sup>	Period End
<b>Year ended December 31,</b>				
2000 . . . . .	28.87	26.90	28.13	28.16
2001 . . . . .	30.30	28.16	29.22	30.14
2002 . . . . .	31.86	30.14	31.39	31.78
2003 . . . . .	31.88	29.25	30.61	29.45
2004 . . . . .	29.45	27.75	28.73	27.75

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

	Rubles per U.S. dollar	
	High	Low
July 2004 . . . . .	29.13	29.04
August 2004 . . . . .	29.28	29.10
September 2004 . . . . .	29.26	29.21
October 2004 . . . . .	29.22	28.77
November 2004 . . . . .	28.78	28.24
December 2004 . . . . .	28.15	27.75

Source: Central Bank of Russia.

On January 26, 2005, the exchange rate between the ruble and the U.S. dollar was 27.98 rubles per U.S. dollar.

The following tables show, for the periods indicated, certain information regarding the exchange rate between the hryvnia and the U.S. dollar, based on data published by the National Bank of Ukraine. These rates may differ from the actual rates used in preparation of our financial statements and other financial information provided herein.

	Hryvnias per U.S. dollar			
	High	Low	Average <sup>(1)</sup>	Period End
<b>Year ended December 31,</b>				
2000 . . . . .	5.60	5.22	5.44	5.43
2001 . . . . .	5.43	5.27	5.37	5.30
2002 . . . . .	5.33	5.30	5.33	5.33
2003 . . . . .	5.33	5.33	5.33	5.33
2004 . . . . .	5.33	5.31	5.32	5.31

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

	Hryvnias per U.S. dollar	
	High	Low
July 2004 . . . . .	5.32	5.32
August 2004 . . . . .	5.32	5.31
September 2004 . . . . .	5.31	5.31
October 2004 . . . . .	5.31	5.31
November 2004 . . . . .	5.31	5.31
December 2004 . . . . .	5.31	5.31

Source: National Bank of Ukraine.

On January 26, 2005, the exchange rate between the hryvnia and the U.S. dollar was 5.30 hryvnias per U.S. dollar.

Our principal exchange rate risk involves changes in the value of the ruble and the euro relative to the U.S. dollar. As a result of inflation in Russia and Ukraine, we link our monetary assets and transactions, when possible, to the U.S. dollar, which under SFAS No. 52 is reported in this offering memorandum 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 a majority of our tariffs in Russia, 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 Central Bank of Russia on the date of payment.

If either of the ruble or the hryvnia declines 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 and hryvnias is also subject to risk of loss in U.S. dollar terms. In particular, we are unable mostly due to virtually absence of the respective market in Russia to hedge the risks associated with our ruble and hryvnia bank or deposit accounts. Generally, as the value of the ruble or the hryvnia declines, our net ruble and hryvnia monetary asset position results in currency remeasurement losses.

The potential decline in the value of the ruble or hryvnia against the U.S. dollar also reduces the U.S. dollar value of tax savings arising from the depreciation of our property, plant and equipment since their basis for tax purposes is denominated in rubles or hryvnias at the time of the investment or acquisition.

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

We would experience a loss of \$14.8 million in the fair value of our ruble and hryvnia-denominated net monetary assets as a result of a hypothetical 10% increase in the U.S. dollar to ruble/hryvnia exchange rate at September 30, 2004. We would experience a loss of \$5.1 million in the fair value of our euro-denominated monetary liabilities as a result of a hypothetical 10% decline in the U.S. dollar to euro exchange rate at September 30, 2004. We are unable to estimate future loss of earnings as a result of such changes.

## BUSINESS

### Business Overview

We are a leading provider of mobile cellular communications services in the Russian Federation, Ukraine and certain other CIS countries, employing technology based primarily on Global System for Mobile Communications, or GSM. For the nine months ended September 30, 2004, we generated net revenues of \$2,807.3 million and had a subscriber base of 26.6 million (20.8 million in Russia, 5.5 million in Ukraine and 0.3 million in Uzbekistan) at September 30, 2004, making us the largest mobile operator in each of these three countries in terms of subscribers.

In addition to standard voice services, we offer our subscribers value-added services including voice mail, short message service, or SMS, general packet radio service, or GPRS, and various SMS- and GPRS-based information and entertainment services (including multi-media message service, or MMS). We also offer our subscribers the ability to roam automatically throughout Europe and in much of the rest of the world, and as of September 30, 2004 we had bilateral roaming agreements with 283 wireless operators in 159 countries.

We have grown rapidly since 1999 through organic growth, as well as acquisitions. The table below sets forth our total subscribers as of the end of, and net revenues for each of, the last five years and the nine months ended September 30, 2004:

<u>Period</u>	<u>Subscribers<sup>(1)</sup></u>	<u>Net revenues</u>
	(in thousands)	
1999 .....	306	\$ 358,327
2000 .....	1,194	535,712
2001 .....	2,650	893,247
2002 .....	6,644	1,361,756
2003 .....	16,720	2,546,198
September 30, 2004 .....	26,633	2,807,338

<sup>(1)</sup> We define a subscriber as an individual or organization whose account shows chargeable activity within the previous 61 days (or 183 days in the case of the “Jeans” brand tariffs) and whose account does not have a negative balance for more than this period.

According to AC&M-Consulting, we had a leading 35% market share of total wireless subscribers in Russia at September 30, 2004. Our market share in the Moscow license area, which encompasses the City of Moscow and the Moscow region, was higher at 45%. The Moscow license area accounts for approximately 25% of our total subscriber base. In Ukraine, we had a leading 52% market share at September 30, 2004, according to AC&M-Consulting. Our subscriber base continued to grow in the fourth quarter of 2004. At December 31, 2004, we had approximately 34.2 million subscribers, of which 26.5 million were in Russia, 7.4 million were in Ukraine and 0.3 million were in Uzbekistan.

Russia is our principal market, both in terms of subscribers and revenues. At September 30, 2004, approximately 78% of our subscriber base was in Russia and approximately 21% was in Ukraine. For the nine months ended September 30, 2004, approximately 79.0% of our revenues came from operations in Russia and 20.6% from operations in Ukraine.

Overall wireless penetration in Russia was at approximately 41% at September 30, 2004, and higher in Moscow at 87%, according to AC&M-Consulting. Mobile cellular penetration in Ukraine was lower than in Russia at approximately 22% at September 30, 2004, according to AC&M-Consulting. Mobile cellular penetration in Uzbekistan was at approximately 2% at September 30, 2004, according to AC&M-Consulting. The relatively low level of mobile penetration in the markets in which we operate presents us with future growth opportunities.



As of September 30, 2004, we had licenses to operate in 87 regions of Russia with a population of approximately 142.6 million people, or approximately 98% of the country's total population, for the entire territory of Ukraine with a population of approximately 48 million people and for the entire territory of Uzbekistan with a population of approximately 25.2 million people. As of September 30, 2004, we had commercial operations in 63 regions of Russia, with a combined population of approximately 125.3 million people, in all of Ukraine and in selected areas of Uzbekistan. Since September 30, 2004, we have commenced operations in four additional regions with a combined population of approximately 3.5 million people.

To maintain and increase our market share and brand awareness, we use a combination of print media, radio, television, direct mail and outdoor advertising, focusing on brand and image advertising as well as promotion of particular tariff plans. Supporting these efforts, we have developed an extensive distribution network with over 300 proprietary sales and customer service offices and an additional 27,000 points of sale operated by our dealers, as of September 30, 2004.

We seek to minimize our exposure to the credit risk of our subscribers through our advance-payment billing system, which is used by over 98% of our subscribers in Russia and approximately 80% of our subscribers in Ukraine. Under this system, our subscribers prepay for their access, usage and value-added service fees.

MTS Belarus had 0.97 million subscribers and a leading market share of 49% at September 30, 2004, according to AC&M-Consulting. The subscriber base of MTS Belarus grew to 1.2 million at December 31, 2004. Belarus, a country with a population of approximately 9.8 million, had a mobile cellular penetration rate of 20% at September 30, 2004, according to AC&M-Consulting.

### **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 Sidorov, President and Chief Executive Officer; Mr. Yuri Gromakov, Vice President; Mr. Nikolai Tsekhomsky, Vice President—Finance and Chief Financial Officer; Ms. Tatiana Evtushenkova, Vice President—Investment and Corporate Development; Mr. Igor Stolyarov, Vice President—Sales and Customer Service; and Mr. Sergey Aslanyan, Vice President and Chief Information Officer. 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 brand recognition helps us to attract new customers and retain existing subscribers.***

As penetration in the mobile markets in which we operate increases, we expect competitive advantage to shift towards operators with favorable 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 in Russia and the “UMC,” “Sim-Sim” and “Jeans” brands in Ukraine.

#### ***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 12,705 base stations operational in Russia and Ukraine as of September 30, 2004. We were operational in 63 regions of Russia and in Ukraine and Uzbekistan, as of September 30, 2004. MTS Belarus, our 49%-owned affiliate, operates in Belarus.

In most of the regions where we hold licenses, we have frequency allocations in both the 900 and 1800 MHz bands. These allocations allow us 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.

### **Business Strategy**

Our primary goal is to maintain our position as a leading wireless operator in Russia and the CIS by strengthening our position across the markets in which we operate and deploying a customized approach to different customer segments. To accomplish this, we intend to implement the following strategies:

- Maintain our leading position by growing our subscriber base and focusing on the quality of our subscriber mix.
- Selectively expand our network to areas in which we do not already operate, focusing on high-density population areas and on areas along transportation routes.
- Continue to provide clearly structured tariff plans and branding propositions, as well as value-added service options, which appeal to the various groups of subscribers within our network, including SMS- and GPRS-based services.
- Continue to take advantage of our strong position in the major urban license areas, including Moscow and St. Petersburg, as a platform from which to test and launch new products and services.
- Further develop subscriber loyalty programs aimed at retaining our most valuable high-revenue subscribers.

In the past few years, we have rapidly expanded into the Russian regions and select CIS countries through launches of operations in territories in which we had licences and through acquisitions of other mobile operators. Starting in 2003, we have become particularly focused on the integration of our existing businesses into a single company with a unified marketing approach and centralized network and operations management. We are currently working to complete the implementation of a centrally-managed corporate function to enhance performance and efficiency at all levels of our operations and simultaneously integrate our operations. In addition, we intend to continue to consolidate our ownership in regional subsidiaries by acquiring remaining minority stakes.

Our capital expenditures (consisting of purchases of property, plant and equipment and intangible assets) in 2003 and for the nine months ended September 30, 2004 were \$958.8 million and \$780.2 million, respectively, and we expect to invest approximately \$400 million in the fourth quarter of 2004 and approximately \$1.8 billion in 2005. These investments are required to support the growth of our subscriber base (*i.e.*, to improve network capacity) and to develop our network in the new regions for which we received licenses in 2003 and 2004.

We may also expand our operations into other countries of the CIS through the acquisition of existing operators or new licenses as attractive opportunities arise.

Implementation of these strategies is subject to a number of risks. See “Risk Factors” for a description of these and other risks we face.

## **History**

Mobile TeleSystems CJSC, or MTS 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%. JSFC Sistema, or Sistema, currently owns 50.6% of our share capital. See “Principal Shareholders.”

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.

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, which is our date of incorporation, 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 American Depositary Shares, or ADSs, on the New York Stock Exchange under the symbol “MBT.” Each ADS represents five underlying shares of our common stock. Prior to January 1, 2005, each ADS represented 20 shares.

In December 2004, T-Mobile completed an offering of 300,800,000 of our shares, or approximately 15.1%, in the form of GDRs through an unsponsored GDR program.

Article 2.1 of our charter provides that our principal purpose is to obtain profits through the planning, marketing and operation of a radiotelephone mobile cellular network in the Russian Federation. We are recorded in the Unified State Register of Legal entities with registration number 1027700149124.

## **Expansion**

### **Russia**

In furtherance of our goal to be a nationwide operator in Russia, we have extended our focus beyond our original market of 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. For a listing of our acquisitions, see Note 4 to our annual consolidated financial statements and Notes 2 and 11 to our interim condensed consolidated financial statements.

### **Belarus**

In September 2001, we won a tender held by the Telecommunications Ministry of the Belarus Republic to form a joint venture with a GSM 900/1800 license to operate in Belarus. Belarus had a

population of approximately 9.8 million and a nationwide mobile penetration rate of approximately 20% as of September 30, 2004, according to AC&M-Consulting. Pursuant to the tender conditions:

- we formed a company in Belarus, MTS Belarus, and contributed approximately \$2.5 million in exchange 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;
- MTS Belarus made a one-time payment of \$5 million (which was funded by a \$5 million loan from us to it) and will make annual payments of \$60,000 to the government of Belarus for its GSM 900/1800 license; 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, MTS Belarus received all of the governmental approvals and licenses required to commence operations in Belarus and it began operations on June 27, 2002. See Note 20 to our annual consolidated financial statements for further description of MTS Belarus.

Under the terms of the tender, MTS Belarus' 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 Belarusian state enterprises, Beltelecom and Beltechexport, which jointly own 51%, and SB Telecom, a Cypriot company owning 49%.

MTS Belarus has spent \$45.3 million in the nine months ended September 30, 2004 for network development in Belarus. MTS Belarus estimates that it will spend approximately \$19.7 million in the fourth quarter of 2004 and expects to spend at least \$80 million in 2005 for network development. MTS Belarus initially plans 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, MTS Belarus expects to develop its network in certain areas near Belarus' border with Ukraine and Russia.

## **Ukraine**

In March 2003, we purchased a 57.7% stake in UMC for \$199.0 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. 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. As of September 30, 2004, these loans were fully repaid.

At the time of our acquisition, UMC had trailed the market leader, Kyivstar, in terms of subscribers, but had maintained market leadership in terms of revenue. Our main strategy for UMC for 2003 was to regain market leadership in terms of subscribers. By the end of the third quarter of 2003, UMC had regained the market leadership by subscribers, following four strong months of subscriber growth, in part fuelled by the launch of the "Jeans" brand in mid-August 2003. UMC ended the year with 3.4 million subscribers, a growth of 97% during the year, and achieved a 51% overall market share in Ukraine. As of September 30, 2004, UMC had 5.5 million subscribers and a 52% market share, according to AC&M-Consulting. As of December 31, 2004, UMC had 7.4 million subscribers.

## Uzbekistan

In August 2004, we acquired a 74% stake in Uzdunrobita, the largest wireless operator in Uzbekistan, for \$121 million in cash. We also entered into put and call option agreements with the existing shareholders to acquire the remaining 26% stake for not less than \$37.7 million. The exercise period for the call and put option is 48 months from the acquisition date.

## Recent Acquisitions

In November 2004, we won a government tender to acquire 76% stake in Gorizont RT, a cellular operator in the Republic of Saha (Yakutia) in the Far-East of Russia, for cash consideration of \$52.2 million. Gorizont RT is the sole mobile services provider in the region with a population of 949,300. The company's subscriber base is approximately 100,000 subscribers.

In November 2004, we signed an agreement to acquire from MCT Corp. a 93.5% stake in Sibintertelecom, a mobile phone operator in the Chita region and Aginsk-Buryatsk Autonomous District in the Far-East of Russia, for cash consideration of \$37.3 million. Sibintertelecom is the sole mobile services provider in the two regions with a total population of 1.2 million. The company's subscriber base is approximately 100,000 subscribers.

In December 2004, we signed an agreement to acquire from UTK OJSC a 52.5% stake in Telesot-Alania, a mobile phone operator in the Republic of North Ossetia in the Southern part of Russia, for cash consideration of \$6.2 million. Telesot-Alania is the largest mobile services provider in the region with a total population of 710,000. The company's subscriber base is approximately 54,000 subscribers.

## Current Operations

### Subsidiaries

For a list of our major subsidiaries and our ownership percentages in these subsidiaries, see Note 1 to our interim condensed consolidated financial statements.

Consistent with our strategy, in November 2004, the general meeting of our shareholders approved a reorganization of MTS OJSC in the form of merger with Telecom XXI, Kuban-GSM, UDN-900, Donteicom, MTS Barnaul, MTS-NN and Telecom-900.

### License Areas

The following table shows, as of September 30, 2004, information with respect to the license areas in which we and our affiliates provide or expect to provide GSM services:

License Region	GSM 900		GSM 1800	
	Licensee	Expiry date	Licensee	Expiry date
<b>Moscow License Area</b>				
Moscow . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Moscow region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
<b>St. Petersburg License Area</b>				
St. Petersburg . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Leningrad region . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008

License Region	GSM 900		GSM 1800	
	Licensee	Expiry date	Licensee	Expiry date
<b>Russian Regional License Areas</b>				
<b>European Russia</b>				
Adygeya Republic . . . . .	Kuban-GSM	April 28, 2008	Kuban-GSM	April 28, 2008
Arkhangelsk region . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Astrahansk region . . . . .	MTS OJSC	December 11, 2013	Astrahan-Mobile	October 18, 2011
Bashkortostan Republic . .	BM-Telecom	August 22, 2007	BM-Telecom	August 22, 2007
Belgorod region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Belgorod region . . . . .	ReCom	May 15, 2008	—	—
Bryansk region . . . . .	ReCom	May 15, 2008	—	—
Bryansk region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Chuvashia Republic <sup>(1)</sup> . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Dagestan Republic <sup>(1)</sup> . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Ivanovo region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Ingushetia Republic <sup>(1)</sup> . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Kabardino-Balkar Republic <sup>(1)</sup> . . . . .	—	—	MTS OJSC	December 30, 2013
Kaliningrad region . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Kalmykia Republic <sup>(1)</sup> . . . .	BIT	January 25, 2011	MTS OJSC	December 30, 2013
Kaluga region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Karachaevo-Cherkesia Republic <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Karelia Republic . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Kirov region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Komi Republic . . . . .	MTS OJSC	August 22, 2007	MTS OJSC	April 28, 2008
Komi-Permyatsk Autonomous District . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Kostroma region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Krasnodar territory . . . . .	Kuban-GSM	May 30, 2007	Kuban-GSM	May 30, 2007
Kursk region . . . . .	—	—	MTS OJSC	April 28, 2008
Kursk region . . . . .	ReCom	May 15, 2008	—	—
Lipetsk region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Lipetsk region . . . . .	ReCom	May 15, 2008	—	—
Mari-El Republic <sup>(1)</sup> . . . . .	Mar Mobile GSM	January 15, 2012	Mar Mobile GSM	January 15, 2012
Mordovia Republic <sup>(1)</sup> . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Murmansk region . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Nenets Autonomous District . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Nizhny Novgorod region . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Novgorod region . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Orel region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Orel region . . . . .	ReCom	May 15, 2008	—	—
Orenburg region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Perm region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Rostov region . . . . .	Dontelecom	July 1, 2005	Dontelecom	July 1, 2005
Pskov region . . . . .	MTS OJSC	October 1, 2006	—	—
Pskov region . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008



License Region	GSM 900		GSM 1800	
	Licensee	Expiry date	Licensee	Expiry date
Ryazan region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Samara region . . . . .	MTS OJSC	December 30, 2012	MTS OJSC	December 30, 2012
Saratov region . . . . .	MTS OJSC	July 11, 2012	MTS OJSC	July 11, 2012
Severnaya Osetia-Alania Republic <sup>(1)</sup> . . . . .	—	—	MTS OJSC	December 30, 2013
Smolensk region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Stavropol territory <sup>(1)</sup> . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Tambov region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Tatarstan Republic . . . . .	TAIF Telecom	June 26, 2007	TAIF Telecom	June 26, 2007
Tula region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Tver region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Udmurt Republic . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Udmurt Republic . . . . .	UDN-900	February 21, 2007	—	—
Ulyanovsk region <sup>(1)</sup> . . . . .	—	—	MTS OJSC	December 30, 2013
Vladimir region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Volgograd region . . . . .	—	—	Volgograd-Mobile	October 4, 2011
Vologda region . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Voronezh region . . . . .	ReCom	May 15, 2008	—	—
Voronezh region . . . . .	—	—	MTS OJSC	April 28, 2008
Yaroslavl region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
<b>Asian Russia</b>				
Aginski-Buryatski Autonomous District <sup>(1)</sup> . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Altai territory . . . . .	MTS-Barnaul	September 8, 2010	MTS-Barnaul	September 8, 2010
Altai Republic . . . . .	SCS-900	July 19, 2011	MTS OJSC	December 30, 2013
Amur region . . . . .	ACC	January 10, 2007	ACC	January 10, 2007
Amur region . . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Buryatiya Republic <sup>(1)</sup> . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Chelyabinsk region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Chita region <sup>(1)</sup> . . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Chukotsk Autonomous District <sup>(1)</sup> . . . . .	BIT	July 19, 2011	—	—
Chukotsk Autonomous District <sup>(1)</sup> . . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Evenkia Autonomous District <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Jewish Autonomous region <sup>(1)</sup> . . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Irkutsk region . . . . .	MTS OJSC	December 30, 2013	—	—
Irkutsk region . . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Kamchatka region <sup>(1)</sup> . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Kemerov region <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Khabarovsk Territory . . . .	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	Sibchallenge	September 13, 2011

License Region	GSM 900		GSM 1800	
	Licensee	Expiry date	Licensee	Expiry date
Khanty Mansiysk Autonomous District . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Koryakski Autonomous District <sup>(1)</sup> . . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Krasnoyarsk Territory . . .	Sibchallenge	December 21, 2010	Sibchallenge	September 13, 2011
Kurgan region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Magadan region <sup>(1)</sup> . . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Novosibirsk region . . . . .	SCS-900	February 21, 2007	SCS-900	February 21, 2007
Omsk region . . . . .	MSS	December 20, 2006	MSS	December 20, 2006
Primorsky Territory . . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Saha Republic (Yakutia) <sup>(1)</sup> . . . . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Sakhalin region <sup>(1)</sup> . . . . .	BIT	July 19, 2011	—	—
Sakhalin region <sup>(1)</sup> . . . . .	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
Tomskaya region . . . . .	TSS	June 5, 2008	TSS	June 5, 2008
Tyumen region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Tyva Republic <sup>(1)</sup> . . . . .	BIT	July 19, 2011	MTS OJSC	December 30, 2013
Ust-Ordynski Buriatsk Autonomous District <sup>(1)</sup> . .	Primtelefon	April 28, 2008	Primtelefon	April 28, 2008
Yamalo-Nenetsk Autonomous District . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
<b>Ukraine</b>				
Ukraine . . . . .	UMC	December 3, 2013	UMC	December 3, 2013
<b>Uzbekistan</b>				
Uzbekistan . . . . .	Uzdunrobita <sup>(2)</sup>	June 30, 2016	Uzdunrobita	June 30, 2016
<b>Belarus</b>				
Belarus . . . . .	MTS Belarus	April 30, 2012	MTS Belarus	April 30, 2012

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

<sup>(2)</sup> Our GSM 900 license for Uzbekistan excludes the city of Tashkent.

Each of our licenses requires service to be started by a specific date and most contain further requirements as to network capacity and territorial coverage to be reached by specified dates. 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 government nor other parties have taken or attempted to take legal actions to suspend, terminate 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 September 30, 2004, we had bilateral roaming contracts with 283 wireless operators in approximately 159 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 September 30, 2004, in addition to our network coverage area in 63 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 eight 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 several value-added services to our customers. 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. Some basic value-added services that we offer include:

- 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 via the Internet;
- Short Message Service, or SMS;
- General Packet Radio Service, or GPRS;
- Multi-Media Message Service, or MMS;

- Wireless Application Protocol, or WAP;
- New technologies-based services, including wireless local area network, or WLAN, location based services, or LBS, and others; and
- SIM-browser.

We also provide many voice and SMS-based value-added services in cooperation with various content providers.

### **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 mobile cellular services market, aggressively targeting new customer segments. With mobile cellular penetration in Russia above 41%, as of September 30, 2004, mobile cellular services are now used by a much wider group of the population, including students and retirees. Though we have historically focused primarily on our core segment of business customers, we have now extended our focus more toward the general population, developing customized products for different market segments. We believe that we will be able to provide network capacity and expand our coverage area to serve these new customer segments.

Over time, we have adjusted our service model to provide differentiated levels of service to meet the needs of distinctive customer segments as such segments have developed. For example, we introduced prepaid tariffs marketed to young subscribers and low-volume subscribers under the “Jeans” brand name in 2002. Based on the popularity of our “Jeans” tariffs, we subsequently revised our service offerings marketed under the “Jeans” brand name to develop unique products for different customer segments, including corporate and individual subscribers. We also actively promote our prepaid services to family members of existing subscribers, students, retirees and other mass market customers.

### **Advertising and Marketing**

Our advertising and public relations initiatives include:

- brand and image advertising and public relations to position us as the leading mobile cellular operator in Russia and Ukraine;
- information advertising and promotion to inform potential customers of the advantages of the high quality and variety of our services and the extensive coverage we offer; and
- product- and tariff-related advertising and promotion for specific marketing campaigns, 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 selected television programs, sporting events,

concerts and other popular events. 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 have expanded our network, we have concentrated a greater part of our advertising and marketing effort on positioning the MTS and Jeans brands as national brands. In addition, we 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 September 30, 2004, we had 250 sales and customer service centers in Russia and 35 in Ukraine. In response to the demand shift to mass market subscribers, we have developed an extensive distribution network through independent dealers that operate numerous outlets in places of high consumer activity, such as supermarkets and malls. 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 revenues generated by subscribers that they enroll. The commission in the Moscow license area, up to \$120 per subscriber as of September 30, 2004, increases with the number of new subscribers a dealer signs. As of September 30, 2004, the commission in St. Petersburg was between \$18.5 and \$50. Dealer commissions in the other regional license areas in Russia were between \$4 and \$60. Dealer commissions in Ukraine were between \$10.1 (for prepaid) and \$21.9 (for postpaid). 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.

Prior to February 1, 2004, we paid the full amount of commission when a dealer activated a subscriber’s contract. If such subscriber’s usage of our voice and non-voice services over the following six-month period amounted to less than the amount of the dealer’s commission, the dealer was required to reimburse the difference to us. Effective from February 1, 2004, in the Moscow license area, dealer commissions are deferred over a period of up to one year. We now pay commissions to dealers on a monthly basis, based on the revenues we receive from subscribers activated by a particular dealer. However, the total amount of commissions paid to dealers has remained unchanged. We believe that the new method for paying commissions to dealers provides dealers with greater incentives to renew subscriptions, reduces the risk of dealer fraud and improves our cash-flow management, as dealers are not credited for up to a year after a subscriber is activated.

During the first nine months of 2004, approximately 71% of our new subscribers enrolled through independent dealers in Russia and 89% in Ukraine, 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**

#### **The Russian wireless telecommunications market**

The Russian wireless telecommunications market is characterized by rapid growth in subscribers and revenues and increasing consolidation among a few large national operators. As of September 30,

2004, overall wireless penetration in Russia was 41%, or approximately 59 million subscribers, according to AC&M-Consulting.

Demand for wireless communications services in Russia grew rapidly over the last ten years due to rising disposable incomes, increased business activity and declining prices due to intensified competition among wireless communications providers. The number of wireless subscribers more than doubled in each of the last two years, with Russia's regional markets growing at almost triple the rate of Moscow and St. Petersburg. The Russian market has achieved high levels of penetration in Moscow and St. Petersburg, with more than 79 subscribers per 100 residents at September 30, 2004, according to AC&M-Consulting. Regional markets remain relatively under-penetrated, with an average of less than 33 subscribers per 100 residents.

The following table sets forth key data on Russia's wireless telecommunications market:

	As of December 31,					As of September 30, 2004
	1999	2000	2001	2002	2003	
	(Amounts in millions)					
Subscribers <sup>(1)</sup> . . . . .	1.0	3.0	6.3	18.0	36.3	59.0
Subscriber penetration . . . . .	1%	2%	4%	12%	25%	41%

Source: AC&M-Consulting.

<sup>(1)</sup> Based on registered subscribers. There is no uniform definition of active lines in service in the Russian fixed line market.

According to AC&M-Consulting and our own data, we accounted for 43% and 45% of subscribers in Moscow, 34% and 32% of subscribers in the North-West region and 37% and 35% of total Russian subscribers as of December 31, 2003 and September 30, 2004, respectively.

The competition has evolved in recent years to exist primarily between us, Vimpelcom and MegaFon, each of which has effective national coverage in Russia. Competition today is based largely on local tariff prices and secondarily on network coverage and quality, the level of customer service provided, roaming and international tariffs and the range of services offered. For a description of the risks 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 and loss of market share, as well as different pricing, service or marketing policies."

The following table illustrates the number of wireless subscribers for each network operator in Russia as of December 31, 2001, 2002, 2003 and at the nine months ended September 30, 2004:

Operator	As of December 31,			Nine Months Ended September 30, 2004
	2001	2002	2003	
MTS <sup>(1)</sup> . . . . .	2,650,000	6,640,000	13,370,000	20,842,423
Vimpelcom <sup>(2)</sup> . . . . .	2,111,500	5,153,088	11,436,900	20,550,000
MegaFon group <sup>(2)</sup> . . . . .	913,004	2,935,936	6,340,335	11,487,353
Others <sup>(2)</sup> . . . . .	2,365,496	3,275,976	5,082,765	6,867,443

<sup>(1)</sup> According to MTS' data.

<sup>(2)</sup> Source: AC&M-Consulting.

### Vimpelcom

Vimpelcom, which operates both D-AMPS and GSM 900/1800 networks, is one of our primary competitors in Russia, and it is the second largest GSM wireless operator in Russia in terms of



subscribers. We believe that Vimpelcom will continue to be our primary competitor for the foreseeable future.

According to AC&M-Consulting, Vimpelcom had approximately 20.6 million subscribers in Russia at September 30, 2004, including 6.6 million in the Moscow license area. At September 30, 2004, according to AC&M-Consulting, Vimpelcom had a 45% market share in Moscow and a 34% market share of total wireless subscribers in Russia.

### **MegaFon**

In addition to Vimpelcom, we also compete with MegaFon, which is the third largest operator in Russia in terms of subscribers. The MegaFon group holds GSM 900/1800 licenses to operate in all 89 regions of the Russian Federation.

According to AC&M-Consulting, MegaFon had a subscriber base of 11.5 million in Russia at September 30, 2004, including 1.4 million subscribers in the Moscow license area. At September 30, 2004, according to AC&M-Consulting, MegaFon had a 46% market share in the North-West region and a 19% market share of total wireless subscribers in Russia.

In addition, there has been speculation in the media of a merger between MegaFon and Vimpelcom following Alfa Group's August 2003 purchase of a 25.1% stake in MegaFon. For a description of the potential impact of such merger on us, see "Risk Factors—Risks Relating to Our Industry—A merger between our two largest competitors would result in a change in our relative market share in the Russian mobile communications market."

### **Other Operators**

In addition to our principal competitors, Vimpelcom and MegaFon, we also compete with local GSM and D-AMPS operators in several Russian regions.

In certain regions of the Urals part of Russia, our primary competitor is Uralsvyazinform, which had approximately 1.78 million subscribers as of September 30, 2004. In certain regions of the Volga part of Russia, we compete with SMARTS, which had approximately 1.6 million customers as of September 30, 2004. The preceding subscriber numbers, in each case, are according to AC&M-Consulting.

### **The Ukrainian wireless telecommunications market**

The Ukrainian wireless telecommunications market has, until recently, been characterized by low levels of penetration and historical under investment in wireless telecommunications infrastructure. Since 2000, the Ukrainian wireless telecommunications market has enjoyed rapid growth in part due to broader economic recovery in Ukraine, changes in ownership of the two major operators and the more recent introduction of calling-party pays billing arrangements. In 2003, overall wireless penetration in Ukraine increased by 6% to reach 14%, or approximately 6.5 million subscribers, according to AC&M-Consulting. According to the same agency, total revenues in the wireless communications market reached \$815 million in 2003, representing an increase of 38% in 2003.

The following table shows the number of subscribers as of the dates indicated and the coverage area of UMC and our competitors in Ukraine:

Operator	December 31, 2003	September 30, 2004	Coverage Area
UMC . . . . .	3,348,610	5,527,519	Nationwide
Kyivstar . . . . .	3,036,000	5,040,000	Nationwide
Golden Telcom . . . . .	41,000	57,000	Kiev, Odessa
DCC . . . . .	85,000	85,000	Kiev, Odessa, Dnepropetrovsk, Donesk, Lugansk, Crimea
WellCOM . . . . .	39,810	47,000	Kiev

Source: MForum.ru

In Ukraine, we compete primarily with Kyivstar, a GSM operator with over 5.0 million subscribers as of September 30, 2004. Kyivstar is owned by Telnor and Alfa Group. Kyivstar offers wireless services using GSM 900 and GSM 1800 technologies and was the market leader in terms of subscribers from June 2001 until September 2003, according to Kyivstar press releases. Golden Telecom Ukraine, which is beneficially owned by Alfa Group, Telnor and Rostelecom, offers wireless services using GSM 1800 technology. DCC holds a license to provide wireless cellular services using the D-AMPS standard and, through its subsidiary Astelit, holds a GSM-1800 license. According to press reports, Turkcell has acquired a controlling interest in DCC. URS WellCOM has a license and operates a limited network in the GSM-900 standard. In addition, Telesystemy Ukrainy and Elsakom-Ukraine each hold licenses to offer wireless services in Ukraine but do not yet operate.

## Tariffs

We customize our marketing efforts and pricing policies in each region of Russia 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 VIP,” “MTS Business” and “MTS Optima”—with each category designed to target specific segments as follows:

- *MTS Corporation*: MTS Corporation tariff plans are available to corporate clients nationwide. They feature substantial discounts on calls within the group of subscribers under a particular contract, 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 to \$100 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.

Although we offer the same categories of tariff plans throughout Russia, the prices of these plans differ from region to region and are generally higher in the Moscow license area. We introduced a unified system of tariff plans to achieve such benefits as better perception of tariff plans and clarity, simplicity and transparency for prospective subscribers throughout Russia, as well as savings on our marketing and advertising expenses through unified advertising campaigns in Moscow and the regions.

We set prices with reference to market conditions 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 began to target the mass-market subscriber segment with a 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. As of September 30, 2004, the per-minute tariff for calls to Moscow from Moscow varied from \$0.15 per minute to \$0.18 per minute during peak periods and from \$0.075 per minute to \$0.09 per minute during off-peak periods, with some plans offering discounted rates at night, sometimes as low as \$0.075 per minute. The “Jeans” tariffs varied from \$0.01 per minute to \$0.36 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 \$0.26 per minute during off-peak periods, with some plans offering discounted rates at night, sometimes as low as \$0.03 per minute; in St. Petersburg tariffs varied from \$0.04 per minute to \$0.17 per minute. The “Jeans” tariffs varied from \$0.01 per minute to \$0.26 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 \$1.27 per minute for calls to Europe to \$2.78 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 of up to \$3.00 per month, depending on the plan.

We also offer unified tariff plans in all territories of Ukraine in which we operate, including private contract, business and prepaid plans. In addition, we are developing new tariff plans for Ukraine that focus on the differing needs of subscribers in the various market segments.

As of September 30, 2004, the per minute prices in Ukraine varied from \$0.39 per minute to \$0 per minute during peak periods and from \$0.39 per minute to \$0 per minute during off-peak and night periods. Certain UMC plans also include special tariffs for intra-network calls that ranged from \$0.15 per minute to \$0 per minute. Higher rates applied to international calls ranging from \$3.60 per minute to \$0.37 per minute (excluding VAT).

In addition, in the Moscow license area, calls from one mobile 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 up to 75% 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 our “Jeans” brand tariff plans geared at mass-market subscribers 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. Our “Jeans” tariff subscribers in Russia receive all incoming calls free of charge from other MTS subscribers and, in many regions, from subscribers of other mobile operators. As of September 30, 2004, Jeans subscribers accounted for 62.5% of our total subscribers and 71.2% and 32.8% of our subscribers in Russia and Ukraine,

respectively. In addition, we offer a second set of prepaid tariffs in Ukraine marketed under the “Sim-Sim” brand. As of September 30, 2004, “Sim-Sim” subscribers accounted for 50.7% of our subscribers in Ukraine.

### **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 prepays 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 seven-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 telephonic reminder or SMS twice in such seven-day period of the decreasing account balance and an additional reminder one day prior to termination, 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 September 30, 2004, subscribers using the credit system of payment had a maximum credit limit of \$500. 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 September 30, 2004, approximately 1% of our customers used the credit system, while 99% 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 balances. However, during 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 adverse effect on our business and results of operations” for further description of this fraud.

We are currently in the process of migrating our “Jeans” subscribers onto a new billing system and plan to migrate our other subscribers in Russia onto this system during 2005.

Our tariffs are primarily quoted in currency units equivalent to U.S. dollars, except for some regions of Russia where tariffs are quoted in rubles or the local currency. Invoices quoted in U.S. dollar-equivalent units specify the amount owed in such 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.

All tariffs for UMC subscribers are quoted in hryvnias. We offer our subscribers in Ukraine various ways to pay for our services, including by cash or credit card, wire transfer, on account, prepaid 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 markets 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.

UMC subscribers are able to access the information about their account balance, order additional services and receive information about UMC by calling, at no charge to the customer, our call center at “111” or “8-800-500-0-500.”

### **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 and Ukraine, 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, Lucent Technologies, Huawei and other major network equipment manufacturers.

In the Moscow license area, we have allocated frequencies spanning  $2 \times 11.4$  MHz of spectrum in the GSM 900 frequency and  $2 \times 24.6$  MHz of spectrum in the GSM 1800 frequency for operation of a dual GSM 900/1800 network.

In St. Petersburg and the Leningrad region, we have allocated frequencies spanning  $2 \times 8.0$  MHz of spectrum in the GSM 900 frequency and  $2 \times 18.2$  MHz of spectrum in the GSM 1800 frequency for operation of a dual GSM 900/1800 network.

We have frequencies allocated to us for the operation of GSM 900 span and GSM 1800 span in all regions of Ukraine. The radio frequencies allocated to us for the operation of GSM 900 span from 5.6 MHz of spectrum in the Kiev and Zakarpattya regions to 10.4 MHz in Kiev city. We also have been allocated frequencies spanning from 10 MHz in the Ternopil region to 52.8 MHz in the Dnepropetrovsk region for operation of GSM 1800 base stations. In addition, we have applied for an additional 394.8 MHz of GSM 1800 and 9.6 MHz of GSM 900 frequency allocations for all license regions in Ukraine and intend to apply for additional frequency allocations in the 1800 MHz band.

We believe that we have been allocated adequate spectrum in each of our license areas.

In many regions we have upgraded our network to enable us to offer GPRS services, which permit our subscribers access to the Internet, WAP and MMS. As of September 30, 2004, we provided GPRS services to our contract subscribers in 11 regions in Russia, including major metropolitan areas such as Moscow, St. Petersburg and Novosibirsk. We also offer GPRS services in Ukraine.

### **Property and Equipment**

We occupy premises in Moscow at 4 Marksistskaya Street, 5/2 Vorontsovskaya Street, 12/12 Pankratievskaya Street and 10 Teterinsky Pereulok, which we use for administration, as well as operation of mobile switching centers. The rights to use the Marksistskaya and Teterinsky premises were contributed to our charter capital by a founding shareholder. We intend to acquire additional buildings for placement of our switching systems, as well as for use by our sales and customer service, billing, financial control and technical services departments. We also lease 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 and lease office space on an as-needed basis. We also own office buildings in some of our regional license areas and in Ukraine, and we lease office space on an as-needed basis.

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 12,705 base stations comprising our network as of September 30, 2004, 8,209 operated in the 900 MHz band and 4,496 operated in the 1800 MHz band. We also operated 354 base station controllers in Russia and approximately 93 switches in Russia as of September 30, 2004.

Of the 3,397 base stations comprising our network in Ukraine as of September 30, 2004, 2,076 operated in the 900 MHz band and 1,321 operated in the 1800 MHz band. We also operated 98 base station controllers and 12 switches in Ukraine as of September 30, 2004.

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 Invest-Svyaz-Holding, a wholly-owned subsidiary of Sistema and our shareholder. 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 Government 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 Government was expected to announce the license allocation procedure during the second half of 2002 and issue the licenses during 2003, to date, no allocation procedures have been announced. 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 and in Ukraine, including the public switched telephone network operator in the city of Moscow, MGTS, as well as MTU-Inform, majority owned by MGTS, Telmos, a joint venture of MGTS with Sistema and Rostelecom, and Ukrtelecom, UTEL, Golden Telecom and other public switched telephone network operators in Ukraine. 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 in Russia 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. 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 cellular 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. 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 may require us to make substantial investments in public switched telephone networks.” 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 September 30, 2004, we had numbering capacity for over 10.1 million subscribers in the Moscow license area. For a description of how we amortize the acquisition costs of numbering capacity, see Note 2 to our annual 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 ministerial 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.

In Ukraine, mobile operators are allocated numbering capacity by the NCRC. We believe that we have been allocated sufficient numbering capacity in Ukraine for the development of our mobile network. However, the numbering capacity for fixed network development (if we decide to utilize a local license granted to UMC) is insufficient.

### **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.

Our network in Ukraine is monitored by our Kiev operations and maintenance center. In addition to monitoring performance of the network, our Kiev operations and maintenance center analyzes network quality parameters and provides reports and recommendations to management.

## **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 \$12 to \$50 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 2003. 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. Our handset subsidies in Russia for the nine months ended September 30, 2004, were not significant. For the nine months ended September 30, 2004, we provided net handset subsidies of \$35.8 million in Ukraine. 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 are also considering a new marketing initiative under which we would sell MTS-branded handsets.

We have entered into arrangements with Sony Ericsson, Nokia, Motorola, Philips, Panasonic, Samsung, Siemens, Benefon and Alcatel to purchase handsets. We offer approximately 80 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 \$35 to \$640.

## **Employees**

At September 30, 2004, we had 21,553 employees. Over 20% of these employees, or 4,499, worked in Moscow. Of our employees in Russia, 17 were executives; 4,029 were technical and maintenance employees; 9,151 were sales, marketing and customer service staff; and 4,613 were administration and finance staff. As of September 30, 2004, 1,419 of our employees worked in Ukraine. Of these employees, we estimate that six were executives; 486 were technical and maintenance employees; 777 were sales, marketing and customer service staff; and 132 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, 2001, 2002 and 2003 and September 30, 2003 and 2004:

	At December 31,			At September 30,	
	2001	2002	2003	2003	2004
Moscow license area . . . . .	2,633	3,388	4,067	3,909	4,499
Other regions in Russia . . . . .	2,357	7,654	14,367	11,873	14,872
Ukraine . . . . .	—	—	1,121	1,085	1,419
Uzbekistan . . . . .	—	—	—	—	763
Total . . . . .	<u>4,990</u>	<u>11,042</u>	<u>19,555</u>	<u>16,867</u>	<u>21,553</u>

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.

### 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**

### **Regulation in the Russian Federation**

In the Russian Federation, the federal government regulates telecommunications services. The principal law regulating telecommunications in the Russian Federation is the Federal Law on Communications, which provides, among other elements, for the following:

- licensing of telecommunications services;
- requirements for obtaining a radio frequency allocation;
- equipment certification;
- equal rights for individuals and legal entities, including foreign individuals and legal entities, to offer telecommunications services;
- fair competition;
- freedom of pricing other than pricing by companies with monopoly power; and
- liability for violations of Russian legislation on telecommunications.

The new Federal Law on Communications came into force on January 1, 2004 and replaced the law of 1995 regulating the same subject matter. The Federal Law on Communications creates a framework in which government authorities may enact specific regulations. Regulations enacted under the legislative framework in place prior to enactment of the Federal Law on Communications continue to be applied to the extent they do not conflict with the Federal Law on Communications. In the transition period before these regulations are put in compliance with the new law, it is not clear how they would interact with provisions of the new law.

The new law, which confers broad powers to the state to regulate the communications industry, including the allocation of frequencies, the establishment of fees for frequency use and the allocation and revocation of numbering capacity, significantly modifies the system of government regulation of the provision of communications services in Russia. In particular, while under the previous law the Ministry of Communications issued licenses for the provision of wireless communications services at its own discretion, under the new law, licenses to provide communications services in territories where frequency and numbering capacity are limited may be issued only on the basis of a tender. In addition, the new law provides for the establishment of a “universal services reserve fund” to be funded by a levy imposed on all telecommunications service providers, including us. See “Risk Factors—Risks Relating to the Russian Federation and Ukraine—Legal Risks—The implementation of the new Federal Law on Communications and the new Ukrainian Law on Telecommunications will impose an additional financial burden on us which may materially adversely affect our financial condition and results of operations.” The new law also attempts to simplify the succession of licenses to merged or otherwise reorganized companies by instituting a license re-issuance procedure, whereas under the previous law, merged or reorganized companies were required to apply to the Ministry of Communications for the issuance of a new license in such circumstances.

### **Regulatory Authorities**

The Russian telecommunications industry is regulated by several governmental agencies. These agencies, whose functions are not always clearly defined, form a complex, multi-tier system of regulation that resulted, in part, from the implementation of the Federal Law on Communications, as well as from the March 2004 large-scale restructuring of the Russian government. The system of regulation is still evolving and further changes are expected.

*The Ministry of Information Technologies and Communications* is the federal executive body that develops and supervises the implementation of governmental policy in the area of communications and coordinates and controls the activities of its subordinate agencies. The Ministry may issue regulations in the area of communications if authorized to do so by federal legislation (including presidential and governmental decrees).

The following bodies, each of which is subordinate to the Ministry of Information Technologies and Communications, also regulate the telecommunications industry.

*The Federal Service for Supervision in the Area of Communications* is a federal executive body that supervises and controls certain areas of communications and information technologies, including:

- the issuance of licenses and permissions in the area of communications and informatization;
- the registration of radio-electronic and high-frequency equipment;
- the technical supervision of networks and network equipment throughout Russia;
- the monitoring of compliance by network operators with applicable regulations, terms of their licenses and terms of the use of frequencies allocated to them; and
- the enforcement of equipment certification requirements.

*The Federal Agency of Communications* is a federal executive body that implements governmental policy, manages federal property and provides public services in the area of communications, including:

- the allocation of radio frequencies based on decisions taken by the State Radio Frequencies Commission and registration of such allocations;
- the allocation of numerical resources;
- the certification of equipment for compliance with technical requirements;
- the examination of electromagnetic compatibility of equipment with existing civil radio-electronic equipment; and
- the organization of tenders with respect to licenses in the sphere of communications.

*State Radio Frequencies Commission.* The State Radio Frequencies Commission is an inter-agency coordination body acting under the Ministry of Information Technologies and Communications which is responsible for the regulation of radio frequency spectrum and develops a long-term policy for frequency allocation in the Russian Federation.

*Other regulatory authorities.* In addition, the Federal Antimonopoly Service supervises competition regulations and enforces the Federal Law on the Natural Monopolies and the regulations enacted thereunder. The Federal Tariffs Service regulates certain tariffs in the sphere of telecommunications, including the tariffs on the local and DLD calls by subscribers of PSTNs and installation and subscription fees. The Federal Service for Supervision in the Area of Consumer Rights Protection and Human Well-Being is responsible for the enforcement of sanitary regulations, including some authority over the location of telecommunications equipment, and supervises the compliance of companies with the regulations relating to the protection of consumer rights.

### **Licensing of Telecommunications Services and Radio Frequency Allocation**

Telecommunications licenses are issued based on the Regulations on Licensing in the Field of Telecommunications in the Russian Federation, enacted in June 1994, as amended, and, with regard to wireless telecommunications services, on the Approval of Regulations for Holding a Competitive Tender for Receipt of Licenses Associated with the Provision of Cellular Radiotelephone Services, enacted in June 1998. Under these regulations, licenses for telecommunications services were issued



and renewed for periods ranging from three to fifteen years. Under the new law, effective January 1, 2004, licenses may be issued and renewed for periods ranging from three to twenty-five years. Several different licenses to conduct different communication services may be issued to one entity. Provided the licensee has conducted its activities in accordance with the applicable law and terms of the license, renewals may be obtained upon application to the Ministry of Information Technologies and Communications. Officials of the Ministry of Information Technologies and Communications have broad discretion with respect to both issuance and renewal procedures.

A company must complete a multi-stage process before the commercial launch of its communications network. A company must:

- obtain approval to use specific frequencies within the specified band from the State Radio Frequencies Commission and the Federal Agency of Communications if providing wireless telecommunications services;
- receive a license from the Federal Service for Supervision in the Area of Communications to provide communications services; and
- obtain permission from the Federal Service for Supervision in the Area of Communications for network operations. To receive this permission, a wireless telecommunications services provider must develop a frequency allocation and site plan, which is then reviewed and certified by the Federal Service for Supervision in the Area of Communications for electromagnetic compatibility of the proposed cellular network with other radio equipment operating in the license area. The Federal Service for Supervision in the Area of Communications has discretion to modify this plan, if necessary, to ensure such compatibility.

Under the old Federal Law on Communications and related licensing regulations, the transfer of a license, including assignment or pledge of a license as collateral, was prohibited except for transfer of licenses for the provision of wireless telecommunications services awarded through a competitive tender. Effective January 1, 2004, the prohibitions on the transfer of licenses were relaxed and, in particular, in case of mergers, licenses may be re-issued upon application by a transferee as a new license holder following the transfer. Additionally, the Ministry of Communications has declared that agreements on the provision of telecommunications services must be concluded and performed by the license holder.

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

- failure to comply with Russian law or the terms and conditions of the license;
- failure to provide services for over three months from the start-of-service date set forth in the license; and
- annulment of a frequency allocation if it results in the inability to render communications services.

In addition, licenses may be terminated for various reasons by the court, including:

- failure to remedy in a timely manner a violation that led to the suspension of the license;
- provision of inaccurate information in documents on the basis of which a license was issued; and
- failure to fulfill obligations undertaken in the process of a tender or auction.

The license may also be terminated in a number of cases, including liquidation of a license holder or failure to pay a license fee on time. A suspension or termination of a license may be appealed in court.

Frequencies are allocated for a maximum term of ten years which may be extended upon the application of a frequency user. Under the new Federal Law on Communications, frequency allocations may be changed for purposes of state management, defense, security and protection of legal order in the Russian Federation with the license holder to be compensated for related losses. Further, frequency allocations may be suspended or terminated for a number of reasons, including failure to comply with the conditions on which frequency was allocated.

The following one-time license fees are payable in respect of each region covered by the license; 15,000 rubles, for services involving use of a frequency spectrum, lease of communication channels running beyond one region of Russia as well as in number of other cases specified by law; and 1,000 rubles in other cases. The license fee for a license received through a tender or auction is determined by the terms of such tender or auction.

In addition to licensing fees, a government decree enacted on June 2, 1998 requires payment of fees for the use of radio frequencies for cellular telephone services. The payment procedure was established by a government decree enacted on August 6, 1998, which requires that all wireless telecommunications services operators pay an annual fee set by the State Radio Frequencies Commission and approved by the Federal Antimonopoly Service for the use of their frequency spectrums. Additionally, as prescribed in government decree No. 223 on Reorganization of the System of State Surveillance over Telecommunications, dated April 26, 2004, operators must make monthly payments to fund supervisory services in the communications sphere. In 2004, this fee amounted to 0.3% of revenues generated from the provision of communications services. In addition, the new Federal Law on Communication contemplates an industry-wide levy to finance a supervisory arm of the Ministry of Telecommunications. See “Risk Factors—Risks Relating to the Russian Federation and Ukraine—The implementation of the new Federal Law on Communications and the new Ukrainian Law on Telecommunications will impose an additional financial burden on us which may materially adversely affect our financial condition and results of operations.”

The new Federal Law on Communications empowers the Russian Government to determine and annually review the list of licensing conditions. Licenses also generally contain a number of other detailed conditions, including a date by which service must begin, technical standards and a schedule of the number of subscribers and percentage coverage of the licensed territory that must be achieved by specified dates. We have either commenced service by the applicable deadline or received an extension of the applicable deadline for all of our licenses.

### **Equipment Certification**

Telecommunications equipment must be certified to be used in the interconnected communications network of the Russian Federation, which includes all fixed-line and wireless networks open to the public. All networks of our telecommunications subsidiaries must be certified. A government decree on Regulation of Use of Equipment in the Interconnected Telecommunications Network, enacted on August 5, 1999 gives the Ministry of Information Technologies and Communications and the Federal Antimonopoly Service the right to restrict the use of certain equipment, including equipment manufactured outside Russia, and to set the technical requirements for the equipment used in the interconnected telecommunications network. The Federal Agency of Communications issues certificates of compliance with technical requirements to equipment suppliers based on the Agency’s internal review. In addition, a Presidential decree requires that licenses and equipment certifications be obtained from the Federal Security Service to design, produce, sell, use or import encryption devices. Some commonly used digital cellular telephones are designed with encryption capabilities and must be certified by the Federal Security Service.

Further, certain high-frequency equipment, a list of which was approved by Government Resolution No. 539 of October 12, 2004, manufactured or used in the Russian Federation requires

special permission from the Federal Service for Supervision in the Area of Communications. These permissions are specific to the entity that receives them and do not allow the use of the equipment by other parties.

### **Competition, Interconnection and Pricing**

The Federal Law on Communications requires federal regulatory agencies to encourage competition in the provision of communication services and prohibits the abuse of a dominant position to limit competition. The Federal Law on Communications provides that telecommunications tariffs may be regulated in cases provided for by legislation. Presidential Decree No. 221, enacted on February 28, 1995, on Measures for Streamlining State Regulation of Prices (Tariffs), and a government decree enacted on October 11, 2001, allow for regulation of tariffs and other commercial activities of telecommunications companies that are “natural monopolies.” Government Decree No. 332, dated June 30, 2004, authorized the Federal Tariffs Service to set the following tariffs for the natural monopolies in the communication market:

- installation fees;
- monthly subscription fees; and
- local call charges, including per-minute charges, if used by the operator.

In accordance with the Federal Law on the Natural Monopolies, the Federal Antimonopoly Service maintains a Register of Natural Monopolies. A telecommunications operator may be included in this register if: (1) there is no other operator providing similar services and (2) the operator is properly licensed. At present, none of our subsidiaries is included in the Register of Natural Monopolies.

The Federal Antimonopoly Service 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 Federal Antimonopoly Service. As of July 25, 2003, the Federal Antimonopoly Service has categorized us and our subsidiaries SCC-900 (Siberian Cellular Systems-900), Tomsk Cellular Communications LLC, CJSC Kuban-GSM and UDN 900 as companies with a market share exceeding 35%. See also “Risk Factors—Risks Relating to Our Industry—If we are found to have a dominant position in our markets, the government may regulate our tariffs and restrict our operations.”

The Federal Antimonopoly Service 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 PSTNs may not refuse to provide connections or discriminate against one operator in favor of another. However, a regional fixed-line operator may charge different interconnection rates to different mobile operators. Notwithstanding the above, fixed-line operators not included in the Register of Natural Monopolies, as well as mobile operators, are free to set their own tariffs.

## **Regulation in Ukraine**

### **Regulatory Authorities**

*The State Department on Communications and Informatization, or SDCI* (formerly the State Committee on Communications and Informatization, or SCCI), regulates the telecommunications industry largely through the issuance of regulations, establishment of requirements relating to the quality of telecommunications services and technical requirements relating to telecommunications networks and facilities. The SDCI also oversees the technical condition and development of the

telecommunications industry, including the development of standards and technical rules and supervision of the GSM, D-AMPS, NMT and TDMA networks. The SDCI was established in September 2004 as a division of the Ministry of Transport and Communications of Ukraine, or MTCU. The MTCU was established in July 2004 as a result of the merger of the Ministry of Transport and the SCCI. The SDCI is headed by a director nominated by the Minister of Transport and Communications and appointed by the Cabinet of Ministers of Ukraine.

*The National Commission for the Regulation of Communications, or NCRC*, established by the new Telecommunications Law described in “—Legislation” below, is an independent regulatory body that will consist of seven members and a chairperson. The members and chairperson of the NCRC are nominated by the Prime Minister and appointed by the President of Ukraine for a five-year term. Although the NCRC had yet to be formed as of the date of this offering memorandum, the NCRC technically took over responsibility for issuing licenses for telecommunication services commencing January 1, 2005 as well as various other responsibilities of the SDCI from that date. The SDCI, on the other hand, remains responsible mainly for establishing and overseeing technical policies and standards.

*The State Center for Radio Frequencies of Ukraine, or SCRF*. While licenses for radio frequencies for wireless communications are issued by the NCRC, SCRF is the authority responsible for all technical issues related to the use of radio frequency resources and, in such capacity, is also involved in the issuance of radio frequency licenses. In particular, the SCRF determines frequency availability and the technical aspects of frequency allocation, as well as provides the NCRC with an expert opinion in relation to each application for radio frequency. The SCRF also monitors use of the frequencies and will continue monitoring compliance with the license terms and physically inspecting operators and providers of telecommunications services until the establishment of the State Inspection of Communications, as described below. The SCRF also independently issues individual permissions for the use of radio-electronic and radio-emitting equipment, its development, import, sale and purchase.

*The State Inspection of Communications, or SIC*, established by the new Telecommunications Law, will be a division of the NCRC. The SIC will be responsible for the general supervision of the telecommunications market and the use of radio frequency resources. The SIC will also monitor compliance with license terms, physically inspect operators and providers of telecommunications services and, together with the SCRF, review cases relating to administrative violations in the areas of telecommunications and radio frequencies. The SCRF will perform the functions of the SIC until the SIC's establishment.

### **Legislation**

The principal legislation regulating the telecommunications industry consists of the Law on Telecommunications dated November 18, 2003, or the Telecommunications Law, and the Radio Frequencies Law dated June 1, 2000, or the Radio Frequencies Law. The Radio Frequencies Law was amended in its entirety in June 2004.

The Telecommunications Law has yet to be implemented and the NCRC has yet to be formed. Thus, as of the date of this offering memorandum, the NCRC has not commenced regulating the telecommunications area and issuing telecommunications licenses, and no other regulatory authority has been designated under the law to perform these functions. Regulations implementing the 1995 Communications Law (now repealed) and the Radio Frequencies Law prior to its amendment are still in effect, as are certain regulations enacted prior to the 1995 Communications Law and the Radio Frequencies Law. Telecommunications operators are required to comply with the Telecommunications Law and the Radio Frequencies Law, as well as with the older regulations to the extent that such regulations do not conflict with the Telecommunications Law or the 2004 amendments of the Radio Frequencies Law. Consequently, the current regulatory environment for telecommunications in Ukraine is complicated and uncertain.

The Telecommunications Law provides for, among other things, equal rights for individuals and legal entities, including foreign entities, to offer telecommunications services, fair competition and freedom of pricing. The Telecommunications Law also sets forth the legal, economic and organizational framework for the operation of companies, associations and government bodies forming part of the telecommunications and postal networks. The licensing of telecommunications services, the requirements for equipment certification and liability for violations of Ukrainian legislation on telecommunications are also determined by this legislation. The Telecommunications Law also governs the relations between the state and local governmental bodies, telecommunications operators, organizations and users of telecommunications services and radio frequencies.

The Telecommunications Law addresses new areas of telecommunications services in Ukraine, including numbering requirements, tariff and settlement regulations, interconnection, public telecommunication services, market access rules and licensing issuance and renewal. The Telecommunications Law also significantly expands the definition of the telecommunication services market, including in its scope Internet Protocol telecommunications, transmission of data and facsimile communications.

The Telecommunications Law also restructured the regulatory bodies governing the area of telecommunications. It provided for the creation of the NCRC, which, as of January 1, 2005, is assigned many powers previously held by the SDCI. The NCRC is authorized, *inter alia*, to issue regulations for the telecommunications services, issue telecommunications licenses to operators and providers, issue frequency licenses, request information from operators, providers and authorities, impose administrative penalties and maintain the register of the operators and providers. The NCRC is also authorized to conduct hearings and to resolve disputes among operators concerning the interconnection of telecommunications networks. The powers of the SDCI in the telecommunications area are now relegated primarily to that of technical standards overseer.

Foreign investments in Ukrainian telecommunications operators are not limited; however, in order to provide telecommunications services in Ukraine an entity must be located on the territory of Ukraine and registered in accordance with Ukrainian legislation.

The Radio Frequencies Law sets forth comprehensive rules regarding the allocation, assignment, interrelation and use of radio frequencies, the licensing of the users of radio frequencies and other relevant issues. The 2004 amendments to the Radio Frequencies Law introduced new procedures for issuance, re-execution and termination of frequency licenses and operation permits.

### **Licensing of Telecommunications Services and Radio Frequency Allocation**

Ukrainian legislation provides for two types of telecommunications licenses: telecommunications licenses and frequency licenses. Prior to January 1, 2005, the SDCI issued telecommunications and frequency licenses based on the Law on Licensing Certain Types of Business Activity dated June 1, 2000, the Telecommunications Law and the Radio Frequencies Law. Commencing January 1, 2005, the NCRC has assumed responsibility for issuing telecommunications licenses and frequency licenses pursuant to the Telecommunications Law and the 2004 amendments to the Radio Frequencies Law.

Telecommunications licenses are issued for the following specific types of telecommunications services:

- fixed telephone (local, intercity, international) communication services;
- mobile telecommunications services;
- technical maintenance and exploitation of telecommunications networks and the lease of electric communications channels; and
- intercity and international telecommunications services.

Other telecommunications services do not require licenses.

An operator that is granted a telecommunications license may not commence the provision of wireless telecommunications services until it receives a frequency license. The issuance of a frequency license is, in turn, subject to the availability of radio frequencies in the respective regions of Ukraine. Frequency licenses are issued for specific bandwidths within certain frequency spectrums in specific regions. The GSM spectrum is presently considered to be the most commercially attractive for telecommunications operators. It is currently deemed to be virtually impossible to obtain a license for GSM frequencies in major Ukrainian cities because most of the GSM radio frequencies in such cities are already licensed to the existing GSM operators, including us.

Under applicable legislation, licenses for telecommunications services may be issued and renewed for periods of not less than five years, with the actual period generally ranging from 10 to 15 years. Renewal of a license is made by an application submitted to the NCRC at least four months prior to the expiration of the license term. NCRC officials have fairly broad discretion with respect to both the issuance and the renewal of licenses. The Telecommunications Law further provides that the NCRC must award licenses on a first come-first serve basis within 30 days from submission of an application. If resources are limited or consumer interests so require, the NCRC may adopt a decision to limit the number of licenses. In this event, the law requires that such decision be made public along with the rationale and that the licenses be allocated through a tender.

In accordance with the Radio Frequencies Law, the NCRC issues a frequency license concurrently with the issuance of the license for the type of telecommunication services requiring use of radio frequency resources. A telecommunications operator that has a respective telecommunications license may apply for licenses for additional radio frequency bands. Frequency licenses may not be issued for a period shorter than the term of the relevant telecommunications license.

Under applicable legislation, a public tender or an auction for a radio frequency license must be held by the NCRC if demand for radio frequency resources exceeds available resources. Radio frequency licenses issued on the basis of a public tender or an auction for the same type of radio technology must include identical conditions regarding the radio frequency bands and development period.

Applicable legislation prohibits the transfer of a license by the licensee, including by means of assignment or pledge of a license as collateral, and agreements regarding the provision of telecommunications services must be executed and performed by the actual licensee.

Licenses generally contain a number of detailed conditions, including the date by which service must be commenced, the requirement to use only certified equipment, the technical standards which must be observed and the requirement to comply with all environmental regulations. Frequency licenses issued after January 1, 2005 will also contain the date by which the radio frequency resources must be fully utilized.

Telecommunications operators are subject to strict environmental regulations, especially regarding electromagnetic radiation; construction and technical maintenance of a telecommunications network must be carried out in accordance with local regulations applicable in particular regions of Ukraine. Telecommunications operators must submit periodical reports to the NCRC on the amount and quality of services provided under the telecommunications license. We believe that we are in material compliance with the applicable laws and regulations related to our Ukrainian licenses.

Some licenses also provide that services for persons entitled to certain social benefits must be provided at or below maximum tariffs established by Ukrainian legislation in effect at that time.



If the terms of a license are not fulfilled or the service provider violates legislation, the license may be suspended or terminated. Both telecommunications services licenses and radio frequency licenses may be terminated for various reasons, including:

- failure to comply with the terms and conditions of the license, including failure to provide services within the period set forth in the license;
- provision of inaccurate information in the application or about the communications services rendered to consumers;
- refusal to provide documents requested by the NCRC or the SIC;
- failure to remedy in a timely manner the circumstances which resulted in a violation of the license terms;
- unfair competition by the license holder in providing the licensed services;
- repeated violation of the license terms;
- transfer or assignment of the license to a third party; and
- other grounds set forth by Ukrainian laws or international treaties.

Radio frequency licenses may also be terminated for the following reasons:

- failure to commence using radio frequency resources within the time period specified in the license;
- termination of use of radio frequency resources specified in the license for more than one year; and
- failure to use radio frequency resources to the full extent within the time period specified in the license.

Decisions of the NCRC on termination of licenses may be appealed in court.

### **Equipment Certification**

The Telecommunications Law requires that all technical devices and equipment to be used in networks of general use must be certified in Ukraine. All radio equipment must also be certified in Ukraine.

If the equipment a prospective operator intends to use is certified in Ukraine by either the manufacturer or the vendor, there is no need for the operator to go through the equipment certification process. However, if the equipment is not certified in Ukraine or if it is certified by a third party that is unwilling or unable to give the operator its permission to utilize its certification, then the operator will need to apply for the certification of the equipment in its own name.

The Radio Frequencies Law provides that users of radio frequency resources must obtain permits for the operation of radio-electronic and radio-emitting equipment, except for equipment used on a permit-free basis in accordance with this law. In order to obtain such operation permit, a company is required to file an application with the SCRF. The Radio Frequencies Law also requires producers and importers of radio-electronic and radio-emitting equipment to be used on the territory of Ukraine to register such equipment with the NCRC.

### **Competition**

The Communications Law provides that one of the purposes of the licensing of telecommunication services is to encourage competition and de-monopolization in the telecommunications industry.

The Antimonopoly Committee of Ukraine, or the AMC, is the state administrative body charged with the administration of competition legislation and the protection and regulation of economic competition in Ukraine, including economic competition among industry participants in the telecommunications sector.

Ukrainian antimonopoly legislation prohibits a company operating in Ukraine from using its dominant position in its market to gain an unfair or anti-competitive advantage in the provision of its services or products. A business entity is deemed to be in a dominant position if such entity has no competitor in the market or is not subject to substantial competition due to restricted access or entry barriers for other business entities. Moreover, Ukrainian antimonopoly legislation sets forth that a company having more than 35% of the market share in a given product market may be deemed to be in the dominant position on such market, unless it proves that it is subject to substantial competition.

A telecommunications operator which is found by the AMC to have a dominant position in the market, in particular, may specifically be required to:

- annually submit to the NCRC irrevocable public offers regarding interconnection with the other operators' telecommunications networks;
- comply with the regulations of the NCRC regarding the technical, organizational and commercial terms of interconnection with the other operators' telecommunications networks;
- comply with the calculation factors set by the NCRC for access to the operator's own network;
- not discriminate against other players in telecommunications market; and
- undertake to develop the "public telecommunications services" at the operator's own expense if the NCRC so decides based on the insufficient supply of such services in certain regions.

Although UMC currently has over a 35% market share of the wireless communications market in Ukraine, it has not been declared a dominant market force by the AMC. In September 2003, the AMC began a review of the telecommunications services market for the purpose of determining the status of competition and the existence of dominant market forces. In August 2004, the AMC notified UMC and its largest competitor, Kyivstar, that the preliminary results of its review of the wireless telecommunications industry indicated that each of UMC and Kyivstar qualified as having a dominant position in the market. The AMC offered UMC and Kyivstar the opportunity to submit their objections to these preliminary findings and indicated that it would issue a decision following its review thereof. On December 21, 2004, the AMC announced its issuance of a decision in which it confirmed that neither UMC nor Kyivstar qualified as having a dominant position in the wireless communications market.

In addition, following disruptions of UMC's service that occurred in the Kiev area on August 31, 2004 and on September 1-2, 2004, the AMC issued a recommendation to UMC to (i) restore trouble-free network operation and provision of cellular services of due quality; (ii) reimburse damages caused to UMC's subscribers; and (iii) take measures to prevent such disruptions in the future. According to an AMC press release, UMC carried out these recommendations by, *inter alia*, providing compensation to subscribers affected during the period of service disruptions and installing a new switchboard that would service 350,000 additional subscribers.

### **Tariffs**

Telecommunications tariffs are regulated by the NCRC for:

- "public telecommunications" services; and
- access to the telecommunications networks (use of electric communications channels) of the operator with the dominant position on the market.

The Telecommunications Law withdrew the authority of the Cabinet of Ministers of Ukraine to regulate the prices for telecommunications services.

Prior to enactment of the Telecommunications Law, the SCCI set maximum tariffs for fixed-line public telecommunications services and for access to the wireless communications networks from local universal telephone networks. These tariffs will be revised or cancelled pursuant to the Telecommunications Law. There are currently no other tariff limits in respect of wireless telecommunications services or operators. It is not yet clear how the NCRC will regulate the tariffs for telecommunications services.

Also, where competition laws are violated, the AMC can find tariffs unfair and injurious to competition. In such cases, the AMC may request the violating telecommunications operator to remedy the situation, in particular, by amending its tariff schedule.

Subject to the above, wireless operators are free to set tariffs at levels they consider appropriate.

### **Interconnection**

As of January 1, 2005, interconnection activity is to be regulated by the NCRC. Operators may provide offers for interconnection to the NCRC, and the NCRC is required to publish on an annual or regular basis a catalog of such offers. Operators with a dominant market position on the market are obligated to submit interconnection offers to the NCRC for each catalog.

Interconnection is made pursuant to interconnection agreements between network operators. Such agreements are required under the law to contain certain provisions. An operator with a dominant market position cannot refuse an offer to conclude an interconnection agreement with another operator, if the offeror has offered points of interconnection that were previously published by the NCRC in the catalog of interconnection proposals.

The NCRC is authorized to conduct hearings and to resolve disputes among operators concerning the interconnection of telecommunications networks. The decision of NCRC is binding upon the parties in the dispute.

## MANAGEMENT

### Key Biographies

Our directors and executive officers, and their dates of birth and positions as of the date of this offering memorandum, were as follows:

Name	Year of Birth	Position
Vassily V. Sidorov . . . . .	1971	President and CEO, Director
Vladimir S. Lagutin . . . . .	1947	Chairman
Alexei N. Buyanov . . . . .	1968	Director
Alexander U. Goncharuk . . . . .	1956	Director
Michael Guenther . . . . .	1944	Director
Fridbert Gerlach . . . . .	1957	Director
Helmut Reuschenbach . . . . .	1948	Director
Dr. Yury A. Gromakov . . . . .	1946	Vice President—Technology
Mikhail V. Susov . . . . .	1967	Vice President—Marketing
Nikolai V. Tsekhomsky . . . . .	1974	Vice President—Finance and Chief Financial Officer
Tatiana V. Evtushenkova . . . . .	1976	Vice President—Investments and Corporate Development
Valeriy A. Kozlov . . . . .	1956	Vice President—Administrative Affairs
Igor U. Stolyarov . . . . .	1969	Vice President—Sales and Customer Service
Rainer Hennike . . . . .	1943	Vice President—International Affairs
Sergey G. Aslanyan . . . . .	1973	Vice President and Chief Information Officer

**Vassily V. Sidorov** has served as our President since October 2003 and has served as a member of our Board of Directors since June 2004. From 2000 until August 2003, he served as First Vice President for Finance and Investments at Sistema Telecom, a subsidiary of Sistema. He also serves on the Board of Directors of Sistema Telecom and Personal Communications CJSC, an affiliate of Sistema, and our subsidiaries and affiliates ReCom, MSS, UMC, Uzdurobita, MTS Belarus and SCS-900.

**Vladimir S. Lagutin** has served as Chairman of our Board of Directors since October 2003. He has also served as the General Director of Sistema Telecom since July 2003, and served as the General Director of MGTS from 1995 to July 2003. In addition, Mr. Lagutin serves as the Chairman of the Boards of Directors of MGTS and Comstar, and serves on the Boards of Directors of Sistema and Sistema Telecom. All of these companies are subsidiaries of Sistema.

**Alexei N. Buyanov** has served as one of our Directors since June 2003. Mr. Buyanov has served as First Vice President of 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 various other companies affiliated with Sistema.

**Alexander U. Goncharuk** has served as one of our Directors since 1996. He also acted as our Chairman from June 2002 until October 2003 and in 1998, and as Deputy Chairman during 1997 and from January 1999 through June 1999. Mr. Goncharuk served as President of Sistema Telecom from 1998 until 2003. Since 2003, he has served as General Director of OJSC CSC, a subsidiary of Sistema. He also serves on the board of directors of various other companies affiliated with Sistema.

**Michael Guenther** has served as one of our Directors since October 2000. 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 the following companies affiliated with T-Mobile: T-Mobile Deutschland GmbH, T-Mobile Worldwide Holding GmbH, Zeta GmbH, Matav, T-Mobile Croatia LLC, Polska Telefonica Cyfrowa Sp., T-Mobile Hungary Co. Ltd., Eurotel Bratislava a.s and Hrvatske Telekomunikacije d.d.

**Fridbert Gerlach** has served as one of our Directors since June 2004. He is a member of the supervisory board of Polska Telefonica Cyfrowa Sp.z.o.o (PTC), which is affiliated with T-Mobile, and Zeta GmbH. He is Executive Vice President Joint Venture Management of T-Mobile International AG and COKG. He has also served as a member of the board of directors of T-Mobile Czech Republic a.s., T-Sistems PragoNet a.s., Slovak Telecom a.s., Eurotel Bratislava a.s. and Matav Mgyar Tavkozlesi Rt., and as a member of the supervisory boards of Telecom Croatia LLC, and T-Mobile Austria GmbH, T-Mobile Hungary and Makedonski Telekomunikacii AD.

**Helmut Reuschenbach** has served as one of our Directors since November 2004. Mr. Reuschenbach has served as a Director at Lazard & Co. GmbH Frankfurt since 2001. Prior to that, he was at Deutsche Telekom AG where he served as Treasurer and Senior Executive Vice President for Finance for six years. Prior to 1994, he was the Chief Financial Officer and a member of the Board of Directors of Mercedes-Benz S.A. in Belgium and also served as Chief Executive Officer of Daimler-Benz Coordination Center S.A. and Daimler-Benz Financial Company S.A. From 1989 to 1993 Mr. Reuschenbach served as Vice President for Finance at Daimler-Benz AG in Stuttgart. Previously, he has served as Director of Finance at AEG Aktiengesellschaft in Frankfurt, Director of Finance and Administration at AEG Italiana S.p.A. in Milan and Corporate Finance Manager at AEG-TELEFUNKEN Aktiengesellschaft in Frankfurt.

**Dr. Yury A. Gromakov** has served as our Vice President—Technology 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 over 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.

**Mikhail V. Susov** currently serves as our Vice President—Marketing. Prior to that, he was our Vice President and Chief Marketing Officer since February 2002. From December 2001 until February 2002, Mr. Susov served as the General Director of Comstar, a subsidiary of Sistema. From 1996 until December 2001, he served as the General Director of Personal Communications CJSC, an affiliate of Sistema.

**Nikolai V. Tsekhomsky** has served as our Vice President—Finance and 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 serves as Chairman of the Board of Directors of our subsidiaries MTS-RK (Syktyvkar), Uraltel (Ekaterinburg), Primtelefon (Vladivostok), Astrakhan Mobile (Astrakhan), Volgograd Mobile (Volgograd) and as a member of the Board of Directors of our subsidiaries Mobile TeleSystems (Omsk) and MTS P, SCS-900 (Novosibirsk) and our affiliate MTS Belarus. He also serves on the board of directors of the Moscow Bank for Reconstruction and Development, a subsidiary of Sistema.

**Tatiana V. Evtushenkova** has served as our Vice President—Investments and Corporate Development since October 2002. From December 1999 to October 2002, Ms. Evtushenkova served as the Director of the Investment Department at Sistema Telecom, a subsidiary of Sistema. 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.

**Valeriy A. Kozlov** has served as our Vice President—Administrative Affairs since 1994. Prior to joining us, Mr. Kozlov served as Administrative Director for Comstar, a joint Russian-British venture,

and for VAST, a joint Russian-Canadian venture formerly called M-Bell, which is also one of our shareholders. He has also served as Deputy Head of Communications at MGTS.

**Igor U. Stolyarov** has served as our Vice President—Sales and Customer Service since May 2004. Prior to joining us, Mr. Stolyarov worked at Gillette International as Regional Director in charge of the CIS and Baltic States from July 2000 to May 2004. From 1995 to 1997, he worked for Duracell Russia, and from 1993 to 1995, he worked for Coca-Cola Moscow.

**Rainer Hennike** has served as our Vice President—International Affairs since September 2003. Prior to joining us, Mr. Hennike worked at DeTeMobil Deutsche Telekom MobilNet GmbH, a subsidiary of Deutsche Telekom AG, as a Managing Director and Head of the representative office in the Russian Federation from 1995 to 2003. He has also worked at Deutsche Post, DETECOM and other subsidiaries of Deutsche Telekom AG. Mr. Hennike served as Chairman of our Board of Directors during 2001 to 2002 and as Vice Chairman during 2000 to 2001 and 2002 to 2003. He currently serves on the Board of Directors of Uzdunrobita, MTS Belarus and UMC.

**Sergey G. Aslanyan** has served as our Vice President and Chief Information Officer since December 2003. Prior to joining us, Mr. Aslanyan worked at TNK-BP Management as the Deputy Director of Information Technology. He worked at PricewaterhouseCoopers from 1997 to 2001.

The terms of all of our directors expire on the date of our next annual shareholders' meeting, which will take place in June 2005.

The business address of each of our directors is 4 Marksistaya Street, Moscow 109147, Russian Federation.

#### **Executive Compensation**

Our officers and directors were paid during 2003 an aggregate amount of approximately \$6.1 million for services in all capacities provided to us; this amount was comprised of \$3.9 million in base salary and a \$2.2 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 shares of our common stock and will participate in a stock option plan under which they may receive options to purchase up to an additional 9,966,631 shares of our common stock. 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 shares of common stock 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 shares of our common stock or, in lieu of shares, receive a cash award equal to the difference between the price per share fixed in the option agreement and the market price per share of 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 shares of our common stock to our board members and 808,529 shares of our common stock to our key employees. These options provided that, on July 15, 2003, board members and key employees could purchase shares of our common stock 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 shareholders' 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. Fifty-seven 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 shares of our common stock to our board members and 1,107,041 shares of our common stock 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 shareholders' meeting. The stock option agreement for a key employee would have terminated if the employee left 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.

In July-August 2004, board members and key employees purchased a total of 2,726,966 shares pursuant to the October 2002 option agreements. In addition, options relating to 119,715 shares were cancelled pursuant to the termination provisions described above.

In July 2003, pursuant to option agreements, we granted options in respect of 1,434,400 shares of our common stock to our board members and 518,232 shares of our common stock to our key employees. These options have an exercise price of \$2.43 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 2004 annual shareholders' meeting. The stock option agreement for a key employee would have terminated if the employee left us before July 15, 2005. We expect to recognize a compensation expense of approximately \$1.0 million based on the intrinsic value of these options over the 24-month period.

In August 2004, pursuant to option agreements, we granted options in respect of 745,436 shares of our common stock to our board members and 919,820 shares of our common stock to our key employees. These options have an exercise price of \$5.95 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 will terminate if the board member is

terminated as a board member before our 2005 annual shareholders' meeting. The stock option agreement for a key employee will terminate if the employee leaves us before July 15, 2006. We expect to recognize a compensation expense of approximately \$1.8 million based on the intrinsic value of these options over the 22-month period

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 shares of our common stock 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 shareholders' 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.

### **Audit Committee**

Our Audit Committee consists of three members appointed by the Board of Directors. The current members are Alexei Buyanov, Helmut Reuschenbach and Michael Guenther. The Audit Committee is primarily responsible for the integrity of our financial statements, our compliance with legal and regulatory requirements, assuring the qualifications and independence of our independent auditors and overseeing the audit process, including audit fees, resolving matters arising during the course of audits and coordinating internal audit functions.

### **President**

The shareholders' meeting, 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 between him and us, as represented by our Chairman or by a person authorized by our Board of Directors. 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 December 31, 2003, our Review Commission had three members:

- Natalia G. Tomilina holds the position of Deputy Director of the Finance Department at Sistema Telecom.
- Vassily V. Platoshin holds the position of Chief Accountant at Sistema.
- Bernd Willmann holds the position of Head of Competence Center Joint Ventures of T-Mobile International AG, the parent company of T-Mobile.

The members of our Review Commission do not serve pursuant to a contract, and their terms expire at the next annual shareholders' meeting, which will take place in June 2005.

## PRINCIPAL SHAREHOLDERS

The following table sets forth, as of December 31, 2004, information regarding the beneficial ownership of our common stock by each person known by us to own beneficially any of our common stock and our directors and executive officers as a group. All shares of common stock have the same voting rights.

Name	Beneficial ownership as of December 31, 2004	
	Number	Percentage
Sistema <sup>(1)</sup> . . . . .	619,860,752	31.2%
Sistema Holding Limited <sup>(2)</sup> . . . . .	193,473,900	9.7%
Invest-Svyaz-Holding <sup>(3)</sup> . . . . .	160,247,802	8.1%
VAST <sup>(4)</sup> . . . . .	60,219,432	3.0%
T-Mobile Worldwide Holding GmbH . . . . .	200,525,554	10.1%
ING Bank (Eurasia) ZAO <sup>(5)</sup> . . . . .	746,044,478	37.6%
Other Public Float (including our directors and executive officers) <sup>(6)</sup> . . . . .	5,752,112	0.3%
Total <sup>(7)</sup> . . . . .	<u>1,986,124,030</u>	<u>100.0%</u>

<sup>(1)</sup> 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, Invest-Svyaz-Holding and VAST. Mr. Evtushenkov is also chairman of the board of directors of Sistema.

<sup>(2)</sup> In connection with its April 2003 Eurobond offering, Sistema pledged 193,473,900 shares of common stock held by Sistema Holding Limited to Deutsche Trustee Company Limited.

<sup>(3)</sup> Invest-Svyaz-Holding is a Russian closed joint stock company wholly-owned by Sistema.

<sup>(4)</sup> 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.

<sup>(5)</sup> ING Bank (Eurasia) is the local custodian for our sponsored ADR program and the unsponsored GDR programs. In December 2004, T-Mobile completed an offering of 300,800,000 shares in the form of GDRs through an unsponsored GDR program. As of December 31, 2004, the total number of ADSs outstanding was 21,620,747 representing underlying ownership of 432,414,940 shares, or approximately 21.77% of our outstanding common stock.

<sup>(6)</sup> We believe that our directors and executive officers as a group own less than 1% of our shares.

<sup>(7)</sup> Our wholly-owned subsidiary, Mobile TeleSystems LLC, owns 7,202,108 shares in connection with our Management Stock Bonus and Stock Option Plans.

## **CERTAIN TRANSACTIONS WITH RELATED PARTIES**

### **Transactions with Sistema and its Affiliates**

#### **Dontelecom Acquisition**

In September 2002, we acquired 33.3% of Dontelecom from a company affiliated with Sistema for \$7.5 million.

#### **Telecom-900 Acquisition**

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.

#### **Rosno OJSC**

We arranged medical insurance for our employees and insured our property in the amount of approximately \$784.7 million and \$993.3 million for the nine months ended September 30, 2003 and 2004, respectively, with Rosno OJSC, a subsidiary of Sistema. Insurance premiums paid to Rosno OJSC amounted to \$8.0 million in 2001, \$4.9 million in 2002, \$16.9 million in 2003, \$5.3 million for the nine months ended September 30, 2003 and \$5.2 million for the nine months ended September 30, 2004. Management believes that all of the insurance contracts with Rosno OJSC have been entered into on market terms.

#### **Maxima Advertising Agency**

We have contracts for advertising services with Maxima Advertising Agency, a subsidiary of Sistema. Advertising fees paid to Maxima amounted to \$8.7 million in 2001, \$13.1 million in 2002 and \$24.7 million in 2003. Advertising fees paid to Maxima for the nine months ended September 30, 2003 and 2004 were \$20.7 million and \$50.9 million, respectively. Management believes that these agreements are on market terms.

#### **Moscow City Telephone Network**

We have line rental arrangements with MGTS, a subsidiary of Sistema. We also rent a cable plant from MGTS for installation of fiber-optic cable, as well as buildings for administrative offices, sales and marketing offices and premises for switching and base station equipment. The amounts paid under these arrangements for the years ended December 31, 2001, 2002 and 2003 were \$1.5 million, \$4.4 million and \$5.0 million, respectively. For the nine months ended September 30, 2003 and 2004, the amounts paid were \$3.6 million and \$4.6 million, respectively. In 2001 and 2002, we also purchased buildings from MGTS for \$2.6 million and \$2.0 million, respectively. Management believes that these purchases were, and all other arrangements have been entered into, on market terms.

#### **Moscow Bank for Reconstruction and Development**

We maintain bank and deposit accounts with the Moscow Bank for Reconstruction and Development, or MBRD, which is a subsidiary of Sistema. As of December 31, 2003, our cash position at MBRD amounted to \$279.7 million, including \$265.2 million in time deposits and \$14.5 million in current accounts. As of September 30, 2004, our cash position at MBRD amounted to \$100.3 million, including \$81.1 million in time deposits and \$19.2 million in current accounts.

During 2001, 2002, 2003 and the nine months ended September 30, 2003 and 2004, the related interest accrued and collected on the deposits amounted to approximately \$3.0 million, \$5.1 million,

\$9.9 million, \$2.4 million and \$5.9 million, respectively, which is reflected in our financial statements as a component of interest income.

In August 2004, one of our subsidiaries entered into a ruble-denominated credit facility with MBRD. The facility allowed borrowings of up to 60.0 million rubles (approximately \$2.1 million at September 30, 2004). The amount outstanding under the facility bore interest at 15%. As of September 30, 2004, \$0.2 million was outstanding. The facility matured in December 2004.

In 2003, one of our subsidiaries entered into a ruble-denominated loan agreement with MBRD. The amounts borrowed under this loan bore interest at a rate of 18.5%. During 2003 and the nine months ended September 30, 2004, this subsidiary paid interest of \$0.1 million and \$0.1 million, respectively. As of December 31, 2003, the total amount payable under this loan agreement was \$1.2 million. The loan was fully repaid in June 2004.

During 2003, we signed several short-term loan agreements with MBRD. Amounts borrowed were payable during the period of one to two months. During 2003, interest expense on these loans was approximately \$0.3 million.

In January 2003, we paid MBRD \$20,000 for acting as our financial advisor in connection with our January 2003 offering of 9.75% notes due 2008.

#### **MTU-Inform**

We have interconnection and line rental arrangements with, and receive domestic and international long-distance services from, MTU-Inform, a subsidiary of Sistema. Amounts paid under these arrangements for the years ended December 31, 2001, 2002 and 2003 and the nine months ended September 30, 2003 and 2004 were \$29.0 million, \$24.1 million, \$26.6 million, \$24.2 million and \$21.4 million, respectively. In 2001, 2002 and 2003, we also purchased telephone numbering capacity from MTU-Inform for \$4.7 million, \$1.6 million and \$0.5 million, respectively. Management believes that these purchases were, and all other arrangements have been entered into, on market terms.

#### **Telmos**

We have interconnection and line rental arrangements with, and receive domestic and international long-distance services from, Telmos, a subsidiary of Sistema. Amounts paid under these arrangements for the years ended December 31, 2001, 2002 and 2003 and the nine months ended September 30, 2003 and 2004 were \$4.0 million, \$1.3 million, \$1.6 million, \$1.4 million and \$1.3 million, respectively. Management believes that these arrangements were entered into on market terms.

#### **Comstar**

We have interconnection and line rental arrangements with Comstar, a subsidiary of Sistema. Amounts paid under these arrangements for the years ended December 31, 2002 and 2003 and the nine months ended September 30, 2003 and 2004 were \$3.2 million, \$4.0 million, \$3.5 million and \$2.6 million, respectively. Management believes that these arrangements were entered into on market terms.

#### **Invest-Svyaz-Holding**

We lease network equipment and a billing system from Invest-Svyaz-Holding, a wholly-owned subsidiary of Sistema and one of our shareholders. These leases are classified as capital leases. The interest rate implicit in these leases varies from 14% 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 September 30, 2004:

<u>Payments due in the nine months ended September 30,</u>	<u>Amount</u> <u>(in thousands)</u>
2005 .....	\$ 8,584
2006 .....	4,469
2007 .....	979
Total minimum lease payments (undiscounted) .....	14,032
Less amount representing interest .....	(3,204)
Present value of net minimum lease payments .....	10,828
Less current portion of lease obligations .....	(6,001)
Non-current portion of lease obligations .....	<u>\$ 4,827</u>

Principal and interest paid to Invest-Svyaz-Holding for the years ended December 31, 2001, 2002 and 2003 and the nine months ended September 30, 2003 and 2004 were \$0.5 million and \$0.1 million, \$2.9 million and \$1.4 million, \$5.4 million and \$3.3 million, \$3.3 million and \$2.0 million, and \$5.2 million and \$3.2 million, respectively. Management believes that these agreements were entered into on market terms.

We have also guaranteed debt of Invest-Svyaz-Holding in the amount of \$21.6 million to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to us. For the year ended December 31, 2003, our lease payments to Invest-Svyaz-Holding constituted 99% of its revenues for the year.

#### **STROM Telecom**

During 2003 and 2004, we entered into agreements with STROM Telecom, a subsidiary of Sistema, for the purchase of a billing system, a communications software support system and equipment for a total amount of up to \$32.3 million and \$80.8 million, respectively. Pursuant to these contracts, we purchased billing systems and communication software support systems for approximately \$18.2 million and \$9.1 million during the year ended December 31, 2003 and the nine months ended September 30, 2004, respectively.

#### **MTT**

In 2004, we had an interconnection and line rental agreements with MTT, a subsidiary of Sistema acquired in September 2004. Amounts paid under these agreements for the nine months ended September 30, 2004 amounted to approximately \$15.0 million.

#### **Transactions with T-Mobile and its Affiliates**

##### **T-Mobile**

We have non-exclusive roaming agreements with T-Mobile. These agreements were comparable to roaming agreements we have with other cellular mobile operators. Amounts paid under the agreements for the years ended December 31, 2001, 2002 and 2003 were \$0.7 million, \$1.0 million and \$1.1 million, respectively, and \$1.1 million and \$2.1 million for the nine months ended September 30, 2003 and 2004, respectively. Management believes that these agreements were entered into on market terms.



### **UMC Acquisition**

In March to July 2003, we purchased 100% of UMC, including a 16.3% stake from Deutsche Telekom AG for \$55.0 million. Of this amount, \$27.5 million was payable to Cetel B.V., a wholly-owned subsidiary of Deutsche Telekom AG, within one year, which was paid in March 2004. The amount payable accrued interest at 9% per annum. The remaining amount was paid in cash at the closing of the transaction.

In addition, as part of the transaction, we guaranteed a shareholder loan from Deutsche Telekom AG to UMC in the amount of \$21.3 million. The amount payable accrued interest at LIBOR plus 5-7%. At December 31, 2003, the unpaid balance was \$8.0 million and during the year, we paid \$2.1 million in interest. This debt was repaid in April 2004.

See also Note 8 to our interim condensed consolidated financial statements for related party accounts receivable and payable balances as of December 31, 2003 and September 30, 2004.

## DESCRIPTION OF THE NOTES

The notes will be issued and guaranteed under a document called the “indenture.” The indenture, to be dated January 28, 2005 is a contract among the issuer, us and JPMorgan Chase Bank, N.A., 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 January 28, 2005. The notes will be redeemed, and payment of the full principal amount of the notes at par will be due, on January 28, 2012, the maturity date, to the extent the notes are not redeemed or repurchased prior to that date.

The notes will bear interest at the rate of 8.00% per annum. The issuer will pay interest semi-annually on January 28 and July 28 of each year, beginning July 28, 2005 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 offshore transactions in reliance on Regulation S will be represented by interests in the Regulation S global note. We refer to these notes as “Regulation S notes.” Notes which are sold in the United States to “qualified institutional buyers” (as defined in Rule 144A) in reliance on Rule 144A 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 September 30, 2004, our subsidiaries had \$170.5 million of indebtedness and \$315.6 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.”

### **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 \$2,000 or integral multiples thereof. 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 depository 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 “—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 London located at JPMorgan Chase Bank, N.A., Trinity Tower, 9 Thomas More Street, London E1W 1YT, United Kingdom, and at the office of the paying agent in Luxembourg located at J.P. Morgan Bank Luxembourg S.A., European Bank and Business Centre, 6 route de Trèves, L-2633 Senningerberg, 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 U.S. Exchange Act, 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 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 redeem, and pay the principal amount of, the global notes on January 28, 2012. The issuer will pay interest due on the global notes to the registered holder at a rate of 8.00% 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 U.S. Exchange Act or are not exempt from such reporting requirements pursuant to and in compliance with Rule 12g3-2(b) under the U.S. Exchange Act, we will provide to each holder of the notes (or holder of a beneficial interest therein) and to each prospective purchaser of the notes (as designated by such holder or holder of a beneficial interest), upon the request of such holder, prospective purchaser or holder of a beneficial interest in the notes, 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 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 “—Principal Covenants—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 “—Principal Covenants—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 U.S. Exchange Act, the U.S. Investment Company Act of 1940 or the U.S. 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 has been made for the notes to be listed on the Luxembourg Stock Exchange.

## **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 and prospective 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 to 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, 850 Library Avenue, Suite 204, Newark, Delaware 19715, 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, N.A., 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 depository 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 depository 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 021121568, the ISIN for the Rule 144A notes is US60741AAF21 and the CUSIP number for the Rule 144A notes is 60741A AF 2. The Common Code for the Regulation S notes is 021121649, the ISIN for the Regulation S notes is XS0211216493 and the CUSIP number for the Regulation S notes is L64395 AJ 2.

## 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.

	<b>Principal Amount of Notes</b>
Credit Suisse First Boston (Europe) Limited . . . . .	\$320,100,000
Goldman Sachs International . . . . .	40,000,000
Citigroup Global Markets . . . . .	6,650,000
ING Bank N.V., London Branch . . . . .	6,650,000
HSBC Bank plc . . . . .	6,650,000
Barclays Bank PLC . . . . .	6,650,000
Commerzbank Aktiengesellschaft . . . . .	6,650,000
Bank Austria AG . . . . .	6,650,000
	<u>\$400,000,000</u>

The issuer has agreed to pay to the initial purchasers a commission of 0.5% 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 issue price indicated on the cover page less commissions paid to them by the issuer, and offer to resell the notes at the issue price 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 in offshore transactions to non-U.S. persons, within the meaning of, and in

reliance on, Regulation S. The purchase agreement provides that the initial purchasers may directly or, through their respective U.S. broker-dealer affiliates, arrange for the offer and resale of notes within the United States to “qualified institutional buyers” as defined in Rule 144A in reliance on Rule 144A. Terms used above have the meanings assigned to them in Rule 144A or Regulation S.

The price at which the notes are being sold may be changed at any time without notice.

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 or sell 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, within the United States or to, or for the account or benefit of, U.S. persons, 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. Terms used in this paragraph have the meanings given to them by Regulation S.

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 (that is 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 or pursuant to another exemption from registration under the U.S. Securities Act.

The notes and the guarantee 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 regulation requirements of, the U.S. Securities Act. Terms used in this paragraph have the meanings given to them by Regulation S. See “Transfer Restrictions.”

This offering memorandum has been prepared by the issuer for use in connection with the offer and sale of the notes outside the United States, the resale of the notes in the United States and for the admission of the notes to the Luxembourg Stock Exchange. The issuer and the initial purchasers reserve the right to reject any offer to purchase the notes, in whole or in part, for any reason. This offering memorandum does not constitute an offer to any person in the United States or to any U.S. person, other than any QIB and to whom an offer has been made directly by any of the initial purchasers or their U.S. broker-dealer affiliates. Distribution of this offering memorandum by any non-U.S. person outside the United States or by any QIB in the United States to any U.S. person or to any other person within the United States, other than any QIB and those persons, if any, retained to advise such non-U.S. person or QIB with respect thereto, is unauthorized and any disclosure without the prior written consent of the issuer of any of its contents to any such U.S. person or other person within the United States, other than any QIB and those persons, if any, retained to advise such non-U.S. person or QIB, is prohibited.

### **The United Kingdom**

Each initial purchaser has represented, warranted and agreed in the purchase agreement that:

- (1) 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;

- (2) 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
- (3) 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:

- (1) to professional investors (“*operatori qualificati*”), as defined in Article 31, second paragraph, of CONSOB Regulation No. 11522 of 1st July, 1998, as amended;
- (2) 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
- (3) 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 Netherlands**

Each initial purchaser has represented and agreed in the purchase agreement that it has not, directly or indirectly, offered, sold or transferred and that it will not, directly or indirectly, offer, sell or transfer in the Netherlands any notes, other than to individuals or legal entities, who are considered as

professional market parties pursuant to the Netherlands Banking Act (Wet toezicht kredietwezen 1992) and which trade or invest in securities in the conduct of their profession or trade pursuant to the Netherlands Securities Act (Wet toezicht effectenverkeer 1995) (which includes (among others) duly supervised banks, insurance companies, securities institutions, investment institutions and pension funds), in which case it must be made clear upon making the offer and from any documents or advertisements in which a forthcoming offering of notes is publicly announced that the offer is exclusively made to the said individuals or legal entities.

The notes in global or definitive form will bear a legend substantially to the following effect:

Any person who holds (a beneficial interest in) this obligation, who is resident in the Netherlands, shall be deemed to have represented and agreed that it is a professional market party, and is acquiring this note (or any interest therein) for its own account or for the account of a professional market party, as defined in section 1 sub e of the Exemption Regulation pursuant to the Netherlands Banking Act.

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.

#### **Other**

Credit Suisse First Boston (Europe) Limited, Goldman Sachs International and their respective affiliates have engaged in transactions with and performed various investment banking, financial advisory and other services for us and for our affiliates, for which they received customary fees, and Credit Suisse First Boston (Europe) Limited, Goldman Sachs International and their respective affiliates may provide such services for us or for them in the future.

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.

## 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.*

### Rule 144A notes

Each purchaser of Rule 144A notes within the United States, by accepting delivery of this offering memorandum and the notes, will be deemed to have represented, agreed and acknowledged that:

- (1) It is (a) a QIB, (b) acting for its own account, or for the account of another QIB and (c) aware, and each beneficial owner of such notes has been advised, that the sale of such notes to it is being made in reliance on Rule 144A.
- (2) It understands that the Rule 144A notes have not been and will not be registered under the U.S. Securities Act and may not be offered, sold, pledged or otherwise transferred except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or for the account of a QIB or (b) in an offshore transaction in accordance with Rule 903 or Rule 904 of Regulation S, in each case in accordance with any applicable securities laws of any state of the United States.
- (3) It understands that the Rule 144A notes, unless otherwise agreed between the issuer and the trustee in accordance with applicable law, will bear a legend to the following effect:

THIS NOTE AND THE GUARANTEE IN RESPECT HEREOF HAVE NOT BEEN AND WILL NOT BE REGISTERED UNDER THE U.S. SECURITIES ACT OF 1933 (THE "U.S. SECURITIES ACT") OR WITH ANY SECURITIES REGULATORY AUTHORITY OF ANY STATE OR OTHER JURISDICTION OF THE UNITED STATES AND MAY NOT BE OFFERED, SOLD, PLEDGED OR OTHERWISE TRANSFERRED EXCEPT (1) IN ACCORDANCE WITH RULE 144A UNDER THE U.S. SECURITIES ACT ("RULE 144A") TO A PERSON THAT THE HOLDER AND ANY PERSON ACTING ON ITS BEHALF REASONABLY BELIEVE IS A QUALIFIED INSTITUTIONAL BUYER WITHIN THE MEANING OF RULE 144A (A "QIB") THAT IS ACQUIRING THIS NOTE FOR ITS OWN ACCOUNT OR FOR THE ACCOUNT OF A QIB OR (2) IN AN OFFSHORE TRANSACTION IN ACCORDANCE WITH RULE 903 OR RULE 904 OF REGULATION S UNDER THE U.S. SECURITIES ACT, IN EACH CASE IN ACCORDANCE WITH ANY APPLICABLE SECURITIES LAWS OF ANY STATE OF THE UNITED STATES.

- (4) It acknowledges that MTS, the issuer, the registrar, the initial purchasers and their respective affiliates, and others will rely upon the truth and accuracy of the above acknowledgements, representations and agreements and agrees that, if any of the acknowledgements, representations or agreements deemed to have been made by it by its purchase of Rule 144A notes is no longer accurate, it shall promptly notify MTS, 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 of those accounts and that it has full power to make the above acknowledgements, representations and agreements on behalf of each account.
- (5) It understands that the Rule 144A notes will be evidenced by Rule 144A global note. Before any interest in the Rule 144A global note may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Regulation S global note, it will be required to provide a transfer agent with a written certification (in the form provided in the indenture) as to compliance with applicable securities laws.

**Prospective purchasers are hereby notified that sellers of the notes may be relying on the exemption from the provisions of Section 5 of the U.S. Securities Act provided by Rule 144A.**

**Regulation S notes**

Each purchaser of Regulation S notes outside the United States and each subsequent purchaser of Regulation S notes in resales prior to the expiration of the distribution compliance period, by accepting delivery of this offering memorandum and the Regulation S notes, will be deemed to have represented, agreed and acknowledged that:

- (1) It is, or at the time Regulation S notes are purchased will be, the beneficial owner of such Regulation S notes and (a) it is not a U.S. person and it is located outside the United States (within the meaning of Regulation S) and (b) it is not an affiliate of MTS, the issuer or a person acting on behalf of such an affiliate.
- (2) It understands that the Regulation S notes have not been and will not be registered under the U.S. Securities Act and, prior to the expiration of the distribution compliance period, it will not offer, sell, pledge or otherwise transfer such notes except (a) in accordance with Rule 144A to a person that it and any person acting on its behalf reasonably believe is a QIB purchasing for its own account or the account of a QIB or (b) in an offshore transaction in accordance with Rule 903 or 904 of Regulation S, in each case in accordance with any applicable securities laws of any state of the United States.
- (3) It understands that the Regulation S notes will be evidenced by a Regulation S global note. Before any interest in the Regulation S global note may be offered, sold, pledged or otherwise transferred to a person who takes delivery in the form of an interest in the Rule 144A global note, it will be required to provide a transfer agent with a written certification (in the form provided in the indenture) as to compliance with applicable securities laws.
- (4) It acknowledges that MTS, the issuer, the registrar, the initial purchasers and their respective affiliates, and others will rely upon the truth and accuracy of the above 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 notes is no longer accurate, it shall promptly notify MTS, 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 of those accounts and that it has full power to make the above acknowledgements, representations and agreements on behalf of each 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:
  - (1) the holder is, or is deemed to be, resident in Luxembourg for the purpose of the relevant provisions; or
  - (2) 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:
  - (1) the holder is, or is deemed to be, resident in Luxembourg for the purpose of the relevant provisions; or
  - (2) 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:
  - (1) the holder is, or is deemed to be, resident in Luxembourg for the purpose of the relevant provisions; or
  - (2) 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
  - (3) 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
  - (4) 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 Directive will become effective July 1, 2005. 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 was not yet transposed in the Luxembourg internal legislation as of January 3, 2005.

### **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 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.

Holders of the notes will not be subject to Russian taxation in respect of the purchase, ownership and disposal of the notes and the payment of interest unless otherwise outlined below.



### **Taxation of Gains and Interest on the Notes (non-resident holders)**

For purposes of this summary, a non-resident holder means:

- (1) an individual holder who is factually present in Russia for a period of less than 183 days in a given calendar year; or
- (2) a holder which is an entity not organized under Russian law and does not purchase, hold or dispose of the notes through its permanent establishment in Russia.

#### **Individuals**

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 taxation treaty. However, advance relief may 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 Gains and Interest on the Notes (other holders)**

Holders who are not treated as non-resident will be subject to all normally applicable Russian taxes in respect of income or gains from disposal of notes and interest received on notes.

#### **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 the tax 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 for individuals and obtaining a refund should be done by submission of the personal tax return by April 30 following the end of the calendar year.

### **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 (1) subject to special tax rules (*e.g.*, banks, financial institutions, securities or currency dealers, brokers, insurance companies, regulated investment companies and tax-exempt organizations); (2) holding notes as part of a hedging or larger integrated financial transaction; or (3) 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 (1) a citizen or resident of the United States; (2) 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; (3) any estate the income of which is subject to U.S. federal income taxation regardless of its source; and (4) 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 tax advisor as to such tax consequences.

**PROSPECTIVE PURCHASERS OF THE NOTES SHOULD CONSULT THEIR 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 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, in the case of certain U.S. holders, "financial services income"). Under recently enacted legislation, for taxable years beginning after December 31, 2006, interest income on a note generally will constitute "passive category income" (or, in the case of certain U.S. holders, "general category income"). If withholding taxes are paid with respect to gain realized on a disposition of a note by a "United States resident," tax credits with respect to such withholding taxes may be unavailable or limited because such gain will be treated as U.S. source 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 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 the offering will be opined upon for us by Latham & Watkins LLP, New York, New York; 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 Linklaters.

## **INDEPENDENT AUDITORS**

The consolidated financial statements of Mobile TeleSystems OJSC as of December 31, 2002 and 2003, and for each of the three years in the period ended December 31, 2003, included in this offering memorandum have been audited by ZAO Deloitte & Touche CIS, independent auditors, as stated in their report appearing herein, which expresses an unqualified opinion and includes an explanatory paragraph relating to a change in the method of accounting for subscriber acquisition costs in 2001.

## **AVAILABLE INFORMATION**

We have agreed that, for so long as any notes remain outstanding, we will (1) submit to the 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; (2) 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 (3) 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.

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 U.S. Exchange Act or are not exempt from such reporting requirements pursuant to and in compliance with Rule 12g3-2(b) under the U.S. Exchange Act, we will provide to each holder of the notes (or holder of a beneficial interest therein) and to each prospective purchaser of the notes (as designated by such holder or holder of a beneficial interest), upon the request of such holder, prospective purchaser or holder of a beneficial interest in the notes, any information required to be provided by 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 U.S. 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 transfer 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 from us, without charge, by writing to us at 4 Marksistskaya Street, Moscow 109147, Russian Federation, Attn: Chief Financial Officer. Such documents are also available for inspection and may be obtained free of charge at the offices of the Luxembourg paying and transfer agent, as described under “Listing Information.”



## 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 incorporation 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 Commerce and Companies (*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 incorporation of the issuer;
- the indenture (including the terms of the guarantee);
- the issuer's most recent and future annual financial statements, together with the statutory auditor's report relating thereto, and interim financial statements, if any;
- our most recent and future audited annual consolidated financial statements and unaudited interim financial statements provided to noteholders; and
- our future annual reports on Form 20-F.

We prepare consolidated financial statements in accordance with U.S. GAAP. The issuer prepares annual financial statements in accordance with accounting principles generally accepted in Luxembourg, which are audited by its statutory auditor. 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 offering memorandum, copies of which will be made available at the office of the paying agent at 6 route de Trèves, L-2633 Senningerberg, Luxembourg, and will publish a notice in a leading newspaper having general circulation in Luxembourg. The supplemental offering memorandum 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 have been accepted for clearance through DTC, Euroclear and Clearstream. The Common Code for the Regulation S notes is 021121649, the ISIN for the Regulation S notes is XS0211216493 and the CUSIP number for the Regulation S notes is L64395 AJ 2.

The Common Code for the Rule 144A notes is 021121568, the ISIN for the Rule 144A notes is US60741AAF21 and the CUSIP number for the Rule 144A notes is 60741A AF 2.

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, 2003, the date of our last audited annual 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 January 25, 2005. 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 January 23, 2005.
9. The EU Transparency Obligations Directive may be implemented in Luxembourg in a manner which is unduly burdensome for us. In particular, we may be required to prepare our consolidated financial statements in accordance with International Financial Reporting Standards for accounting periods beginning on or after 1 January 2005. Pursuant to the purchase agreement, in those circumstances, we would be entitled to seek an alternative listing for the notes on a stock exchange outside the European Union.

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## **Report of Independent Registered Public Accounting Firm**

To the Shareholders of OJSC Mobile TeleSystems:

We have audited the accompanying consolidated balance sheets of Mobile TeleSystems, a Russian Open Joint-Stock Company, and subsidiaries (the “Group”) as of December 31, 2003 and 2002, and the related consolidated statements of operations, changes in shareholders’ equity and cash flows for each of the three years in the period ended December 31, 2003. These financial statements are the responsibility of the Group’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2003 and 2002, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2003, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the consolidated financial statements, the Group changed its method of accounting for subscriber acquisition costs in 2001.

/s/ ZAO Deloitte & Touche CIS

March 26, 2004, except for Note 24,  
as to which the date is June 15, 2004

Moscow, Russia

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
**AT DECEMBER 31, 2003 and 2002**  
**(Amounts in thousands of U.S. dollars, except share amounts)**

	<b>December 31,</b>	
	<b>2003</b>	<b>2002</b>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents (Note 5) . . . . .	\$ 90,376	\$ 34,661
Short-term investments (Note 6) . . . . .	245,000	30,000
Trade receivables, net (Note 7) . . . . .	99,951	40,501
Accounts receivable, related parties (Note 18) . . . . .	3,356	3,569
Inventory (Note 8) . . . . .	67,291	41,386
Prepaid expenses . . . . .	46,679	26,537
Deferred tax asset, current portion (Note 15) . . . . .	44,423	12,223
VAT receivable . . . . .	209,629	154,061
Other current assets . . . . .	33,774	15,392
<b>Total current assets</b> . . . . .	<u>840,479</u>	<u>358,330</u>
<b>PROPERTY, PLANT AND EQUIPMENT</b> , net of accumulated depreciation of \$532,268 and \$299,216, respectively (Note 9) . . . . .	2,256,076	1,344,633
<b>LICENSES</b> , net of accumulated amortization of \$257,024 and \$143,402, respectively (Notes 4 and 21) . . . . .	703,103	386,919
<b>OTHER INTANGIBLE ASSETS AND GOODWILL</b> , net of accumulated amortization of \$148,052 and \$78,889, respectively (Note 10) . . . . .	312,677	138,090
<b>DEBT ISSUANCE COSTS</b> , net of accumulated amortization of \$4,586 and \$2,898, respectively (Note 12) . . . . .	9,431	2,957
<b>INVESTMENTS IN AND ADVANCES TO ASSOCIATES</b> (Note 20) . . . . .	103,585	34,034
<b>Total assets</b> . . . . .	<u>\$4,225,351</u>	<u>\$2,264,963</u>

The accompanying notes to consolidated financial statements are an integral part of these statements.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS (Continued)**  
**AT DECEMBER 31, 2003 and 2002**  
(Amounts in thousands of U.S. dollars, except share amounts)

	December 31,	
	2003	2002
<b>CURRENT LIABILITIES:</b>		
Accounts payable, related parties (Note 18) . . . . .	\$ 31,904	\$ 4,968
Trade accounts payable . . . . .	168,039	117,623
Deferred connection fees, current portion (Note 11) . . . . .	21,467	22,210
Subscriber prepayments and deposits . . . . .	191,768	110,950
Debt, current portion (Note 12) . . . . .	103,312	67,098
Notes payable, current portion (Note 12) . . . . .	597,836	—
Capital lease obligation, current portion (Notes 13 and 18) . . . . .	9,122	21,232
Income tax payable . . . . .	11,128	3,987
Accrued liabilities (Note 14) . . . . .	143,789	73,919
Other payables . . . . .	19,604	2,225
<b>Total current liabilities</b> . . . . .	<u>1,297,969</u>	<u>424,212</u>
<b>LONG-TERM LIABILITIES:</b>		
Notes payable, net of current portion (Note 12) . . . . .	800,000	298,943
Debt, net of current portion (Note 12) . . . . .	142,418	59,971
Capital lease obligation, net of current portion (Notes 13 and 18) . . . . .	7,646	7,241
Deferred connection fees, net of current portion (Note 11) . . . . .	25,177	19,694
Deferred taxes (Note 15) . . . . .	180,628	87,485
<b>Total long-term liabilities</b> . . . . .	<u>1,155,869</u>	<u>473,334</u>
<b>Total liabilities</b> . . . . .	<u>2,453,838</u>	<u>897,546</u>
<b>COMMITMENTS AND CONTINGENCIES</b> (Note 22) . . . . .		
<b>MINORITY INTEREST</b> . . . . .	47,603	65,373
<b>SHAREHOLDERS' EQUITY:</b>		
Common stock: (2,096,975,792 shares with a par value of 0.1 rubles authorized and 1,993,326,138 shares issued as of December 31, 2003 and 2002, 345,244,080 of which are in the form of ADS (Note 1) . . . . .	50,558	50,558
Treasury stock (9,929,074 as of December 31, 2003 and 9,966,631 as of December 31, 2002 common shares at cost) (Note 17) . . . . .	(10,197)	(10,206)
Additional paid-in capital . . . . .	559,911	558,102
Unearned compensation (Note 17) . . . . .	(869)	(212)
Shareholder receivable (Note 12) . . . . .	(27,610)	(34,412)
Accumulated other comprehensive income (Note 2) . . . . .	7,595	—
Retained earnings . . . . .	1,144,522	738,214
<b>Total shareholders' equity</b> . . . . .	<u>1,723,910</u>	<u>1,302,044</u>
<b>Total liabilities and shareholders' equity</b> . . . . .	<u>\$4,225,351</u>	<u>\$2,264,963</u>

The accompanying notes to consolidated financial statements are an integral part of these statements.



**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001**  
**(Amounts in thousands of U.S. dollars, except share and per share amounts)**

	<u>2003</u>	<u>2002</u>	<u>2001</u>
<b>NET REVENUES:</b>			
Service revenues . . . . .	\$ 2,435,717	\$ 1,274,287	\$ 830,308
Connection fees . . . . .	29,372	24,854	21,066
Equipment sales . . . . .	81,109	62,615	41,873
	<u>2,546,198</u>	<u>1,361,756</u>	<u>893,247</u>
<b>COST OF SERVICES AND PRODUCTS</b> , exclusive of depreciation and amortization shown separately below (including related party amounts of \$37,680, \$31,607 and \$30,537, respectively):			
Interconnection and line rental . . . . .	187,270	113,052	75,278
Roaming expenses . . . . .	113,838	83,393	68,387
Cost of equipment . . . . .	173,071	90,227	39,828
	<u>474,179</u>	<u>286,672</u>	<u>183,493</u>
<b>OPERATING EXPENSES</b> (including related party amounts of \$11,002, \$9,602 and \$8,882, respectively) (Note 19): . . . . .	406,722	229,056	134,598
<b>SALES AND MARKETING EXPENSES</b> (including related party amounts of \$23,668, \$12,140 and \$8,707, respectively): . . . . .	326,783	171,977	107,729
<b>DEPRECIATION AND AMORTIZATION</b> . . . . .	415,916	209,680	133,318
<b>IMPAIRMENT OF INVESTMENT</b> (Note 20) . . . . .	—	—	10,000
<b>Net operating income</b> . . . . .	922,598	464,371	324,109
<b>CURRENCY EXCHANGE AND TRANSLATION (GAINS) LOSSES</b> . . .	(693)	3,474	2,264
<b>OTHER EXPENSES/(INCOME)</b> (including related party amounts of \$6,161, \$5,141 and \$2,978, respectively):			
Interest income (Note 6) . . . . .	(18,076)	(8,289)	(11,829)
Interest expense . . . . .	106,551	44,389	6,944
Other expenses (income), net . . . . .	3,420	(2,454)	(2,672)
Total other expenses (income), net . . . . .	91,895	33,646	(7,557)
<b>Income before provision for income taxes and minority interest</b> . . . .	831,396	427,251	329,402
<b>PROVISION FOR INCOME TAXES</b> (Note 15) . . . . .	242,480	110,417	98,128
<b>MINORITY INTEREST</b> . . . . .	71,677	39,711	7,536
<b>NET INCOME</b> before cumulative effect of a change in accounting principle . . . . .	517,239	277,123	223,738
Cumulative effect of a change in accounting principle, net of income taxes of \$9,644 (Note 3) . . . . .	—	—	(17,909)
<b>NET INCOME</b> . . . . .	<u>\$ 517,239</u>	<u>\$ 277,123</u>	<u>\$ 205,829</u>
Weighted average number of common shares outstanding . . . . .	1,983,374,949	1,983,359,507	1,983,359,507
Earnings per share, basic and diluted:			
Net income before cumulative effect of a change in accounting principle . . . . .	\$ 0.261	\$ 0.140	\$ 0.113
Net income . . . . .	\$ 0.261	\$ 0.140	\$ 0.104

The accompanying notes to consolidated financial statements are an integral part of these statements.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY**  
**FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001**  
**(Amounts in thousands of U.S. dollars, except share amounts)**

	Common Stock		Treasury Stock		Accumulated Other Comprehensive	Additional	Unearned	Share-	Retained	Total
	Shares	Amount	Shares	Amount	Income	Paid-in Capital	Compensation	holder Receivable	Earnings	
<b>BALANCES,</b>										
December 31, 2000	1,993,326,138	50,558	(9,966,631)	(10,206)	—	552,030	—	(49,519)	258,221	801,084
Receivable from										
Sistema (Note 12):										
Increases for										
interest . . . . .	—	—	—	—	—	3,764	—	(3,764)	—	—
Payments from										
Sistema . . . . .	—	—	—	—	—	—	—	14,325	—	14,325
Net income . . . . .	—	—	—	—	—	—	—	—	205,829	205,829
Dividends declared .	—	—	—	—	—	—	—	—	(2,959)	(2,959)
<b>BALANCES,</b>										
December 31, 2001	1,993,326,138	50,558	(9,966,631)	(10,206)	—	555,794	—	(38,958)	461,091	1,018,279
Receivable from										
Sistema (Note 12):										
Increases for										
interest . . . . .	—	—	—	—	—	2,073	—	(2,073)	—	—
Payments from										
Sistema . . . . .	—	—	—	—	—	—	—	6,619	—	6,619
Issuance of stock										
options (Note 17) .	—	—	—	—	—	235	(235)	—	—	—
Amortization of										
deferred										
compensation										
(Note 17) . . . . .	—	—	—	—	—	—	23	—	—	23
Net income . . . . .	—	—	—	—	—	—	—	—	277,123	277,123
<b>BALANCES,</b>										
December 31, 2002	1,993,326,138	\$50,558	(9,966,631)	\$(10,206)	—	\$558,102	\$ (212)	\$(34,412)	\$ 738,214	\$1,302,044
Receivable from										
Sistema (Note 12):										
Increases for										
interest . . . . .	—	—	—	—	—	807	—	(807)	—	—
Payments from										
Sistema . . . . .	—	—	—	—	—	—	—	7,609	—	7,609
Issuance of stock										
options (Note 17) .	—	—	—	—	—	1,002	(1,002)	—	—	—
Stock options										
exercised										
(Note 17) . . . . .	—	—	37,557	9	—	—	—	—	—	9
Amortization of										
deferred										
compensation										
(Note 17) . . . . .	—	—	—	—	—	—	345	—	—	345
Dividends declared										
(Note 1) . . . . .	—	—	—	—	—	—	—	—	(110,931)	(110,931)
Cumulative										
translation										
adjustment net of										
income taxes . . . .	—	—	—	—	7,595	—	—	—	—	7,595
Net income . . . . .	—	—	—	—	—	—	—	—	517,239	517,239
<b>BALANCES,</b>										
December 31, 2003	1,993,326,138	\$50,558	(9,929,074)	\$(10,197)	\$7,595	\$559,911	\$ (869)	\$(27,610)	\$1,144,522	\$1,723,910

The accompanying notes to consolidated financial statements are an integral part of these statements.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE YEARS ENDED DECEMBER 31, 2003, 2002 and 2001**  
**(Amounts in thousands of U.S. dollars)**

	<b>2003</b>	<b>2002</b>	<b>2001</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>			
Net income . . . . .	\$ 517,239	\$277,123	\$205,829
Adjustments to reconcile net income to net cash provided by operating activities:			
Minority interest . . . . .	71,677	39,475	7,536
Depreciation and amortization . . . . .	415,916	209,680	133,318
Amortization of deferred connection fees . . . . .	(29,372)	(24,854)	(20,027)
Equity in net loss of associates . . . . .	(2,670)	—	—
Cumulative effect of a change in accounting principle . . . . .	—	—	17,909
Gain on debt extinguishment . . . . .	—	—	(2,780)
Inventory obsolescence expense . . . . .	3,307	5,614	2,543
Provision for doubtful accounts . . . . .	32,633	7,047	3,219
Deferred taxes . . . . .	(43,001)	(18,989)	(39,964)
Non-cash expenses associated with stock bonus and stock option plans . . . . .	213	23	—
Impairment of investment . . . . .	—	—	10,000
Changes in operating assets and liabilities:			
Increase in trade receivables . . . . .	(64,597)	(18,945)	(7,181)
Decrease/(Increase) in accounts receivable, related parties . . . . .	213	(1,360)	(3,091)
Increase in inventory . . . . .	(14,737)	(18,186)	(4,129)
Increase in prepaid expenses . . . . .	(11,029)	(2,634)	(8,552)
Increase in VAT receivable . . . . .	(50,230)	(64,154)	(59,618)
(Increase)/Decrease in other current assets . . . . .	(8,122)	(7,422)	1,613
(Decrease)/Increase in accounts payable, related parties . . . . .	(1,417)	81	1,049
Increase/(Decrease) in trade accounts payable . . . . .	2,673	(16,058)	20,470
Increase in subscriber prepayments and deposits . . . . .	76,861	46,064	49,980
Increase/(Decrease) in income tax payable . . . . .	7,141	(19,778)	10,753
Increase in accrued liabilities and other payables . . . . .	63,286	20,045	19,324
Net cash provided by operating activities . . . . .	965,984	412,772	338,201
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>			
Acquisitions of subsidiaries, net of cash acquired . . . . .	(667,206)	(143,396)	(75,858)
Purchases of property, plant and equipment . . . . .	(839,165)	(502,054)	(396,667)
Purchases of intangible assets . . . . .	(119,606)	(72,218)	(44,533)
Purchases of short term investments . . . . .	(215,000)	—	(110,000)
Proceeds from sale of short term investments . . . . .	—	55,304	195,602
Investments in and advances to associates . . . . .	(69,110)	(35,557)	(10,067)
Net cash used in investing activities . . . . .	(1,910,087)	(697,921)	(441,523)
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>			
Proceeds from issuance of notes . . . . .	1,097,000	50,808	248,135
Notes issuance cost . . . . .	(9,556)	(649)	(3,856)
Capital lease obligation principal paid . . . . .	(22,646)	(1,804)	(7,947)
Dividends paid . . . . .	(110,864)	—	(2,959)
Proceeds from loans . . . . .	712,716	52,851	13,577
Loan principal paid . . . . .	(677,374)	(7,008)	(13,683)
Payments from Sistema . . . . .	8,269	6,619	14,325
Net cash provided by financing activities . . . . .	997,545	100,817	247,592
Effect of exchange rate changes on cash and cash equivalents . . . . .	2,273	(636)	(469)
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS:</b>	55,715	(184,968)	143,801
<b>CASH AND CASH EQUIVALENTS, beginning of year</b>	34,661	219,629	75,828
<b>CASH AND CASH EQUIVALENTS, end of year</b>	\$ 90,376	\$ 34,661	\$219,629
<b>SUPPLEMENTAL INFORMATION:</b>			
Income taxes paid . . . . .	\$ 286,016	\$147,346	\$129,418
Interest paid . . . . .	\$ 79,824	\$ 43,438	\$ 4,096
Non-cash investing activities:			
Additions to network equipment and software under capital lease . . . . .	\$ 10,928	\$ 18,917	\$ 34,072
Payable related to business acquisition (Note 4) . . . . .	\$ 27,500	\$ —	\$ —

The accompanying notes to consolidated financial statements are an integral part of these statements.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

(Amounts in thousands of U.S. dollars,  
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**1. DESCRIPTION OF BUSINESS**

*Business of the Group*

OJSC Mobile TeleSystems and its subsidiaries (“MTS” or the “Group”) is the leading provider of wireless telecommunication services in the Russian Federation (“RF”) and Ukraine in terms of the number of subscribers and revenues. The Group has operated primarily in the GSM standard since 1994.

Open Joint-Stock Company Mobile TeleSystems (“MTS OJSC” or the “Company”) was created on March 1, 2000, through the merger of Closed Joint-Stock Company Mobile TeleSystems (“MTS CJSC”) and RTC CJSC, its wholly-owned subsidiary. MTS CJSC was formed in 1993 to design, construct and operate a cellular telecommunications network in Moscow and the Moscow region. The development of the network was achieved through green-field build-out in the regions for which the Company was granted 900 or 1800 MHz (“GSM-900” and “GSM-1800”) cellular licenses or through the acquisition of majority stakes in local GSM operators (see Note 21 Operating Licenses and Note 4 Businesses Acquired).

The Company’s shares are traded in the form of American Depositary Shares (“ADS”). Each ADS represents 20 shares of common stock of the Company. In July 2000, the Company issued a total of 17,262,204 ADS, representing 345,244,080 common shares.

*Ownership*

As of December 31, 2003 and 2002, MTS’ shareholders of record and their respective percentage direct interests were as follows:

	<u>2003</u>	<u>2002</u>
Joint-Stock Financial Corporation “Sistema” (“Sistema”) . . . . .	41.0%	35.0%
T-Mobile Worldwide Holding GmbH (“T-Mobile”) . . . . .	25.4%	36.4%
VAST, Limited Liability Company (“VAST”) . . . . .	3.1%	3.1%
Invest-Svyaz-Holding, Closed Joint-Stock Company . . . . .	8.0%	8.0%
ADS Holders . . . . .	17.4%	17.4%
GDR Holders . . . . .	5.0%	—
All executive officers and directors . . . . .	0.1%	0.1%
	<u>100.0%</u>	<u>100.0%</u>

Sistema owns 51.0% equity interest in VAST, a limited liability company incorporated under the laws of the Russian Federation; the remaining 49.0% interest is held by ASVT, a Russian open joint-stock company. Sistema’s effective ownership in MTS was 50.6% and 44.6% at December 31, 2003 and 2002, respectively.

In March 2003, Sistema and T-Mobile (together, “the Shareholders”) entered into a call option agreement, pursuant to which T-Mobile granted Sistema the option to acquire from it 199,332,614 shares of MTS, representing 10.0% of outstanding common stock of MTS. On April 26, 2003, Sistema exercised its option with T-Mobile to purchase an additional 6.0% of the outstanding common stock of MTS and purchased T-Mobile’s 49.0% interest in Invest-Svyaz-Holding, bringing its interest in Invest-Svyaz-Holding to 100.0%. Concurrently with this transaction, T-Mobile sold its holding of 5.0% in MTS

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Amounts in thousands of U.S. dollars,  
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on the open market in the form of Global Depositary Receipts (“GDRs”) listed on the London Stock Exchange.

In April 2003, Sistema issued \$350.0 million 10.25% notes, due in 2008. These notes are collateralized by 193,473,900 shares of common stock of MTS OJSC.

On June 30, 2003, the Group approved cash dividends of \$1.12 per ADS (\$0.056 per share) for a total of \$111.0 million. As of the date of these statements, dividends in the amount of \$96.7 million, net of tax in the amount of \$10.5 million, were paid.

On November 28, 2003, common shares of MTS OJSC were included by the Board of Moscow Interbank Currency Exchange (“MICEX”) into the MICEX “B” Quotation List.

**2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NEW ACCOUNTING PRONOUNCEMENTS**

*Accounting principles*

MTS maintains its accounting books and records in Russian rubles for its subsidiaries located in the Russian Federation and Ukrainian hryvnias for Ukrainian Mobile Communications (“UMC”) based on local accounting and tax legislation. The accompanying consolidated financial statements have been prepared in order to present MTS’ financial position and its results of operations and cash flows in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) and expressed in terms of U.S. dollars.

The accompanying consolidated financial statements differ from the financial statements used for statutory purposes in that they reflect various adjustments, not recorded on the entities’ books, which are appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP. The principal adjustments are related to revenue recognition, foreign currency translation, deferred taxation, consolidation, and depreciation and valuation of property and equipment and intangible assets.

*Basis of consolidation*

Wholly owned subsidiaries and majority owned subsidiaries where the Company has operating and financial control are consolidated. Those ventures where the Company exercises significant influence, but does not exercise operating and financial control are accounted for by the equity method. All significant intercompany accounts and transactions are eliminated upon consolidation. The Company’s share in net income of unconsolidated affiliates was insignificant for each of the three years in the period ended December 31, 2003, and is included in other income in the accompanying consolidated statements of operations. Results of operations of subsidiaries acquired are included in the consolidated statements of operations from the date of their acquisition.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Amounts in thousands of U.S. dollars,  
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As of December 31, 2003 and 2002, MTS has investments in the following significant operating and holding entities:

	Accounting Method	December 31,	
		2003	2002
Rosico <sup>(1)</sup> . . . . .	Consolidated	—	100.0%
ACC . . . . .	Consolidated	100.0%	100.0%
Telecom XXI . . . . .	Consolidated	100.0%	100.0%
Telecom-900 . . . . .	Consolidated	100.0%	100.0%
SCS-900 . . . . .	Consolidated	88.5%	51.0%
FECS-900 . . . . .	Consolidated	60.0%	60.0%
Uraltel . . . . .	Consolidated	99.8%	53.2%
MTS Finance <sup>(2)</sup> . . . . .	Consolidated	100.0%	100.0%
BM Telecom . . . . .	Consolidated	100.0%	100.0%
Kuban-GSM . . . . .	Consolidated	100.0%	52.7%
Dontelecom . . . . .	Consolidated	100.0%	100.0%
MTS-Barnaul . . . . .	Consolidated	100.0%	100.0%
BIT . . . . .	Consolidated	100.0%	100.0%
MTS-Capital . . . . .	Consolidated	100.0%	—
UMC . . . . .	Consolidated	100.0%	—
Sibchallenge . . . . .	Consolidated	100.0%	—
TSS . . . . .	Consolidated	100.0%	—
Volgograd Mobile . . . . .	Equity	50.0%	—
Astrakhan Mobile . . . . .	Equity	50.0%	—
Mar Mobile GSM . . . . .	Consolidated	100.0%	—
Primtelefon . . . . .	Equity	50.0%	—
MSS . . . . .	Consolidated	83.5%	83.5%
ReCom . . . . .	Consolidated	53.9%	53.9%
TAIF Telecom . . . . .	Consolidated	52.7%	—
UDN-900 . . . . .	Consolidated	51.0%	51.0%
Novitel . . . . .	Consolidated	51.0%	51.0%
MTS Belarus . . . . .	Equity	49.0%	49.0%

<sup>(1)</sup> On June 9, 2003, the Group's wholly owned subsidiary, Rosico, merged into MTS OJSC pursuant to a shareholders' resolution approving the transaction.

<sup>(2)</sup> Represents beneficial ownership.

*Translation methodology*

Effective January 1, 2003, the Russian economy ceased to be considered hyperinflationary. Management believes that the U.S. dollar is the appropriate functional currency because the majority of its revenues, costs, property and equipment purchased, and debt are either priced, incurred, payable or otherwise measured in U.S. dollars. Each of the legal entities domiciled in Russia, Ukraine and Belarus maintains its records and prepares its financial statements in the local currency, principally either Russian ruble, Ukrainian hryvnia or Belarusian ruble, in accordance with the requirements of local statutory accounting and tax legislation.



**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Amounts in thousands of U.S. dollars,  
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Translation (re-measurement) of financial statements denominated in local currencies into U.S. dollars has been performed in accordance with the provisions of Statement of Financial Accounting Standard ("SFAS") No. 52 "Foreign currency translation."

For subsidiaries of the Group where functional currency is the U.S. dollar, monetary assets and liabilities have been translated at the period end exchange rates. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows have been translated at historical rates. Translation differences resulting from the use of these rates have been accounted for as foreign currency exchange gains and losses in the accompanying consolidated statements of operations.

For UMC and Kuban-GSM where functional currency is the local currency, Ukrainian hryvnia and Russian ruble, respectively, a "new cost basis" for all non-monetary assets has been established as of January 1, 2003. All year end balance sheet items have been translated into U.S. dollars at the period end exchange rate. Revenues and expenses have been translated at period average exchange rate. Cumulative translation adjustments in the amount of \$7,595, net of income taxes were recorded directly in the consolidated statement of shareholders' equity.

*Management estimates*

The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Examples of significant estimates include the allowance for doubtful accounts, the recoverability of intangible assets and other long-lived assets, and valuation allowances on deferred tax assets.

*Cash and cash equivalents*

Cash represents cash on hand and in MTS' bank accounts and short-term investments having original maturities of less than three months.

*Short-term investments*

Short-term investments represent investments in time deposits, which have original maturities in excess of three months but less than twelve months. These investments are being accounted for at cost.

*Allowance for doubtful accounts*

MTS provides an allowance for doubtful accounts based on management's periodic review of accounts receivable from customers and other receivables.

*Prepaid expenses*

Prepaid expenses are primarily comprised of advance payments made for inventory and services to vendors.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Amounts in thousands of U.S. dollars,  
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*Inventory*

Inventory, accounted for at lower of cost, determined by the first-in, first-out, or FIFO method, or market, consists of telephones and accessories, held for sale and spare parts, to be used for equipment maintenance within next twelve months and other inventory items.

Telephones and accessories, held for sale, are written down to their market values based on specific monthly reviews of significant inventoried items and are expensed as cost of equipment.

*Value-added taxes ("VAT")*

Value-added taxes related to sales are payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed, subject to certain restrictions, against VAT related to sales.

*Property, plant and equipment*

Property, plant and equipment with a useful life of more than one year are capitalized at historical cost and depreciated on a straight-line basis over their expected useful lives as follows:

Network and base station equipment . . . . .	5–12 years
Leasehold improvements . . . . .	shorter of 10 years or lease term
Office equipment and computers . . . . .	5 years
Buildings . . . . .	50 years
Vehicles . . . . .	4 years

Construction in progress and equipment held for installation are not depreciated until the constructed or installed asset is ready for its intended use.

Maintenance and repair costs are expensed as incurred, while upgrades and improvements that extend useful lives are capitalized.

*License costs*

License costs are capitalized as a result of (a) purchase price allocated to licenses acquired in business combinations (see Note 4 Businesses Acquired) and (b) licenses purchased directly from government organizations, which require license payments.

Our current operating licenses do not provide for automatic renewal upon expiration, and as the Group and the industry do not have sufficient experience with the renewal of licenses, license costs are being amortized, subject to periodic review for impairment, on a straight-line basis over three to ten years starting from the date such license area becomes commercially operational.

Upon adoption of SFAS No. 142, "Goodwill and Other Intangible Assets" on January 1, 2002, the Group reclassified \$22.0 million relating to the 1998 acquisition of Rosico from goodwill to licenses.

*Other intangible assets and Goodwill*

Intangible assets represent various purchased software costs, telephone numbering capacity, acquired customer base and rights to use premises. A significant portion of the rights to use premises was contributed by shareholders to the Group's charter capital. Telephone numbering capacity costs

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Amounts in thousands of U.S. dollars,  
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with finite contractual life are being amortized over five to ten years and the rights to use premises are being amortized over ten years.

Software costs are amortized over four years. Acquired customer base is amortized over the estimated average subscriber life from 30 to 70 months. Other intangible assets are being amortized over three to four years. All finite-life intangible assets are being amortized using the straight-line method.

Telephone numbering capacity with unlimited contractual life is not amortized, but is reviewed, at least annually, for impairment in accordance with the provisions of SFAS No. 142. Amortization of deferred numbering capacity costs starts immediately upon the purchase of numbering capacity.

Goodwill represents the excess of the cost of business acquired over the fair market value of identifiable net assets at the date of acquisition, namely fair value of workforce-in-place acquired in the purchase of UMC (see Note 4 Business Acquired).

Goodwill is reviewed annually, as of the beginning of the fourth quarter, for impairment or whenever it is determined that impairment indicators exist. The Company determines whether an impairment has occurred by assigning goodwill to the reporting unit identified in accordance with SFAS No. 142, and comparing the carrying amount of the reporting unit to the fair value of the reporting unit. If a goodwill impairment has occurred, the Company recognizes a loss for the difference between the carrying amount and the implied fair value of goodwill. To date, no impairment of goodwill has occurred.

*Leasing arrangements*

The Group accounts for leases based on the requirements of SFAS No. 13, "Accounting for Leases." Majority of the Group's operating leases are for the premises. Certain subsidiaries of the Group lease switches, base stations and other cellular network equipment as well as billing systems. For capital leases, the present value of future minimum lease payments at the inception of the lease is reflected as an asset and a liability in the balance sheet. Amounts due within one year are classified as short-term liabilities and the remaining balance as long-term liabilities.

*Subscriber acquisition costs*

Subscriber acquisition costs represent the direct costs paid for each new subscriber enrolled through MTS' independent dealers. MTS expenses these costs as incurred. Prior to 2001, these costs were capitalized to the extent of any revenues that had been deferred from the acquisition of a subscriber, such as connection fees charged to a subscriber to initiate call service, and amortized as a component of sales and marketing expense on a straight-line basis over the estimated average subscriber life (see also Note 3 Change in Accounting Principle).

*Investments impairment*

Management periodically assesses the realizability of the carrying values of the investments and if necessary records impairment losses to write the investment down to fair value.

For the three years in the period ended December 31, 2003, no such impairments have occurred, except as discussed in Note 20 Investments In and Advances to Associates.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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*Debt issuance costs*

Debt issuance costs are amortized using the effective interest method over the terms of the related debt.

*Impairment of long-lived assets*

MTS periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, MTS compares undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, MTS records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. For the three years in the period ended December 31, 2003, no such impairments have occurred.

*Subscriber prepayments*

The Group requires the majority of its customers to pay in advance for telecommunication services. All amounts received in advance of service provided are recorded as a subscriber prepayment liability and are not recorded as revenues until the related services have been provided to the subscriber.

*Revenue recognition*

Revenues are recognized on an accrual basis, when services are actually provided or title to equipment passes to customer, regardless of when the resulting monetary or financial flow occurs.

MTS categorizes the revenue sources in the statements of operations as follows:

- Service revenues: (a) subscription fees, (b) usage charge, (c) value-added service fees, (d) roaming fees charged to other operators for guest roamers utilizing MTS' network and (e) prepaid phone cards;
- Connection fees;
- Equipment sales: (a) sales of handsets, and (b) sales of accessories.

*Subscription fees*

MTS recognizes revenues related to the monthly network fees in the month that the wireless service is provided to the subscriber.

*Usage charges and Value-added services fees*

Usage charges consist of fees based on airtime used by subscriber, the destination of the call and the service utilized.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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Value-added service fees are based on usage of airtime or volume of data transmitted for value added services, such as short message services, internet usage and data services. MTS recognizes revenues related to usage charges and value-added services in the period when services were rendered.

*Roaming fees*

MTS charges roaming per-minutes fees to other wireless operators for non-MTS subscribers utilizing MTS' network. Guest roaming fees were \$153,271, \$83,393 and \$52,639 for the years ended December 31, 2003, 2002 and 2001, respectively.

*Prepaid phone cards*

MTS sells to subscribers prepaid phone cards, separately from the handset. These cards allow subscribers to make a predetermined allotment of wireless phone calls and/or take advantage of other services offered by the Group, such as short messages and sending or receiving faxes.

At the time that the prepaid phone card is purchased, MTS records the receipt of cash as a subscriber prepayment. The Group recognizes revenues from the phone cards in the period when subscriber uses time under the phone card. Unused time on sold phone cards is not recognized as revenues until the related services have been provided to the subscriber or the prepaid phone card has expired.

In 2002, MTS introduced a new line of prepaid service tariff plans, whereby a customer may purchase a package that allows a connection to the MTS network and a predetermined allotment of wireless phone calls and/or other services offered by the Group. Revenues under these plans are allocated between connection fees and service fees based on their relative fair values.

*Connection fees*

MTS defers initial connection fees from the moment of initial signing of the contract with subscribers over the estimated average subscriber life. The Group estimates that the average expected term of the subscriber relationship is 39 months in Russia and 47 months in Ukraine (see also Note 11 Deferred Connection Fees).

*Equipment sales*

MTS sells handsets and accessories to customers who are entering into contracts for service and as separate distinct transactions. The Group recognizes revenues from the handsets and accessories when title passes to the customer. MTS records estimated returns as a direct reduction of sales at the time the related sales are recorded.

In Ukraine, MTS also from time to time sells handsets at prices below cost. MTS recognizes these subsidies in cost of equipment when sale is recorded.

*Expense recognition*

Expenses incurred by MTS in relation to the provision of wireless communication services mainly relate to interconnection and line rental costs, roaming expenses, costs of handsets and other accessories sold, depreciation and amortization, and maintenance of the network.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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Calls made by subscribers from areas outside of territories covered by the Group licenses are subject to roaming fees charged by the wireless provider in those territories. These fees are recorded as roaming expenses, as MTS acts as the principal in the transaction with the subscriber and bears the risk of non-collection from the subscriber. Roaming fees are charged to MTS subscribers based on Group's existing tariffs and recorded as service revenues.

The costs of handsets and accessories, whether sold to subscribers through the distribution channel or as part of the service contract, are expensed when title passes to the customer. Any fees paid to dealers as commissions are recorded as a component of sales and marketing expenses.

*Taxation*

Deferred tax assets and liabilities are recognized for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and loss or tax credit carryforwards using enacted tax rates expected to be in effect at the time these differences are realized. Valuation allowances are recorded for deferred tax assets for which it is more likely that these assets will not be realized.

*Advertising costs*

Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2003, 2002 and 2001 were \$102,018, \$48,624 and \$42,715, respectively, and are reflected as a component of sales and marketing expenses in the accompanying consolidated statements of operations.

*Government pension fund*

Subsidiaries of the Group contribute to the local state pension fund and social fund, on behalf of all its employees.

In Russia, starting from January 1, 2001 all social contributions, including contributions to the pension fund, were substituted with a unified social tax ("UST") calculated by the application of a regressive rate from 35.6% to 2% of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 28% to 2%, respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

In Ukraine the subsidiary of the Group is required to contribute a specified percentage of each employee payroll up to a fixed limit to Pension Fund, Unemployment Fund and Social Security Fund.

*Earnings per share*

Basic earnings per share ("EPS") have been determined using the weighted average number of shares outstanding during the year. Diluted EPS reflect the potential dilution of stock options, granted to employees. There are 4,797,410 stock options outstanding as of December 31, 2003.



**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

(Amounts in thousands of U.S. dollars,  
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The following is the reconciliation of the share component for basic and diluted EPS:

	December 31,		
	2003	2002	2001
Weighted average number of common share outstanding	1,983,374,949	1,983,359,507	1,983,359,507
Dilutive effect of stock options . . . . .	1,727,131	405,946	30,133
Weighted average number of common shares and potential shares outstanding . . . . .	<u>1,985,102,080</u>	<u>1,983,765,453</u>	<u>1,983,389,640</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. The fair value of our publicly traded long-term notes as of December 31, 2003 ranged from 103.6% to 110.2% of the principal amount. As of December 31, 2003, fair value of other fixed rate debt including capital lease obligation approximated its carrying value. The fair value of variable rate debt is equivalent to carrying value.

*Comprehensive income*

Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. The following is a reconciliation of comprehensive income, net of income taxes:

	December 31,		
	2003	2002	2001
Net income . . . . .	\$517,239	\$277,123	\$205,829
Cumulative translation adjustment . . . . .	7,595	—	—
Total comprehensive income . . . . .	<u>\$524,834</u>	<u>\$277,123</u>	<u>\$205,829</u>

*Comparative information*

Certain prior years amounts have been reclassified to conform to the current year presentation.

*Stock-based compensation*

MTS accounts for stock options issued to employees, non-employee directors and consultants following the requirements of SFAS No. 123, "Accounting for Stock-Based Compensation" and SFAS No. 148 "Accounting for Stock Based Compensation—Transition and Disclosure, an amendment to FASB Statement No. 123." Under the requirements of these statements compensation to employees and non-employee directors is measured based on the intrinsic value of options on the measurement date, calculated as a difference between the fair market value of stock and exercise price at that date. Compensation to consultants is measured based on the fair value of options on the measurement date as determined using a Black-Scholes option-pricing model.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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If the Group had elected to recognize compensation costs based on the fair values of options at the date of the grant, net income and earning per share amounts would have been as follows:

	December 31,		
	2003	2002	2001
Net income as reported . . . . .	\$517,239	\$277,123	\$205,829
Pro-forma effect of the application of fair value method of accounting for stock options . . . . .	(727)	(460)	(129)
Pro-forma net income . . . . .	<u>\$516,512</u>	<u>\$276,663</u>	<u>\$205,700</u>
Earnings per share—basic and diluted			
As reported . . . . .	\$ 0.261	\$ 0.140	\$ 0.104
Pro-forma . . . . .	\$ 0.260	\$ 0.140	\$ 0.104

*Recently adopted accounting pronouncements*

In June 2001, Financial Accounting Standard Board (“FASB”) issued SFAS No. 143, “Accounting for Asset Retirement Obligations.” SFAS No. 143 requires that the fair value of a liability for an asset retirement obligation is recorded in the period in which it is incurred if a reasonable estimate of fair value can be made. The associated asset retirement costs are capitalized as part of the carrying amount of the long-lived asset and depreciated over the asset’s useful life. Changes in the liability resulting from the passage of time will be recognized as operating expense. The Group adopted SFAS No. 143 effective January 1, 2003. The adoption of SFAS No. 143 did not have a material impact on the Group’s financial position or results of operations.

In April 2002, FASB issued SFAS No. 145, “Rescission of FASB Statements Nos. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections”. SFAS No. 4, “Reporting Gains and Losses from Extinguishments of Debt,” addressed statement of operations classification of gains and losses from extinguishment of debt. SFAS No. 64 amended SFAS No. 4 and is no longer necessary due to the rescission of SFAS No. 4. SFAS No. 145 also amended SFAS No. 13 “Accounting for Leases,” to eliminate an inconsistency between the required accounting for sale-leaseback transactions and the required sale-leaseback accounting for certain lease modifications that have economic effects that are similar to sale-leaseback transactions. Following the adoption of the requirements of SFAS No. 145 effective January 1, 2003, MTS reclassified a gain on the extinguishment of a credit facility with OJSC AB Inkombank of \$2.8 million and the related income tax expense of \$0.7 million from extraordinary gain on debt repayment to other income and income tax expense, respectively, in the consolidated statement of operations for the year ended December 31, 2001.

In June 2002, FASB issued SFAS No. 146, “Accounting for Costs Associated with Exit or Disposal Activities,” which requires the recognition of a liability when incurred for costs associated with an exit or disposal activity. The fundamental conclusion reached by the FASB in this Statement is that an entity’s commitment to a plan, by itself, does not create a present obligation to others that meets the definition of a liability. SFAS No. 146 also establishes that the liability should initially be measured and recorded at fair value. The Group adopted the provisions of SFAS No. 146 effective January 1, 2003. The adoption of SFAS No. 146 did not have a material impact on the Group’s financial position or results of operations.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
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In November 2002, FASB issued FASB Interpretation No. 45, "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others" ("FIN 45"). FIN 45 requires that the guarantor recognizes, at the inception of certain guarantees, a liability for the fair value of the obligation undertaken in issuing such guarantee. FIN 45 also requires additional disclosures about the guarantor's obligations under certain guarantees that it has issued. The Group adopted the initial recognition and measurement provisions of this interpretation on a prospective basis to guarantees issued or modified after December 31, 2002. The adoption of FIN 45 did not have a material impact on the Group's financial position or results of operations.

In November 2002, the Emerging Issues Task Force ("EITF") issued a final consensus on EITF Issue No. 00-21, "Accounting for Revenue Arrangements with Multiple Deliverables." EITF Issue No. 00-21 provides guidance on when and how an arrangement involving multiple deliverables should be divided in separate units of accounting. The Group adopted the requirements of EITF Issue No. 00-21 prospectively for arrangements entered into after June 15, 2003. The adoption of EITF Issue No. 00-21 did not have a material impact on the Group's financial position or results of operations.

In April 2003, FASB issued SFAS No. 149, "Amendments of FASB Statements No. 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 clarifies under what circumstances a contract with an initial investment meets the characteristic of a derivative, clarifies when a derivative contains a financing component, amends the definition of an underlying and certain other existing pronouncements. The Group adopted the requirements of SFAS No. 149 for contracts entered into or modified and for hedging relationships designated after June 30, 2003. The adoption of SFAS No. 149 did not have a material impact on the Group's financial position or results of operations.

In May 2003, FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity". SFAS No. 150 requires issuers to classify as liabilities (or assets in some circumstances) certain classes of freestanding financial instruments that embody obligations for the issuer, including mandatory redeemable financial instruments, obligations to repurchase the issuer's equity shares by transferring assets and certain obligations to issue a variable number of shares. The Group adopted the requirements of SFAS No. 150 effective July 1, 2003. The adoption of SFAS No. 150 did not have a material impact on the Group's financial position or results of operations.

*New accounting pronouncements*

In December 2003, FASB issued a revision to Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46R" or the "Interpretation"). FIN 46R clarifies the application of ARB No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both.

Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public

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companies, to the end of the first reporting period ending after March 15, 2004, except that all public companies must at a minimum apply the provisions of the Interpretation to entities that were previously considered “special-purpose entities” under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003.

The Group is evaluating whether the adoption of FIN 46 will have a material impact on its financial position, cash flows and results of operations. The Group did not enter into any transactions under the scope of FIN 46R after February 1, 2003.

In December 2003, the Securities Exchange Commission (SEC) issued Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition. SAB 104 updates portions of the interpretive guidance included in Topic 13 of the codification of Staff Accounting Bulletins in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The Group believes it is following the guidance of SAB 104.

### **3. CHANGE IN ACCOUNTING PRINCIPLE**

Effective January 1, 2001, the Group changed its accounting principle regarding recognition of subscriber acquisition costs. Subscriber acquisition costs represent the direct costs paid for each new subscriber enrolled through MTS’ independent dealers. Prior to the 2001, these costs were capitalized to the extent of any revenues that had been deferred from the acquisition of a subscriber, such as connection fees charged to a subscriber to initiate call service, and amortized as a component of sales and marketing expense on a straight-line basis over the estimated average subscriber life. MTS now expenses subscriber acquisition costs as incurred. This change of accounting principle was made to facilitate the comparison of MTS’ results with other telecommunication companies.

As a cumulative effect of this change, the remaining balance of capitalized subscriber acquisition cost as of January 1, 2001 in the amount of \$17,909 (\$0.009 per basic and diluted share), net of \$9,644 in taxes was expensed and included in income during the year ended December 31, 2001.

### **4. BUSINESSES ACQUIRED**

#### *Telecom XXI acquisition*

In May 2001, MTS acquired 100% of the outstanding common stock of Telecom XXI, a Russian closed joint-stock company, for cash consideration of \$49.7 million. Telecom XXI has GSM-900 and GSM-1800 licenses, covering northwest of Russia, including St. Petersburg and Leningrad region as well as Kaliningrad. Telecom XXI did not have any subscribers at the date of the acquisition. The Telecom XXI acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

Current assets . . . . .	\$ 849
Non-current asset . . . . .	1,322
License costs . . . . .	74,639
Current liabilities . . . . .	(944)
Deferred taxes . . . . .	(26,124)
Purchase price . . . . .	<u>\$ 49,742</u>

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License costs are amortized over the remaining term of the license of approximately 7 years at the date of the acquisition.

*Telecom-900 acquisition*

In August 2001, MTS acquired 81% of the outstanding common stock of Telecom-900, a Russian closed joint-stock company, for a cash consideration of \$26.8 million from Sistema. Telecom-900 is the holding company for three regional mobile phone operators, Siberia Cellular System 900 CJSC (“SCS-900”), Uraltel CJSC (“Uraltel”), and Far East Cellular Systems 900 CJSC (“FECS-900”). At the date of acquisition, these companies had approximately 96,000 subscribers and licenses to provide GSM-900/1800 mobile services in the Novosibirsk region, Altai Republic, Sverdlovsk region and Khabarovsk region.

Telecom-900 acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

Current assets . . . . .	\$ 12,136
Non-current assets . . . . .	29,297
License costs . . . . .	31,542
Current liabilities . . . . .	(21,883)
Non-current liabilities . . . . .	(10,626)
Deferred taxes . . . . .	(7,754)
Minority interest . . . . .	(5,900)
Purchase price . . . . .	<u>\$ 26,812</u>

In November 2002, MTS acquired the remaining 19% of Telecom-900 from Invest-Svyaz-Holding, a shareholder of the Group and a wholly owned subsidiary of Sistema, for a cash consideration of \$6.9 million. The acquisition was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by \$2.7 million.

On August 13, 2003, Telecom-900 completed the purchase of the 43.7% and 2.95% stakes in Uraltel for a cash consideration of \$35.7 million. The transaction increased Telecom-900’s ownership in Uraltel to 99.85%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$24.5 million.

In November 2003, the Group completed the purchase of the 30% stake in SCS-900 from Sibirtelecom for cash consideration of \$28.6 million. The Group’s acquisition of this stake increased its ownership in SCS-900 to 81.0%. On December 29, 2003, the Group acquired for cash consideration of \$9.3 million a 100% stake in ILIT LLC, a company which owns a 7.5% stake in SCS-900, increasing its ownership in SCS-900 to 88.5%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$25.7 million.

License costs are amortized over the remaining contractual terms of the respective license, ranging from 6 to 10 years at the date of the first acquisition.

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*Kuban-GSM acquisition*

In March 2002, MTS acquired 51% of Kuban-GSM, a Russian closed joint-stock company, for cash consideration of \$71.4 million. At the date of acquisition, Kuban-GSM had approximately 500,000 subscribers. It operates in thirteen major cities throughout the south of the European part of the Russian Federation, including Sochi, Krasnodar and Novorossiisk. The Kuban-GSM acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

Current assets . . . . .	\$ 11,751
Non-current assets . . . . .	80,848
License costs . . . . .	62,549
Acquired customer base . . . . .	3,561
Current liabilities . . . . .	(31,289)
Non-current liabilities . . . . .	(19,827)
Deferred taxes . . . . .	(15,866)
Minority interest . . . . .	(20,327)
Purchase price . . . . .	<u>\$ 71,400</u>

In October 2002, MTS exercised its option to buy additional 353 shares for \$5.0 million payable in cash, increasing its ownership in Kuban-GSM to 52.7%. The acquisition of the additional interest was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by \$4.4 million, increased acquired customer base by \$0.2 million, and decreased minority interest by \$0.5 million.

In September 2003, the Group acquired 100.0% of Kubtelesot for cash consideration of \$107.0 million. Kubtelesot owned 47.3% of Kuban-GSM, and the Group's purchase of this stake increased its ownership in Kuban-GSM to 100.0%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by \$57.5 million, increased acquired customer base by \$8.4 million, and decreased minority interest by \$59.0 million.

License costs are amortized over the remaining contractual term of the license of approximately 5 years at the date of the first acquisition. Acquired customer base is amortized over the average remaining subscribers life of approximately 70 months.

*BM Telecom acquisition*

In May 2002, MTS completed its acquisition of 100% of the outstanding common stock of Ufa-based BM Telecom, a closed joint-stock company, for \$41.0 million in cash. At the date of acquisition BM Telecom had approximately 100,000 subscribers and it holds a GSM-900/1800 license to



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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, a closed joint-stock company, for cash consideration of \$15.0 million (including 33.33% acquired from Sistema for \$7.5 million). At the date of acquisition Dontelecom had approximately 39,000 subscribers. Dontelecom holds a GSM-900/1800 license to operate in the Rostov region. This acquisition was accounted for using the purchase method. The purchase price was allocated as follows:

Current assets . . . . .	\$ 3,422
Non-current assets . . . . .	8,401
License costs . . . . .	14,739
Current liabilities . . . . .	(5,849)
Non-current liabilities . . . . .	(357)
Deferred taxes . . . . .	(3,675)
Minority interest . . . . .	(1,681)
Purchase price . . . . .	<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 \$7.5 million. The acquisition was accounted for using the purchase method of accounting. The purchase increased the recorded license costs by \$7.3 million.

License costs are amortized over the remaining contractual term of the license of approximately 3 years at the date of the acquisition.

*UMC acquisition*

On March 4, 2003, MTS acquired 57.7% of the outstanding voting interest of UMC, a provider of mobile services in Ukraine, for cash consideration of \$199.0 million, including the acquisition of 16.3% of the outstanding voting interest from Deutsche Telekom AG, a related party, for \$55.0 million. Acquisition costs relating to the transaction of \$1.4 million were capitalized. In connection with the acquisition, MTS also assumed debt of UMC with face value of approximately \$65.0 million, with the

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fair value of approximately \$62.0 million. At the date of acquisition, UMC had approximately 1.8 million subscribers.

The acquisition was accounted for using the purchase method. For convenience, MTS consolidated UMC from March 1, 2003. Purchase price allocation is as follows:

Current assets . . . . .	\$ 82,293
Non-current assets . . . . .	272,721
License costs . . . . .	82,200
Acquired customer base . . . . .	30,927
Current liabilities . . . . .	(63,551)
Non-current liabilities . . . . .	(78,580)
Deferred taxes . . . . .	(27,425)
Minority interest . . . . .	(99,581)
Purchase price . . . . .	<u>\$ 199,004</u>

MTS paid \$171.5 million of the purchase price in cash and agreed to pay the balance of the purchase price of \$27.5 million to Cetel B.V., a wholly owned subsidiary of Deutsche Telekom AG, within one year. The amount payable accrues interest of 9% per annum.

MTS also had an option agreement with Ukrtelecom to purchase its remaining 26.0% stake in UMC, exercisable from February 5, 2003 to November 5, 2005, with an exercise price of \$87.6 million. On June 4, 2003, MTS exercised its call option. As a result of the transaction, MTS' ownership in UMC increased from 57.7% to 83.7%. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$10.2 million, increased acquired customer base by \$13.9 million, and decreased minority interest by \$66.4 million.

In addition, MTS entered into a put and call option agreement with TDC Mobile International A/S ("TDC") for the purchase of its 16.3% stake in UMC. The exercise period of the call option was from May 5, 2003 to November 5, 2004, and the put option was exercisable from August 5, 2003 to November 5, 2004. The call option price was \$85.0 million plus interest accrued from November 5, 2002 to the date of the exercise at 11% per annum; the price of the put option was calculated based on reported earnings of UMC prior to the exercise and was subject to a minimum amount of \$55.0 million. On June 25, 2003, MTS notified TDC of its intent to exercise its rights under the put and call option agreement. The purchase was completed during July 2003. MTS paid cash consideration of approximately \$91.7 million to purchase the remaining 16.3% stake in UMC. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by \$52.7 million, increased acquired customer base by \$8.7 million, and decreased minority interest by \$43.8 million.

The UMC license costs are amortized over the remaining contractual terms of the licenses of approximately 9 to 13 years at the date of the acquisition, acquired customer base is amortized over the average remaining subscribers life of approximately 47 months. Other acquired intangible assets, represented mostly by software, are amortized over their respective useful lives of 3 to 10 years.

In accordance with SFAS No. 141 "Business Combinations," the Group recognized \$8.0 million of goodwill relating to workforce-in-place.

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UMC is one of the two leading mobile operators in Ukraine, operating under nationwide GSM 900/1800 and NMT 450 licenses. As at the date of purchase of the controlling stake, it was providing services to approximately 1.8 million subscribers.

*TAIF Telcom acquisition*

In April 2003, MTS acquired 51.0% of the common shares of TAIF Telcom, a Russian open joint-stock company, for cash consideration of \$51.0 million and 50.0% of the preferred shares of TAIF Telcom for cash consideration of \$10.0 million. In May 2003, MTS acquired an additional 1.7% of the common shares of TAIF Telcom for cash consideration of \$2.3 million. In connection with the acquisitions, MTS also assumed indebtedness of approximately \$16.6 million that is collateralized by telecom equipment.

MTS also entered into call and put option agreements with the existing shareholders of TAIF Telcom to acquire the remaining 49.0% of common shares and 50.0% of preferred shares of TAIF Telcom. The exercise period for the call option on common shares is 48 months from the acquisition date and for the put option on common shares is 36 months following an 18 month period after the acquisition date. The call and put option agreements for the common shares stipulate a minimum purchase price of \$49.0 million plus 8% per annum commencing from the acquisition date. The exercise period for the call option on preferred shares is 48 months following a 24 month period after the acquisition date and for the put option on preferred shares it is a 24 month period after the acquisition date. The call and put option agreements for the preferred shares stipulate a minimum purchase price of \$10.0 million plus 8% per annum commencing from the acquisition date.

If all of the options are exercised, MTS' share in TAIF Telcom will increase to 100.0%.

The purchase price allocation was as follows:

Current assets . . . . .	\$ 3,870
Non-current assets . . . . .	48,391
License costs . . . . .	68,407
Current liabilities . . . . .	(26,099)
Non-current liabilities . . . . .	(5,550)
Deferred taxes . . . . .	(16,814)
Minority interest . . . . .	(8,965)
Purchase price . . . . .	<u>\$ 63,240</u>

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 4 years.

TAIF Telcom provides mobile services in the GSM-900/1800 standard in the Republic of Tatarstan and in the Volga region of Russia. At the date of acquisition, TAIF Telcom had approximately 240,000 subscribers.

*Sibachallenge acquisition*

On August 22, 2003, MTS completed the purchase of 100.0% of Sibachallenge, a cellular operator in the Krasnoyarsk region, for cash consideration of \$45.5 million, paid a finder's fee of \$2.0 million

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and assumed net debt of approximately \$6.6 million. Sibachallenge holds licenses to provide GSM-900/1800 and DAMPS mobile services in the Krasnoyarsk region of Siberia, the Republic of Khakasiya, and in the Taimyr Autonomous region, all of which are located in the Siberian part of Russia. At the date of acquisition, Sibachallenge had approximately 132,000 subscribers.

The purchase price allocation was as follows:

Current assets . . . . .	\$ 4,078
Non-current assets . . . . .	16,678
License costs . . . . .	52,625
Current liabilities . . . . .	(6,405)
Non-current liabilities . . . . .	(6,628)
Deferred taxes . . . . .	(12,894)
Purchase price . . . . .	<u>\$ 47,454</u>

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 8 years.

*Tomsk Cellular Communications acquisition*

In September 2003, MTS purchased 100.0% of Siberian operator Tomsk Cellular Communications (“TSS”) for cash consideration of \$47.0 million. TSS holds licenses to provide GSM-900/1800 mobile cellular communications in the Tomsk region. At the date of acquisition, TSS had approximately 183,000 subscribers.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

Current assets . . . . .	\$ 3,299
Non-current assets . . . . .	11,412
License costs . . . . .	49,282
Current liabilities . . . . .	(4,543)
Non-current liabilities . . . . .	(105)
Deferred taxes . . . . .	(12,345)
Purchase price . . . . .	<u>\$ 47,000</u>

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 8 years.

*Acquisitions of various regional 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 MCT Corporation for a total of \$71.0 million. The Group agreed to purchase a 43.7% stake in Uraltel (described above) and 100.0% of Vostok Mobile BV, which holds a 50.0% stake in Primtelefon.

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The Group also agreed to purchase Vostok Mobile South, which holds 50.0% stakes in Astrakhan Mobile and Volgograd Mobile, as well as an 80.0% stake in Mar Mobile GSM. The Group also entered into agreements to acquire the remaining 20.0% of Mar Mobile GSM and another 2.95% stake in Uraltel from existing shareholders unrelated to MCT Corporation for approximately \$1.0 million.

On August 26, 2003, the Group completed the acquisition of Vostok Mobile BV and recorded a 50.0% stake investment in Primtelefon using equity method of accounting.

On October 14, 2003, the Group completed the purchase of Vostok Mobile South and thus acquired a 50.0% stake in Volgograd Mobile and Astrakhan Mobile and an 80.0% stake in Mar Mobile GSM. Also, in a separate transaction the Group completed the acquisition of the remaining 20.0% stake in Mar Mobile GSM from existing shareholders unrelated to MCT corporation, thus consolidating a 100.0% ownership in the company.

*Pro-forma results of operations (unaudited)*

The following unaudited pro forma financial data for the years ended December 31, 2003 and 2002, give effect to the acquisitions of UMC, TAIF Telcom, Sibchallenge, TSS, Kuban-GSM and other various regional companies as if they had occurred at the beginning of the respective years.

	December 31,	
	2003	2002
Pro-forma:		
Net revenues . . . . .	\$2,640,856	\$1,714,532
Net operating income . . . . .	925,149	544,917
Net income . . . . .	583,222	342,595
Earnings per share, basic and diluted . . . . .	\$ 0.294	\$ 0.173

The pro-forma information is based on various assumptions and estimates. The pro-forma information is not necessarily indicative of the operating results that would have occurred if the Group acquisitions had been consummated as of January 1, 2003 and 2002, nor is it necessarily indicative of future operating results. The pro-forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions. The actual results of operations of these companies are included in the consolidated financial statements of the Group only from the respective dates of acquisition.

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**5. CASH AND CASH EQUIVALENTS**

Cash and cash equivalents as of December 31, 2003 and 2002 comprised of the following:

	December 31,	
	2003	2002
Ruble current accounts . . . . .	\$40,597	\$19,860
Ruble deposits . . . . .	20,201	—
U.S. dollar deposits . . . . .	886	7,999
U.S. dollar current accounts . . . . .	20,130	6,404
Other . . . . .	8,562	398
Total cash and cash equivalents . . . . .	<u>\$90,376</u>	<u>\$34,661</u>

**6. SHORT-TERM INVESTMENTS**

Short-term investments, denominated in U.S. dollars, as of December 31, 2003 comprised of the following:

	Annual interest rate	Maturity date	December 31, 2003
OJSC Moscow Bank of Reconstruction and Development . .	4.8%	February 2, 2004	\$200,000
OJSC Moscow Bank of Reconstruction and Development . .	8.0%	October 4, 2004	10,000
OJSC Moscow Bank of Reconstruction and Development . .	8.4%	October 21, 2004	19,100
OJSC Moscow Bank of Reconstruction and Development . .	8.4%	November 23, 2004	5,000
OJSC Moscow Bank of Reconstruction and Development . .	8.4%	December 5, 2004	5,900
OJSC Moscow Bank of Reconstruction and Development . .	8.4%	December 20, 2004	5,000
Total short-term investments . . . . .			<u>\$245,000</u>

Short-term investments, denominated in U.S. dollars, as of December 31, 2002 comprised of the following:

	Annual interest rate	Maturity date	December 31, 2002
OJSC Moscow Bank of Reconstruction and Development . .	9.0%	October 22, 2003	\$19,100
OJSC Moscow Bank of Reconstruction and Development . .	9.0%	November 21, 2003	5,000
OJSC Moscow Bank of Reconstruction and Development . .	9.0%	December 5, 2003	5,900
Total short-term investments . . . . .			<u>\$30,000</u>

OJSC Moscow Bank of Reconstruction and Development is a related party (see also Note 18 Related Party).



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**7. TRADE RECEIVABLES**

Trade receivables as of December 31, 2003 and 2002 were as follows:

	<b>December 31,</b>	
	<b>2003</b>	<b>2002</b>
Accounts receivable, subscribers . . . . .	\$ 87,149	\$29,505
Accounts receivable, roaming . . . . .	26,500	17,266
Allowance for doubtful accounts . . . . .	(13,698)	(6,270)
Trade receivables, net . . . . .	<u>\$ 99,951</u>	<u>\$40,501</u>

The following table summarizes the changes in the allowance for doubtful accounts for the years ended December 31, 2003, 2002 and 2001:

	<b>December 31,</b>		
	<b>2003</b>	<b>2002</b>	<b>2001</b>
Balance, beginning of year . . . . .	\$ 6,270	\$ 5,178	\$1,959
Provision for doubtful accounts . . . . .	32,633	7,047	3,219
Accounts receivable written off . . . . .	(25,205)	(5,955)	—
Balance, end of year . . . . .	<u>\$ 13,698</u>	<u>\$ 6,270</u>	<u>\$5,178</u>

**8. INVENTORY**

Inventory as of December 31, 2003 and 2002 comprised of the following:

	<b>December 31,</b>	
	<b>2003</b>	<b>2002</b>
Spare parts for base stations . . . . .	\$26,635	\$15,519
Handsets and accessories . . . . .	23,499	18,056
Other inventory . . . . .	17,157	7,811
Inventory . . . . .	<u>\$67,291</u>	<u>\$41,386</u>

Obsolescence expense for the years ended December 31, 2003, 2002 and 2001 amounted to \$3,307, \$5,614 and \$2,543, respectively, and was included in operating expenses in the accompanying consolidated statements of operations.

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**9. PROPERTY, PLANT AND EQUIPMENT**

The net book value of property, plant and equipment as of December 31, 2003 and 2002 was as follows:

	December 31,	
	2003	2002
Network and base station equipment (including leased network and base station equipment of \$66,311 and \$55,383 respectively) . . . . .	\$1,775,180	\$ 959,465
Leasehold improvements . . . . .	6,582	4,299
Office equipment, computers, software and other (including leased office equipment, computers and software of \$1,923 and \$1,739, respectively) . . . .	147,395	68,271
Buildings . . . . .	144,680	96,420
Vehicles . . . . .	11,611	7,607
Property, plant and equipment, at cost . . . . .	2,085,448	1,136,062
Accumulated depreciation (including accumulated depreciation on leased equipment of \$23,343 and \$13,420, respectively) . . . . .	(532,268)	(299,216)
Equipment for installation . . . . .	334,264	313,222
Construction in-progress . . . . .	368,632	194,565
Property, plant and equipment, net . . . . .	<u>\$2,256,076</u>	<u>\$1,344,633</u>

Depreciation expenses during the years ended December 31, 2003, 2002 and 2001 amounted to \$233.1 million, \$116.0 million and \$73.7 million, respectively, including depreciation expenses for leased property, plant and equipment in the amount of \$7.6 million, \$3.4 million and \$1.6 million, respectively.

**10. OTHER INTANGIBLE ASSETS**

Intangible assets at December 31, 2003 and 2002 comprised of the following:

		December 31, 2003			December 31, 2002		
	Useful lives	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
<b>Amortized intangible assets:</b>							
Acquired customer base . . . . .	30 to 70 months	\$ 81,289	\$ (18,307)	\$ 62,982	\$ 7,410	\$ (955)	\$ 6,455
Rights to use premises . . . . .	10 years	19,638	(10,476)	9,162	11,752	(8,352)	3,400
Numbering capacity with finite contractual life, software and other . . . . .	3 to 10 years	338,222	(119,269)	218,953	184,237	(69,582)	114,655
		<u>439,149</u>	<u>(148,052)</u>	<u>291,097</u>	<u>203,399</u>	<u>(78,889)</u>	<u>124,510</u>
<b>Unamortized intangible assets:</b>							
Numbering capacity with indefinite contractual life . . . . .		13,047	—	13,047	13,047	—	13,047
Goodwill . . . . .		8,533	—	8,533	533	—	533
Total other intangible assets . . . . .		<u>\$460,729</u>	<u>\$ (148,052)</u>	<u>\$312,677</u>	<u>\$216,979</u>	<u>\$ (78,889)</u>	<u>\$138,090</u>

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**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

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As a result of a limited availability of local telephone numbering capacity in Moscow and the Moscow region, MTS has been required to enter into agreements for the use of telephone numbering capacity with several telecommunication operators in Moscow. Costs of acquiring numbering capacity with finite contractual life are amortized over period of five to ten years in accordance with the terms of the contract entered into to acquire such capacity. Numbering capacity with indefinite contractual life is not amortized.

The principal component of MTS' right to use premises was obtained in the form of contributions to its charter capital in 1993. These premises included MTS' administrative offices and facilities utilized for mobile switching centers.

Amortization expense for the years ended December 31, 2003, 2002 and 2001 amounted to \$69.2 million, \$30.0 million and \$17.5 million, respectively. Based on the amortizable intangible assets existing at December 31, 2003, the estimated amortization expense is \$122.7 million during 2004, \$90.0 million during 2005, \$51.3 million during 2006, \$15.9 million during 2007, \$3.1 million during 2008 and \$8.1 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

**11. DEFERRED CONNECTION FEES**

Deferred connection fees for the years ended December 31, 2003 and 2002 were as follows:

	December 31,	
	2003	2002
Balance at beginning of the year . . . . .	\$ 41,904	\$ 47,412
Payments received and deferred during the year . . . . .	34,112	19,346
Amounts amortized and recognized as revenue during the year . . . . .	(29,372)	(24,854)
Balance at end of the year . . . . .	46,644	41,904
Less current portion . . . . .	21,467	22,210
Non-current portion . . . . .	<u>\$ 25,177</u>	<u>\$ 19,694</u>

MTS defers initial connection fees from the moment of initial signing of the contract with subscribers and recognizes the revenue over the estimated average subscriber life (see Note 2 Summary of Significant Accounting Policies and New Accounting Pronouncements).

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**12. DEBT**

At December 31, 2003 and 2002, debt comprised of the following:

	Currency	Annual interest rate (Actual rate at December 31, 2003)	December 31, 2003	December 31, 2002	Available credit facilities as of December 31, 2003
9.75% Notes due 2008 . . . . .	USD	9.75%	\$ 400,000	\$ —	\$ —
8.38% Notes due 2010 . . . . .	USD	8.375%	400,000	—	—
10.95% Notes due 2004 . . . . .	USD	10.95%	299,640	298,943	—
Floating Rate Notes due 2004 . . . . .	USD	LIBOR+4% (5.15%)	298,196	—	—
<b>Total notes . . . . .</b>			<b>\$1,397,836</b>	<b>\$298,943</b>	<b>\$ —</b>
<b>Less current portion . . . . .</b>			<b>597,836</b>	<b>—</b>	<b>n. a.</b>
<b>Total long-term notes . . . . .</b>			<b>\$ 800,000</b>	<b>\$298,943</b>	<b>n. a.</b>
ING Bank (Eurasia) . . . . .	USD	LIBOR+4.15% (5.30%)	\$ 60,000	\$ —	\$ —
Dresdner Bank . . . . .	USD	LIBOR+3.20%-3.35% (4.35%-4.50%)	15,400	39,280	600
Ericsson . . . . .	USD	LIBOR+4% (5.15%)	23,400	30,150	—
Deutsche Telekom AG . . . . .	USD	LIBOR+5%-7% (6.22%-8.22%)	7,981	—	—
TDC Mobile International A/S . . . . .	USD	LIBOR+5%-7% (6.22%-8.22%)	6,838	—	—
Citibank . . . . .	USD	LIBOR+3.5% (4.65%)	10,000	9,000	—
West LB . . . . .	EUR	EURIBOR+2% (4.17%)	5,092	4,000	—
KFW . . . . .	EUR	LIBOR+0.95%-4% (2.41%-5.46%)	4,313	—	—
HSBC . . . . .	USD	LIBOR+2.75% (3.88%)	25,000	—	—
Hermes Credit Facility . . . . .	EUR	EURIBOR+0.65% (2.82%)	55,550	—	3,700
AVAL Bank . . . . .	UAH	10-16%	10,890	—	9,110
Motorola . . . . .	USD	LIBOR+1.5% (2.72%)	1,361	6,181	—
Guta Bank . . . . .	USD	7%-15%	1,511	—	—
International Moscow Bank . . . . .	RUR	13.4%	10,864	—	1,019
International Moscow Bank . . . . .	USD	LIBOR+3.45% (4.60%)	—	5,000	—
MBRD . . . . .	RUR	18.5%	1,220	—	448
Ruble denominated debt . . . . .	RUR	13.4%-20%	5,860	30,334	7,500
Other debt . . . . .	USD	7%-15%	450	3,124	—
<b>Total debt . . . . .</b>			<b>\$ 245,730</b>	<b>\$127,069</b>	<b>\$22,377</b>
<b>Less current portion . . . . .</b>			<b>103,312</b>	<b>67,098</b>	<b>n. a.</b>
<b>Total long-term debt . . . . .</b>			<b>\$ 142,418</b>	<b>\$ 59,971</b>	<b>n. a.</b>

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
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*The Notes*

On December 21, 2001, MTS Finance S.A. ("MTS Finance"), a 100% beneficially owned subsidiary of MTS, registered under the laws of Luxembourg, issued \$250.0 million 10.95% (effective interest rate of 11.25%) notes at the price of 99.254%. Proceeds received from the notes, net of underwriting discount, were \$248.1 million. Related debt issuance costs in the amount of \$3.9 million were capitalized. On March 20, 2002, MTS Finance issued additional \$50.0 million 10.95% (effective interest rate of 10.25%) notes at a price of 101.616%. Proceeds received from these notes, including the offering premium, were \$50.8 million. Related debt issuance costs in the amount of \$0.6 million were capitalized. All the notes are fully and unconditionally guaranteed by MTS OJSC and mature on December 21, 2004. MTS Finance makes interest payments on the notes semi-annually in arrears on June 21 and December 21 of each year, commencing on June 21, 2002. The notes are listed on the Luxembourg Stock Exchange. In May 2002 these notes were registered with the SEC under the Securities Act of 1933.

On January 30, 2003, MTS Finance issued \$400.0 million 9.75% notes at par. These notes are fully and unconditionally guaranteed by MTS OJSC and mature on January 30, 2008. MTS Finance is required to make interest payments on the notes semi-annually in arrears on January 30 and July 30, commencing on July 30, 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes were \$400.0 million and related debt issuance costs of \$3.9 million were capitalized.

On August 5, 2003, MTS Finance issued \$300.0 million notes bearing interest at floating rate 3 months LIBOR + 4% (5.15% at December 31, 2003) at the price of 99% (effective interest rate of 6.19% at December 31, 2003). These notes are fully and unconditionally guaranteed by MTS OJSC and mature on August 7, 2004. MTS Finance is required to make interest payments on the notes quarterly, commencing on November 5, 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes, net of underwriting discount, were \$297.0 million and related debt issuance costs of \$1.8 million were capitalized.

On October 14, 2003, MTS Finance issued \$400.0 million notes bearing interest at 8.375% at par. The cash proceeds, net of issuance costs of approximately \$4.6 million, amounted to \$395.4 million. These notes are fully and unconditionally guaranteed by MTS OJSC and will mature on October 14, 2010. MTS Finance is required to make interest payments on the notes semi-annually in arrears on April 14 and October 14 of each year, commencing on April 14, 2004. The notes are listed on the Luxembourg Stock Exchange.

These notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, limitations on the Group's ability to enter into sales leaseback transactions, restriction on any merger, consolidation or disposition of assets, restrictions on the sales of any licenses. In addition, these notes provide the holders a right to require MTS Finance to redeem all of the notes outstanding at 101% of the principal amount of the notes plus accrued interest upon any change in control, as defined.

*Ericsson debt restructuring*

In December 1996, Rosico entered into a credit agreement with Ericsson Project Finance AB ("Ericsson") that provided for a credit facility with an aggregate principal amount of \$60,000 and had a

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maximum term of five years (the “Ericsson Loan”). The loan was repayable in ten equal consecutive quarterly payments of \$6.0 million commencing in 1999. On July 24, 2001 MTS, Rosico and Ericsson signed an amendment to the credit agreement rescheduling Rosico principal payments in nineteen consecutive quarterly installments. The amounts advanced under the agreement bear interest of LIBOR + 4% (5.15% at December 31, 2003). If Rosico fails to pay any amount under this facility, the overdue interest would bear interest at a rate of additional 6% per annum. The credit agreement contains covenants restricting Rosico’s ability to encumber its present and future assets and revenues without lender’s express consent.

Concurrent with the Group’s acquisition of Rosico, Sistema agreed to fund the full and timely repayment of the Ericsson Loan and to indemnify Rosico and MTS for any costs incurred by either Rosico or MTS in connection with the repayment of the Ericsson Loan. During 2000, Sistema and MTS agreed on a method that would allow Sistema to fund its obligation in a manner that minimizes the total costs of meeting this obligation (including related tax costs). Under this method, MTS enters into a long-term, ruble-denominated promissory notes with nil% interest and maturities from 2049 to 2052 to repay a portion of the funding from Sistema. The carrying value of these notes is insignificant at December 31, 2003 and 2002. The Group records interest expense on these notes over the term such that the full amount of the obligation will be reflected as a liability at the date of repayment. Through December 31, 2003, Sistema has made payments under this obligation in the amount of \$55.6 million, 36.5 million of which are repayable in the form of long-term, ruble denominated promissory notes with nil% interest. Amounts receivable from Sistema under this indemnification are recorded as shareholder receivable in the accompanying consolidated balance sheets.

At December 31, 2003 and 2002, \$23.4 million and \$30.2 million were outstanding, respectively, under the Ericsson Loan.

On February 25, 2003 Ericsson assigned all of its rights and obligations under the Ericsson Loan to Salomon Brothers Holding Company, Inc.

*Dresdner Bank credit facilities*

In November 2001, Telecom XXI entered into a credit facility with Dresdner Bank CJSC (“Dresdner Bank”) to borrow up to \$20.0 million. Amounts borrowed by Telecom XXI under this credit facility are repayable within one to six months from the disbursement date and the credit facility has a final repayment date of November 2003. The borrowings bear interest of LIBOR + 3.2% (4.35% at December 31, 2003) per annum. Default interest is 12% per annum. The loan was fully repaid in November 2003.

In December 2001 and April 2002, UDN-900 entered into credit agreements with Dresdner Bank, expiring on April 2004. As of December 31, 2003 and 2002, the amounts outstanding under these agreements were \$5.4 and \$4.3 million, respectively. These borrowings bear interest at LIBOR + 3.2% (4.35% December 31, 2003) per annum and are guaranteed by MTS OJSC.

In July 2002, MTS OJSC entered into a credit facility with Dresdner Bank. The credit facility allows borrowings up to \$12.0 million with the final repayment date no later than June 1, 2004. The amount advanced under the facility bears interest of LIBOR + 1.95% (3.10% at December 31, 2003) per annum. Default interest is 12% per annum. As of December 31, 2003 and 2002, nil and \$5.0 million was outstanding under this credit facility, respectively.



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In October 2002, MSS entered into a credit agreement with Dresdner Bank to borrow up to \$10.0 million. As of December 31, 2003 and 2002 \$10.0 million was outstanding under this agreement. Borrowings under this agreement bear interest of LIBOR + 3.35% (4.50% at December 31, 2003) per annum and mature in October 2004. The loan is guaranteed by MTS OJSC.

*ING bank (Eurasia)*

In September 2003, UMC entered into a \$60.0 million syndicated credit facility with ING Bank (Eurasia) ZAO, ZAO Standard Bank and Commerzbank Aktiengesellschaft with an interest rate of LIBOR + 4.15% (5.30% at December 31, 2003). The loan is guaranteed by MTS OJSC. The proceeds were used by UMC to refinance its existing indebtedness. The loan is payable in 8 equal quarterly installments starting from September 2004. As of December 31, 2003 the principal outstanding under this credit facility is \$60.0 million.

*Deutsche Telekom AG and TDC Mobile International A/C*

The credit facilities with Deutsche Telekom AG and TDC bear interest at LIBOR + 5% (6.22% at December 31, 2003) and LIBOR + 7% (8.22% at December 31, 2003) and are redeemable in five equal quarterly installments commencing April 2003. During the year UMC paid \$2.1 million of interest on Deutsche Telekom loan. At December 31, 2003 the unpaid balance on these loans was \$14.8 million. The amounts outstanding under these facilities were guaranteed by MTS OJSC. The debt was fully repaid in April 2004.

*KFW*

On December 21, 1998, UMC entered into two loan agreements with KFW, a German bank, for EUR 1.9 million (approximately \$2.4 million as of December 31, 2003) and EUR 10.9 million (approximately \$13.6 million as of December 31, 2003). These loans bear interest at LIBOR + 4% (5.46% at December 31, 2003) and LIBOR + 0.95% (2.41% at December 31, 2003) per annum, respectively, and mature on March 31, 2004 and February 28, 2005, respectively. At December 31, 2003 the unpaid balance on these loans was \$4.3 million.

*HSBC Bank LLC*

In October 2003, TAIF Telcom entered into a \$25.0 million credit facility with HSBC Bank LLC which is guaranteed by MTS OJSC. The facility bears interest at LIBOR + 2.75% (3.88% at December 31, 2003) and is redeemable in ten equal quarterly installments commencing on June 2004. The loan is subject to certain restrictive covenants including, but not limited to, restriction on the amount of dividends paid by TAIF Telcom until MTS owns 100% of TAIF Telcom's outstanding common stock. At December 31, 2003 the outstanding balance is \$25.0 million.

*Hermes Credit Facility (HECF)*

On December 30, 2003, UMC entered into Hermes Credit Facility with ING BHF Bank and Commerzbank Aktiengesellschaft to finance the acquisition of GSM equipment from Siemens Aktiengesellschaft. The aggregate amount available under this credit facility is EUR 47.4 million (\$59.3 million at December 31, 2003). The loan is guaranteed by MTS OJSC and bears interest at EURIBOR + 0.65% (2.82% at December 31, 2003). The amount outstanding will be redeemable in 10

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
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equal semi-annual installments, starting on July 31, 2004 or earlier, depending on the fulfillment on the credit agreement terms by the borrower. The balance outstanding at December 31, 2003 is EUR 44.5 million (\$55.6 million).

*AVAL Bank*

On December 31, 2003, UMC had the balance of \$10.9 million of overdraft with AVAL Bank. The short-term overdraft facility is limited to 110.0 million hryvnias (\$20.0 million at December 31, 2003), bears interest at 10–16% per annum and matures on June 30, 2004.

*Citibank credit facility*

In November 2002, Telecom XXI entered into a credit facility with Citibank. Amounts borrowed under the credit facility and outstanding at December 31, 2003 must be repaid in June 2004 and bear interest of LIBOR + 3.5% (4.65% at December 31, 2003) per annum. Overdue amounts bear an additional 3% per annum. At December 31, 2003, \$10.0 million is outstanding under this facility. The amount is guaranteed by MTS OJSC.

*Guta Bank*

In January 2003, TAIF Telcom entered into a credit facility agreement with Guta Bank to finance the purchase of telecommunications equipment. The maximum amount allowed to be borrowed under the facility is approximately \$2.2 million. The loan bears interest at 7% to 15% per annum and matures in February 2007. The amount outstanding under this facility was \$1.5 million as of December 31, 2003. The loan is collateralized by equipment with a net book value of \$2.9 million as of December 31, 2003.

*International Moscow Bank*

In February 2002, SCS-900 entered into a credit facility agreement with the International Moscow Bank to borrow up to \$5.0 million for the purpose of current operations and financing of investment outlay, including payments for contract with Ericsson Radio Systems AB. The amount bears interest at LIBOR + 3.45% (4.60% at December 31, 2003). The default interest rate is 7.5% per annum. The debt was redeemed in May 2003.

On June 9, 2003, Kuban-GSM entered into a 350.0 million ruble (approximately \$11.9 million at December 31, 2003) credit facility with International Moscow Bank. Amounts borrowed under this facility mature in June 2005 and have an interest rate of 13.4% until June 2004.

As of December 31, 2003, approximately \$10.9 million was outstanding under this facility. The loan is collateralized by equipment with book value of approximately \$15.5 million at December 31, 2003.

*Moscow Bank of Reconstruction and Development (MBRD)*

In 2003, Dontelecom entered into a ruble denominated loan agreement with MBRD, a related party. The amounts borrowed under this loan bear interest at rate of 18.5% and payable in June 2004. During the year 2003, Dontelecom paid interest of \$0.1 million. As of December 31, 2003, the total amount payable under this loan agreement amounted to \$1.2 million.

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During the year 2003, MTS OJSC signed several short-term loan agreements with MBRD. Amounts borrowed were payable during the period of one to two months. During the year interest expense on these loans was approximately \$0.3 million.

*Rosbank loan*

In February and March 2003, Kuban-GSM entered into ruble-denominated credit facilities with Rosbank permitting borrowings of up to approximately 245.0 million rubles (approximately \$8.3 million at December 31, 2003). Borrowings under this agreement bear interest at rates varying from 18% to 20% per annum and are secured by a pledge of equipment. The facilities mature in February 2005 and March 2005. As of December 31, 2003 the amount outstanding under this agreement was \$0.8 million.

*WestLB International loan*

In July 2002, MTS-P, a wholly owned subsidiary of the Company, entered into a credit facility agreement with WestLB International S.A. As of December 31, 2003 and 2002, the amount of borrowings under this agreement was \$5.0 and \$4.0 million, respectively. Amounts outstanding under this agreement bear interest of EURIBOR + 2% (4.17% at December 31, 2003) per annum for the first two years for each advance and 4% per annum for the remaining interest periods for each advance until maturity. Final maturity of this agreement is December 28, 2006. The loan is guaranteed by MTS OJSC.

*Motorola loan*

In October 1997, MSS issued promissory notes to Motorola Inc. for delivery and installation of GSM 900 cellular equipment in the Omsk region in the amount of \$5.4 million. There promissory notes were due to be repaid on various dates through September 2001. On November 27, 2001, MSS entered into an agreement to restructure this liability. This restructuring established a new repayment schedule under which the notes and the accrued interest as of November 27, 2001 are being repaid in regular installments from February 2002 to May 2004, imputing an interest rate of approximately 2.7%. MSS' total payments under this agreement have not changed by greater than 10% due to this restructuring. As of December 31, 2003, the amount payable under these promissory notes was \$1.4 million.

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 loan was fully repaid in January 2003.

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The following table presents aggregate scheduled maturities of debt principal outstanding as of December 31, 2003:

Payments due in the year ended December 31,	
2004 .....	\$ 701,148
2005 .....	69,974
2006 .....	48,014
2007 .....	16,128
2008 .....	408,302
Thereafter .....	400,000
	<u>\$1,643,566</u>

**13. CAPITAL LEASE OBLIGATIONS**

The following table presents future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2003:

Payments due in the year ended December 31,	
2004 .....	\$12,741
2005 .....	7,217
2006 .....	1,779
2007 .....	32
2008 .....	33
Thereafter .....	277
Total minimum lease payments (undiscounted) .....	22,079
Less amount representing interest .....	(5,311)
Present value of net minimum lease payments .....	16,768
Less current portion of lease payable .....	(9,122)
Non-current portion of lease payable .....	<u>\$ 7,646</u>

For a schedule by years of future minimum lease payments under capital leases to Invest-Svyaz-Holding, a shareholder of the Group and a wholly owned subsidiary of Sistema, together with the present value of the net minimum lease payments as of December 31, 2003, see Note 18 Related Parties.

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**14. ACCRUED LIABILITIES**

Accrued liabilities at December 31, 2003 and 2002 were comprised of the following:

	December 31,	
	2003	2002
VAT . . . . .	\$ 33,545	\$29,393
Interest payable . . . . .	32,911	1,500
Taxes other than income . . . . .	31,139	31,810
Other accruals . . . . .	46,194	11,216
Total accrued liabilities . . . . .	<u>\$143,789</u>	<u>\$73,919</u>

**15. INCOME TAX**

MTS' provision for income taxes was as follows for the respective periods ended:

	December 31,		
	2003	2002	2001
Current provision for income taxes . . . . .	\$285,481	\$129,406	\$138,092
Deferred income tax benefit . . . . .	(43,001)	(18,989)	(39,964)
Total provision for income taxes . . . . .	<u>\$242,480</u>	<u>\$110,417</u>	<u>\$ 98,128</u>

From January 1, 2001, MTS' statutory income tax rate was 35%. In August 2001, a new law regarding taxation of income became effective. Under that law, effective from January 1, 2002, the statutory income tax rate was reduced to 24%. This reduction in the statutory income tax rate resulted in the recognition of a net deferred tax benefit of approximately \$22 million in 2001.

From January 1, 2004, UMC statutory income tax rate changes from 30% to 25% as a result of changes in Ukrainian legislation.

The statutory income tax rate reconciled to MTS' effective income tax rate is as follows for the respective periods ended:

	December 31,		
	2003	2002	2001
Statutory income tax rate for year . . . . .	24.0%	24.0%	35.0%
Adjustments:			
Expenses not deductible for tax purposes . . . . .	2.3	2.1	13.6
Tax allowance generated from investment in infrastructure . . . . .	—	—	(8.3)
Effect of decrease in income tax rate . . . . .	—	—	(6.6)
Effect of higher tax rate of subsidiary . . . . .	0.9	—	—
Currency exchange and translation . . . . .	1.6	—	—
Other . . . . .	0.4	(0.3)	(3.9)
Effective income tax rate . . . . .	<u>29.2%</u>	<u>25.8%</u>	<u>29.8%</u>

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
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Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities at December 31, 2003 and 2002:

	December 31,	
	2003	2002
<b>Assets (liabilities) arising from tax effect of:</b>		
<b>Deferred tax assets</b>		
Depreciation of property, plant and equipment . . . . .	\$ 19,171	\$ 13,606
Deferred connection fees . . . . .	8,805	10,057
Allowance for doubtful accounts . . . . .	14,157	1,505
Loss carryforward (Rosico and MSS) . . . . .	7,113	10,033
Other . . . . .	25,158	8,050
	<u>74,404</u>	<u>43,251</u>
Valuation allowance . . . . .	(7,113)	(12,695)
Total deferred tax assets . . . . .	<u>67,291</u>	<u>30,556</u>
<b>Deferred tax liabilities</b>		
Licenses acquired . . . . .	\$(170,162)	\$(91,606)
Other . . . . .	(33,334)	(14,212)
Total deferred tax liabilities . . . . .	<u>(203,496)</u>	<u>(105,818)</u>
Net deferred tax liability . . . . .	<u>\$(136,205)</u>	<u>\$(75,262)</u>
Net deferred tax assets, current . . . . .	\$ 44,423	\$ 12,223
Net deferred tax liability, long term . . . . .	\$(180,628)	\$(87,485)

Net change in valuation allowance for the years ended December 31, 2003 and 2002 were \$5.6 million and \$13.2 million, respectively.

As of December 31, 2003 and 2002, Rosico and MSS were entitled to loss carryforwards in the amounts of \$29,638 and \$41,803, respectively. These loss carryforwards resulted in deferred tax assets at December 31, 2003 and 2002 in the amounts of \$7,113 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. While Rosico was merged into MTS OJSC in June 2003, the Group has still recorded a valuation allowance for the entire amount of the available tax loss carryforward related to Rosico as MTS has not yet performed all procedures necessary to determine what amounts will be available for deductions in the future. In addition in 2002 the Group recorded a valuation allowance for the lower of cost or market provision in the amount of \$2,662 since it was more likely than not that the tax asset will not be realized.

The Group does not record a deferred tax liability related to undistributed earnings of UMC, as it intends to permanently reinvest these earnings. The undistributed earnings of UMC as of December 31, 2003 were \$327.8 million.

**16. SHAREHOLDERS' EQUITY**

In accordance with Russian laws, earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations, denominated in rubles, after certain



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deductions. Net income of MTS OJSC for the year ended December 31, 2003 and 2002 which is distributable under Russian legislation totaled 13,423.0 million rubles (\$437.4 millions), 10,759.0 million rubles (\$343.3 million) and 8,587.0 million rubles (\$294.4 million), respectively.

**17. STOCK BONUS AND STOCK OPTION PLANS**

On April 27, 2000, MTS established a stock bonus plan and stock option plan for selected officers, key employees and key advisors. Under this plan, directors, key employees and key advisors received the right to participate in a stock option plan under which they may receive options to purchase up to 9,966,631 of MTS common shares.

During 2003, 2002 and 2001, MTS made several grants pursuant to its stock option plan to employees and directors of the Group. These options are generally vested over a two year period from the date of the grant, contingent on continuous employment with the Company. A summary of the status of the Group's stock option plan is presented below:

	Shares	Weighted average exercise price, U.S. dollar
Outstanding at January 1, 2001 . . . . .	—	—
Granted during 2001 . . . . .	1,829,221	1.31
Outstanding at December 31, 2001 . . . . .	1,829,221	1.31
Granted . . . . .	2,846,681	1.49
Forfeited . . . . .	(27,481)	1.31
Outstanding at December 31, 2002 . . . . .	4,648,421	1.42
Granted . . . . .	1,952,632	2.43
Exercised . . . . .	(37,557)	1.31
Exchanged for cash award . . . . .	(1,746,310)	1.31
Forfeited . . . . .	(19,776)	1.31
Outstanding at December 31, 2003 . . . . .	4,797,410	1.87

None of the options outstanding at December 31, 2003 and 2002 were exercisable. Options outstanding at December 31, 2003, have exercise price ranging from \$1.49 to \$2.43 per share and their weighted average remaining contractual life was approximately one year at December 31, 2003.

During 2003 19,776 stock options were forfeited, and 1,746,310 options were exchanged for cash consideration of \$2.9 million that was included in operating expenses in the consolidated statements of operations. Since the date of the grant total options amounted to 1,913, nil and 45,344 related to 2003, 2002 and 2001 grants, respectively have been forfeited.

Fair values of options granted in 2003, 2002 and 2001 were 1.02 U.S. dollars, \$0.50 and \$0.36 per share, respectively, and were estimated using the Black-Scholes option pricing model. The risk free rates applied for 2003, 2002 and 2001 were 5.2%, 6.1% and, 15.5%, respectively. The following assumptions were applied to options granted in 2003, 2002 and 2001, respectively: (i) expected dividend yields of approximately 3.0%; (ii) expected volatility rates of 40.0%, 50.0% and 45.0%, and (iii) expected lives of 2 years.

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In accordance with the Russian legislation, MTS Board members and key employees may be considered insiders with respect to the Group and thus may be restricted from selling their shares.

**18. RELATED PARTIES**

Related party balances as of December 31, 2003 and 2002 comprised of the following:

	December 31,	
	2003	2002
<b>Accounts receivable:</b>		
T-Mobile for roaming . . . . .	\$ 853	\$1,374
Strom Telecom for software . . . . .	1,074	—
Receivables from investee companies . . . . .	1,429	2,195
Total accounts receivable, related parties . . . . .	<u>\$ 3,356</u>	<u>\$3,569</u>
<b>Accounts payable:</b>		
Cetel B.V. for UMC shares . . . . .	\$27,500	\$ —
MGTS for interconnection . . . . .	704	630
Telmos for interconnection . . . . .	—	184
MTU-Inform for interconnection . . . . .	2,398	4,154
Sundry payables . . . . .	1,302	—
Total accounts payable, related parties . . . . .	<u>\$31,904</u>	<u>\$4,968</u>

Transactions with major related parties are described below.

*OJSC Moscow Bank of Reconstruction and Development (“MBRD”)*

Starting August 2000, MTS has been keeping certain bank and deposit accounts with MBRD, whose major shareholder is Sistema. As of December 31, 2003, MTS’ cash position at MBRD amounted to \$279.7 million including \$265.2 million in time deposits and \$14.5 million in current accounts. As of December 31, 2002, MTS’ cash position at MBRD amounted to \$38.7 million including \$34.0 million in time deposits and \$4.7 million in current accounts. The related interest accrued and collected on the deposits for the years ended December 31, 2003, 2002 and 2001 amounted to \$9.9 million, \$5.1 million and \$3.0 million, respectively, and was included as a component of interest income in the accompanying consolidated statements of operations.

Loans transactions with MBRD are described in Note 12 Debt.

*Rosno OJSC*

MTS arranged medical insurance for its employees and insured its property in the amounts of approximately \$874.0 million, \$781.0 million and \$612.0 million in 2003, 2002 and 2001, respectively, with Rosno OJSC, whose significant shareholder is Sistema. Insurance premiums paid to Rosno OJSC for the years ended December 31, 2003, 2002 and 2001, amounted to \$16.9 million, \$4.9 million and \$8.0 million, respectively, including premiums paid for medical insurance amounting to \$5.0 million, \$3.6 million and \$2.5 million, respectively. Management believes that all of the insurance contracts with Rosno OJSC have been entered at market terms.

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*Maxima Advertising Agency (Maxima)*

In 2001, 2002 and 2003, MTS had agreements for advertising services with Maxima. Advertising fees paid to Maxima for the years ended December 31, 2003, 2002 and 2001, were \$24.7 million, \$13.1 million and \$8.7 million, respectively. Maxima is related to MTS through MTS' directors who are also members of Maxima's board of directors.

*Telmos*

In 2003, 2002 and 2001, MTS had interconnection arrangements with, and received domestic and international long-distance services from Telmos, a subsidiary of Sistema. Interconnection and line rental fees paid to Telmos for the years ended December 31, 2003, 2002 and 2001, were approximately \$1.6 million, \$1.3 million and \$4.0 million, respectively. Management believes that these arrangements are at market terms.

*Moscow City Telephone Network (MGTS)*

In 2003, 2002 and 2001, MTS had line rental agreements with MGTS and rented cable plant from MGTS for installation of 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, 2003, 2002 and 2001, were approximately \$5.0 million, \$4.4 million and \$1.5 million, respectively. In 2002 and 2001, MTS also purchased buildings from MGTS and paid \$2.0 million and \$2.6 million, respectively. Management believes that all these transactions were made at market terms. Sistema is the majority shareholder of MGTS.

*MTU-Inform*

In 2003, 2002 and 2001, MTS had interconnection and line rental agreements with MTU-Inform, a subsidiary at Sistema. Amounts paid under these agreements for the years ended December 31, 2003, 2002, and 2001, amounted to approximately \$26.6 million, \$24.1 million and \$29.0 million, respectively. In 2003, 2002 and 2001 MTS also purchased telephone numbering capacity from MTU-Inform. Payments under these agreements for the years ended December 31, 2003, 2002 and 2001, amounted to \$0.5 million, \$1.6 million and \$4.7 million, respectively. Management believes that these agreements are at market terms.

*Comstar*

In 2003 and 2002, MTS had interconnection and line rental agreements with Comstar, a subsidiary of Sistema. Amounts paid under these agreements for the years ended December 31, 2003, and 2002, amounted to approximately \$4.0 million, and \$3.2 million, respectively. Management believes that these agreements are at market terms.

*T-Mobile*

In 2003, 2002 and 2001, the Group had non-exclusive roaming agreements with T-Mobile, a shareholder of the Group. Payments made by MTS under these roaming agreements were approximately \$1.1 million, \$1.0 million and \$0.7 million for the years ended December 31, 2003, 2002 and 2001, respectively.

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As discussed in Note 12, UMC had \$8.0 million payable to Deutsche Telecom AG, parent company of T-Mobile. As discussed in Note 4, at December 31, 2003 MTS had a payable related to the purchase of UMC for \$27.5 million to Cetel B.V., a wholly owned subsidiary of Deutsche Telecom AG.

*Invest-Svyaz-Holding*

In 2003, 2002 and 2001, MTS entered into agreements with Invest-Svyaz-Holding, a shareholder of MTS and a wholly owned subsidiary of Sistema, for leasing of network equipment and billing system. These leases were recorded as capital leases based on the requirements of SFAS No. 13, "Accounting for Leases." The present value of future lease payments is reflected as a liability in the balance sheet. Amounts due within one year are classified as current liabilities, and the remaining balance as long-term liabilities. The interest rate implicit in these leases varies from 11% to 44%, which management believes are market terms.

The following table summarizes the future minimum lease payments under capital leases to Invest-Svyaz-Holding together with the present value of the net minimum lease payments as of December 31, 2003:

Payments due in the year ended December 31,	
2004 .....	\$ 9,518
2005 .....	6,786
2006 .....	<u>1,732</u>
Total minimum lease payments (undiscounted) .....	18,036
Less amount representing interest .....	<u>(4,892)</u>
Present value of net minimum lease payments .....	13,144
Less current portion of lease obligations .....	<u>(6,223)</u>
Non-current portion of lease obligations .....	<u>\$ 6,921</u>

In addition to the above lease transactions, the Group guarantees debt of Invest-Svyaz-Holding in the amount of \$21.6 million to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to the Group. For the year ended December 31, 2003 leases to the Group amounted to approximately 99% of revenues of Invest-Svyaz-Holding.

For the year ended December 31, 2003, principal and interest paid to Invest-Svyaz-Holding were \$5.4 million and \$3.3 million, respectively. Principal and interest paid to Invest-Svyaz-Holding for the year ended December 31, 2002 were \$2.9 million and \$1.4 million. Principal and interest paid to Invest-Svyaz-Holding for the period from the date of acquisition of Telecom-900 on August 10, 2001 through December 31, 2001, were \$0.5 million and \$0.1 million, respectively. Management believes that these agreements are at market terms.

*Strom Telecom*

During 2003 the Group entered into three agreements, for a total amount up to \$32.3 million with Strom Telecom, an associate of Sistema. Pursuant to these contracts, the Group purchased a billing system, a communication software support system and equipment for approximately \$23.7 million.

See Note 4 Businesses Acquired for other related parties transactions.

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**19. OPERATING EXPENSES**

Operating expenses for 2003, 2002 and 2001, consisted of the following:

	December 31,		
	2003	2002	2001
Salaries and social contributions . . . . .	\$156,808	\$ 84,706	\$ 44,425
General and administrative . . . . .	42,530	26,549	21,569
Taxes other than income taxes . . . . .	40,432	39,119	25,312
Repair and maintenance . . . . .	39,406	20,361	10,578
Provision for doubtful accounts . . . . .	32,633	7,047	3,219
Rent . . . . .	31,968	15,578	9,479
Billing and data processing . . . . .	22,067	9,549	2,981
Consulting expenses . . . . .	11,361	7,692	2,093
Insurance . . . . .	7,351	6,774	5,258
Other operating expenses . . . . .	22,166	11,681	9,684
Total operating expenses . . . . .	<u>\$406,722</u>	<u>\$229,056</u>	<u>\$134,598</u>

**20. INVESTMENTS IN AND ADVANCES TO ASSOCIATES**

At December 31, 2003 and 2002, the Group's investments in and advances to associates included, respectively, the following:

	December 31,	
	2003	2002
MTS Belarus—loans receivable . . . . .	\$ 51,481	\$30,089
MTS Belarus—equity investment . . . . .	5,884	2,455
Primtelefon—equity investment . . . . .	31,174	—
Astrakhan Mobile and Volgograd Mobile—equity investment . . . . .	5,806	—
Astrakhan Mobile and Volgograd Mobile—loans receivable . . . . .	6,850	—
Volgograd Mobile—loans receivable . . . . .	204	—
MSS—note receivable . . . . .	827	—
Receivables from other investee companies . . . . .	1,359	1,490
Total investments in and advances to associates . . . . .	<u>\$103,585</u>	<u>\$34,034</u>

*MTS Belarus*

In September 2001, MTS won a tender initiated by the Telecommunications Ministry of the Republic of Belarus to form a joint venture, which will have a GSM-900/1800 license to operate in Belarus. In accordance with the tender, in November 2001 the Group made an initial \$10.0 million payment to the government of Belarus.

From December 2001, soon after the date the Group was awarded the tender, it became increasingly apparent based upon various communications and correspondence that the Group would not be able to commence operations in Belarus as expected. The Company halted additional payments

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under the original agreement and expensed its initial \$10.0 million investment, as it appeared probable that the investment would not be recoverable. This charge is reflected as an impairment of investment in the accompanying consolidated statements of operations for the year ended December 31, 2001.

As a result of additional negotiations, and a change in the Belarus government's position, effective June 26, 2002, the joint venture received all of the governmental approvals and licenses required to commence operations in Belarus. Subsequently, the Group continued investing in MTS Belarus.

As of December 31, 2003 and 2002, the Group provided MTS Belarus with a total of \$51.5 million and \$30.1 million in loans, respectively. These loans bear interest at 3% to 11% per annum. All loans outstanding as of December 31, 2002 have been repaid according to the original terms.

Based on projected future cash flows as well as other factors, management believes that no impairment of the Group's investments in Belarus is required as of December 31, 2003.

*Primtelefon, Astrakhan Mobile and Volgograd Mobile*

As described in Note 4 Businesses Acquired, in August 2003 the Group purchased equity interests in various Russian regional mobile operators, including stakes in Primtelefon, Astrakhan Mobile and Volgograd Mobile, as a part of its strategic business plans.

**21. OPERATING LICENSES**

In connection with providing telecommunication services, the Group has been issued various operating licenses by the Ministry of Information Technologies and Communications. In addition to the licenses received directly from the Ministry of Information Technologies and Communications, the Group was granted access to various telecommunication licenses through acquisitions. At December 31, 2003 and 2002, recorded values of the Group's telecommunication licenses were as follows:

	December 31, 2003	December 31, 2002
Moscow license area (MTS OJSC) . . . . .	\$ 255,812	\$ 255,812
North-Western region (Telecom XXI) . . . . .	74,639	74,639
Krasnodar and Adigeys regions (Kuban-GSM) . . . . .	124,396	66,919
Bashkortostan Republic (BM Telecom) . . . . .	48,932	48,932
Five regions of Asian Russia (Telecom-900) . . . . .	84,395	34,237
Rostov region (Dontelecom) . . . . .	22,067	22,067
Krasnoyarsk region, Taimyr region and Khakassia Republic (Sibchallenge) . .	52,625	—
Tomsk region (TSS) . . . . .	49,282	—
Tatarstan Republic (TAIF Telcom) . . . . .	68,407	—
Ukraine (UMC) . . . . .	151,857	—
Seven regions of European Russia . . . . .	19,503	19,503
Other . . . . .	8,212	8,212
Licenses, at cost . . . . .	960,127	530,321
Accumulated amortization . . . . .	(257,024)	(143,402)
Licenses, net . . . . .	<u>\$ 703,103</u>	<u>\$ 386,919</u>



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Amortization expense for the years ended December 31, 2003, 2002 and 2001 amounted to \$113.6 million, \$63.7 million and \$42.1 million, respectively.

Based on the licenses existing at December 31, 2003, the estimated amortization expense is \$149.5 million during 2004, \$145.3 million during 2005, \$140.7 million during 2006, \$106.6 million during 2007, \$63.4 million during 2008 and \$97.6 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

The following table summarizes GSM-900/1800 telecommunication licenses held by the Group at December 31, 2003:

License region	GSM-900		GSM-1800	
	Licensee	Expiry date	Licensee	Expiry date
<b>Moscow License Area</b>				
Moscow . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Moscow Region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
<b>St. Petersburg License Area</b>				
St. Petersburg . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Leningrad Region . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
<b>Regional License Areas</b>				
<b>European Russia</b>				
Adygeya Republic . . . . .	Kuban-GSM	April 28, 2008	Kuban-GSM	April 28, 2008
Arkhangelsk . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Bashkortostan Republic . . . . .	BM Telecom	August 22, 2007	BM Telecom	August 22, 2007
Belgorod . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Belgorod . . . . .	ReCom	May 15, 2008		
Bryansk . . . . .	ReCom	May 15, 2008	MTS OJSC	April 28, 2008
Chuvashia Republic <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Dagestan Republic <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Ivanovo . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Ingushetia Republic <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Kabardino-Balkar Republic <sup>(1)</sup> . . . .	—	—	MTS OJSC	December 30, 2013
Kaliningrad . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Kalmykia Republic <sup>(1)</sup> . . . . .	BIT	January 25, 2011	MTS OJSC	December 30, 2013
Kaluga . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Karachaevo-Cherkesia Republic <sup>(1)</sup> .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Karelia . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Kirov . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Komi Republic . . . . .	MTS OJSC	August 22, 2007	MTS OJSC	April 28, 2008
Komi-Permyatsk <sup>(1)</sup> . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Kostroma . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Krasnodar Region . . . . .	Kuban-GSM	May 30, 2007	Kuban-GSM	May 30, 2007
Kursk . . . . .	ReCom	May 15, 2008	MTS OJSC	April 28, 2008
Lipetsk . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Lipetsk . . . . .	ReCom	May 15, 2008	—	—
Mari-El Republic <sup>(1)</sup> . . . . .	Mar Mobile GSM	January 15, 2012	Mar Mobile GSM	January 15, 2012

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License region	GSM-900		GSM-1800	
	Licensee	Expiry date	Licensee	Expiry date
Mordovia Republic <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Murmansk . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Nenetsk region . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Nizhny Novgorod . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Novgorod . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Orel . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Orel . . . . .	ReCom	May 15, 2008	—	—
Orenburg . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Perm . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Rostov . . . . .	Dontelecom	July 1, 2005	Dontelecom	July 1, 2005
Pskov . . . . .	MTS OJSC	October 1, 2006	—	—
Pskov . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Ryazan . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Samara <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2012	MTS OJSC	December 30, 2012
Saratov . . . . .	MTS OJSC	July 11, 2012	MTS OJSC	July 11, 2012
Severnaya Osetia-Alania Republic . . . . .	—	—	MTS OJSC	December 30, 2013 <sup>(1)</sup>
Smolensk . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Stavropol region <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Tambov . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Tatarstan Republic . . . . .	TAIF Telcom	June 26, 2007	TAIF Telcom	June 26, 2007
Tula . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Tver . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Udmurt Republic . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Udmurt Republic . . . . .	UDN-900	February 21, 2007	—	—
Ulyanovsk <sup>(1)</sup> . . . . .	—	—	MTS OJSC	December 30, 2013
Vladimir . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Vologda . . . . .	Telecom XXI	April 28, 2008	Telecom XXI	April 28, 2008
Voronezh . . . . .	ReCom	May 15, 2008	MTS OJSC	April 28, 2008
Yaroslavl . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
<b>Asian Russia</b>				
Altai Region . . . . .	MTS-Barnaul	September 8, 2010	MTS-Barnaul	September 8, 2010
Altai Republic . . . . .	SCS-900	July 19, 2011	MTS OJSC	December 30, 2013
Amur region . . . . .	ACC	January 10, 2007	ACC	January 10, 2007
Chelyabinsk . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Chukotka <sup>(1)</sup> . . . . .	BIT	July 19, 2011	—	—
Evenkia autonomous region <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Kemerovo <sup>(1)</sup> . . . . .	MTS OJSC	December 30, 2013	MTS OJSC	December 30, 2013
Khabarovsk . . . . .	FECS-900	January 10, 2007	FECS-900	January 10, 2007
Khakassia Republic . . . . .	Sibchallenge	September 13, 2011	Sibchallenge	September 13, 2011
Khanty Mansiysk region . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Krasnoyarsk region . . . . .	Sibchallenge	December 21, 2010	Sibchallenge	September 13, 2011
Kurgan . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Novosibirsk . . . . .	SCS-900	February 21, 2007	SCS-900	February 21, 2007
Omsk . . . . .	MSS	December 20, 2006	MSS	December 20, 2006
Sakhalin <sup>(1)</sup> . . . . .	BIT	July 19, 2011	—	—
Sverdlovsk Region . . . . .	Uraltel	March 1, 2006	Uraltel	March 1, 2006
Sverdlovsk Region . . . . .	—	—	MTS OJSC	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	Licensee	Expiry date
Taimyr autonomous region . . . . .	Sibchallenge	December 21, 2010	Sibchallenge	September 13, 2011
Tomsk . . . . .	TSS	June 5, 2008	TSS	June 5, 2008
Tyumen . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
Tyva Republic <sup>(1)</sup> . . . . .	BIT	July 19, 2011	MTS OJSC	December 30, 2013
Yamalo-Nenetsk region <sup>(1)</sup> . . . . .	MTS OJSC	April 28, 2008	MTS OJSC	April 28, 2008
<b>Ukraine</b>				
Ukraine . . . . .	UMC	December 3, 2013	UMC	December 3, 2013

<sup>(1)</sup> Our regional license areas in which the licensee has not commenced commercial operations as at December 31, 2003.

Each of the Group's licenses, except the licenses covering the Moscow license area, contains a requirement for service to be commenced and for subscriber number and territorial coverage targets to be achieved by a specified date. The Group has met these targets or received extensions to these dates in those regional license areas in which the Group has not commenced operations. The management believes that the Group is in compliance with all material terms of our licenses.

The Group's operating licences do not provide for automatic renewal. The Group has limited experience with the renewal of its existing licenses. However, management believes that licenses required for the Group's operations will be renewed upon expiration.

## 22. COMMITMENTS AND CONTINGENCIES

**Capital Commitments**—As of December 31, 2003, MTS had executed non-binding purchase agreements in the amount of approximately \$266.1 million to subsequently acquire property, plant and equipment.

**Operating lease**—The Group has entered into lease agreements of space for telecommunication equipment and offices, which expire in various years up to 2052. Rental expenses under these operating leases of \$32.0 million, \$15.6 million and \$9.5 million for the years ended December 31, 2003, 2002 and 2001, respectively, are included in operating expenses in the accompanying statements of operations. Future minimum lease payments due under non-cancelable leases at December 31, 2003 were:

Payments due in the year ended December 31,	
2004 . . . . .	\$10,248
2005 . . . . .	4,497
2006 . . . . .	2,924
2007 . . . . .	1,932
2008 . . . . .	1,376
Thereafter . . . . .	12,389
Total . . . . .	<u>\$33,366</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

**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)**

improvements, which in the aggregate could total approximately \$110.2 million, as at December 31, 2003. However, a decision on the terms and conditions of such payments has not been finalized. Accordingly, MTS has not made any payments to date pursuant to any of current operating licenses. Further, management believes that MTS will not be required to make any such payments. If such payments would be required in the future, management believes that it would be limited to purchasing certain equipment for its own use in the related license area. In relation to these uncertainties, MTS has not recorded a contingent liability in the accompanying financial statements.

***Provision for doubtful accounts***—The increase in the provision for doubtful accounts to \$32.6 million at December 31, 2003 from \$7.0 million at December 31, 2002 was primarily attributable to a \$16.7 million provision related to dealer and subscriber fraud. Certain dealers and subscribers together fraudulently exploited billing time lags by placing a sizeable amount of domestic and international long-distance calls using subscriber accounts registered under false names. MTS discovered the fraud in March 2003 and has taken measures to prevent further fraud of this nature.

***Issued guarantees***—As of December 31, 2003, the Group has issued guarantees to third party banks for the loans taken by Invest-Svyaz-Holding, a shareholder of the Group and a wholly owned subsidiary of Sistema for a total amount of \$21.6 million (see also Note 18 Related Parties). The Group issued additional guarantees on behalf of MTS-Belarus, an equity investee, for the total amount of \$14.5 million. Under these guarantees the Group could be potentially liable for a maximum amount of \$36.1 million in case of the borrower's default under the obligations. The guarantees expire by August 2005.

As of December 31, 2003, no event of default has occurred under any of the guarantees issued by the Group.

***Contingencies***—The Russian economy continues to display certain traits consistent with that of an emerging market. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be subject to the government's continued actions with regard to supervisory, legal, and economic reforms.

On January 1, 2004, a new Law on telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. The Group cannot predict with any certainty how the new law will affect MTS. The new law creates a new interconnect pricing regime in 2004 that should be more transparent and unified and it creates a universal service charge calculated as a percentage of revenue which will be introduced from 2005. The new law may increase the regulation of the MTS's operations and until the time when appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax ("VAT"), corporate income tax (profits tax), a number of turnover-based taxes, and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been

**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)**

established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that is more significant than typically found in countries with more developed tax systems.

In recent years, the Russian government has initiated revisions of the Russian tax system. Effective January 1, 1999, the first part of the Tax Code was enacted. Effective January 1, 2001, the second part of the Tax Code was enacted and effective January 1, 2002 new regulations, relating to federal income tax were enacted. The new tax system is generally intended to reduce the number of taxes, the overall tax burden on businesses, and to simplify the tax laws.

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2003, substantially all of the tax declarations of the Group for the preceding three years were open to further review.

In the ordinary course of business, MTS may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which MTS operates. In the opinion of management, the MTS's liability, if any, in all pending litigation, other legal proceeding or other matters, will not have a material effect upon the financial condition, results of operations or liquidity of MTS.

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

**23. SEGMENT INFORMATION**

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance. The Group's business is organized based on geographical operations. Management of the Group regularly reviews certain operational and statistical information by license area, however currently no discrete financial information is available on this basis, therefore the performance is measured and decisions about resource allocation are made by management based on operating income by legal entities as an aggregate of the license area information.

Intercompany eliminations presented below consist primarily of the following items: intercompany sales transactions, elimination of gross margin in inventory and other intercompany transactions conducted under the normal course of operations.

**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)

At December 31, 2003, the Group has several operating segments, of which three are reportable segments—MTS OJSC (merged with Rosico), UMC and Telecom XXI. UMC is located in Ukraine whereas all other operating segments are located in RF.

	Year ended December 31,		
	2003	2002	2001
Revenue:			
MTS OJSC . . . . .	\$1,471,198	\$1,044,877	\$ 831,857
UMC <sup>(1)</sup> . . . . .	394,038	—	—
Telecom XXI . . . . .	210,460	79,166	—
Other regions . . . . .	601,171	291,143	64,780
Intercompany eliminations . . . . .	(130,669)	(53,430)	(3,390)
Total revenue . . . . .	<u>\$2,546,198</u>	<u>\$1,361,756</u>	<u>\$ 893,247</u>
Depreciation and amortization:			
MTS OJSC . . . . .	\$ 199,946	\$ 144,004	\$ 114,923
UMC <sup>(1)</sup> . . . . .	66,392	—	—
Telecom XXI . . . . .	36,782	17,343	—
Other regions . . . . .	114,484	48,333	18,395
Intercompany eliminations . . . . .	(1,688)	—	—
Total depreciation and amortization . . . . .	<u>\$ 415,916</u>	<u>\$ 209,680</u>	<u>\$ 133,318</u>
Operating income:			
MTS OJSC . . . . .	\$ 527,837	\$ 365,698	\$ 316,894
UMC <sup>(1)</sup> . . . . .	131,704	—	—
Telecom XXI . . . . .	80,632	2,331	—
Other regions . . . . .	198,176	100,531	8,039
Intercompany eliminations . . . . .	(15,751)	(4,189)	(824)
Total operating income . . . . .	<u>\$ 922,598</u>	<u>\$ 464,371</u>	<u>\$ 324,109</u>
Total operating income . . . . .	\$ 922,598	\$ 464,371	\$ 324,109
Currency exchange and translation losses (gains) . . . . .	(693)	3,474	2,264
Interest income . . . . .	(18,076)	(8,289)	(11,829)
Interest expense . . . . .	106,551	44,389	6,944
Other (income)/expenses . . . . .	3,420	(2,454)	(2,672)
Income before provision for income taxes and minority interest . . . . .	<u>831,396</u>	<u>427,251</u>	<u>329,402</u>
Additions to long-lived assets:			
MTS OJSC . . . . .	\$ 389,446	\$ 360,598	\$ 415,336
UMC <sup>(1)</sup> . . . . .	900,465	—	—
Telecom XXI . . . . .	174,128	175,361	—
Other regions . . . . .	566,475	169,378	176,211
Total additions to long-lived assets . . . . .	<u>\$2,030,514</u>	<u>\$ 705,337</u>	<u>\$ 591,547</u>

<sup>(1)</sup> Acquired in March 2003.



**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,	
	2003	2002
Long-lived assets:		
MTS OJSC .....	\$ 1,454,570	\$ 1,288,062
UMC <sup>(1)</sup> .....	648,812	—
Telecom XXI .....	288,256	150,533
Other regions .....	899,920	435,236
Intercompany eliminations .....	(19,702)	(4,189)
Total long-lived assets .....	<u>\$ 3,271,856</u>	<u>\$ 1,869,642</u>
Total assets:		
MTS OJSC .....	\$ 3,245,545	\$ 1,908,018
UMC <sup>(1)</sup> .....	394,470	—
Telecom XXI .....	296,042	130,011
Other regions .....	558,091	557,801
Intercompany eliminations .....	(268,797)	(330,867)
Total assets .....	<u>\$ 4,225,351</u>	<u>\$ 2,264,963</u>

<sup>(1)</sup> Acquired in March 2003.

## 24. SUBSEQUENT EVENTS

**Acquisition of additional interests**—In March 2004, MTS acquired an additional 11% shares in SCS-900. The value of consideration equals \$8.5 million. SCS provides GSM mobile services in the Novosibirsk region and Altay Republic.

On April 16, 2004, MTS acquired an additional 40% stake in FECS-900 from Far East Telecommunications Company OJSC, increasing its ownership in the company to 100%. The value of consideration equals \$8.3 million. FECS-900 provides GSM-900/1800 services under the MTS brand in the Khabarovsk region.

On April 13, 2004 MTS acquired an additional 7.5% stake in MSS from Sibirtelecom OJSC, increasing its ownership in the company to 91.0%. The value of consideration paid equals \$2.2 million. MSS provides GSM-900/1800 services under MTS brand in the Omsk region.

The purchase price allocation for these acquisitions has not been finalized at the date of these statements.

**Payment to Cetel B.V.**—On March 17, 2004, MTS settled a balance of \$27.5 million due to Cetel B.V., a wholly owned subsidiary of Deutsche Telecom AG, due for UMC acquisition (see Note 4 Business Acquired).

**License expansions**—In December 2003, at the open tender organized by the State Committee for Radio Frequencies and the Ministry of Defense MTS acquired additional GSM-900/1800 frequency licenses to operate in 11 new regions of Russia. MTS has also received 900 MHz license extensions to existing licenses in several regions. The term of the 900/1800 MHz GSM license for the Moscow Region has been extended until December 2008.

**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)**

Total purchase consideration paid for the licenses and extensions identified above was less than \$0.1 million.

***Additional loan facility***—In April 2004, the Group entered into a short-term loan facility with Credit Suisse First Boston International in the amount of \$200.0 million. The proceeds were used to repay the floating rate notes. Amounts outstanding under the loan facility agreement bear interest at LIBOR + 2.25% per annum.

***Redemption of the floating rate notes***—On May 5, 2004 the Group redeemed all of the outstanding \$300.0 million floating rate notes, issued on August 5, 2003 in the principal amount plus accrued interest thereon to the date of redemption.

***UMC***—During 2003, MTS acquired 100% of the outstanding voting interest of UMC (see also Note 4 Business Acquisition) from various parties. On June 7, 2004, the General Prosecutor of Ukraine filed a claim against MTS and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to MTS. The complaint also seeks an order that would prohibit MTS from alienating 51% of its stake in UMC until the claim is resolved. As of the date of these statements MTS has started the process of evaluating the claim. The Company believes that it acquired UMC in full compliance with Ukrainian law and intends to vigorously defend its acquisition of UMC.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
**AT SEPTEMBER 30, 2004 AND DECEMBER 31, 2003 (UNAUDITED)**  
**(Amounts in thousands of U.S. dollars, except share and per share amounts)**

	<u>September 30, 2004</u>	<u>December 31, 2003</u>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents, including related party amounts of \$50,300 and \$34,700, respectively (Note 8) . . . . .	\$ 192,544	\$ 90,376
Short-term investments, including related party amounts of \$50,000 and \$245,000, respectively (Note 8) . . . . .	50,730	245,000
Accounts receivable, net, including related party amounts of \$28,883 and \$4,261, respectively (Note 8) . . . . .	168,386	103,564
Inventory . . . . .	68,757	67,291
VAT receivable . . . . .	200,887	209,629
Prepaid expenses and other current assets . . . . .	150,405	124,619
<b>Total current assets</b> . . . . .	<u>831,709</u>	<u>840,479</u>
<b>PROPERTY, PLANT AND EQUIPMENT</b> , net of accumulated depreciation of \$766,930 and \$532,268, respectively (Note 4) . . . . .	2,808,573	2,256,076
<b>LICENSES AND OTHER INTANGIBLE ASSETS</b> , net of accumulated amortization of \$610,069 and \$405,076, respectively (Note 5) . . . . .	1,066,180	1,015,780
<b>INVESTMENTS IN AND ADVANCES TO AFFILIATES</b> . . . . .	77,957	103,585
<b>OTHER ASSETS</b> (Note 2) . . . . .	81,279	9,431
<b>Total assets</b> . . . . .	<u>\$4,865,698</u>	<u>\$4,225,351</u>

See notes to condensed consolidated financial statements.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS (Continued)**  
**AT SEPTEMBER 30, 2004 AND DECEMBER 31, 2003 (UNAUDITED)**  
**(Amounts in thousands of U.S. dollars, except share and per share amounts)**

	<u>September 30, 2004</u>	<u>December 31, 2003</u>
<b>CURRENT LIABILITIES:</b>		
Accounts payable, including related party amounts of \$11,930 and \$33,729, respectively (Note 8) . . . . .	\$ 198,730	\$ 199,943
Subscriber prepayments . . . . .	221,750	191,768
Accrued expenses, current portion of deferred revenue and other current liabilities . . . . .	355,812	195,988
Current portion of debt and capital lease obligations (Notes 6, 7 and 8) . .	383,173	710,270
<b>Total current liabilities</b> . . . . .	<u>1,159,465</u>	<u>1,297,969</u>
<b>LONG-TERM LIABILITIES:</b>		
Long-term debt, net of current portion (Notes 6 and 8) . . . . .	1,099,015	942,418
Capital lease obligations, net of current portion (Notes 7 and 8) . . . . .	5,061	7,646
Deferred income taxes . . . . .	161,351	180,628
Deferred revenue, net of current portion, and other long-term liabilities . .	40,157	25,177
<b>Total long-term liabilities</b> . . . . .	<u>1,305,584</u>	<u>1,155,869</u>
<b>Total liabilities</b> . . . . .	<u>2,465,049</u>	<u>2,453,838</u>
<b>COMMITMENTS AND CONTINGENCIES (Note 9)</b>		
<b>MINORITY INTEREST</b> . . . . .	69,020	47,603
<b>SHAREHOLDERS' EQUITY:</b>		
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 September 30, 2004 and December 31, 2003, 345,244,080 of which are in the form of ADS) . . . . .	50,558	50,558
Treasury stock (7,202,108 and 9,929,074 common shares at cost as of September 30, 2004 and December 31, 2003) . . . . .	(7,396)	(10,197)
Additional paid-in capital . . . . .	563,791	559,911
Unearned compensation (Note 1) . . . . .	(2,147)	(869)
Shareholder receivable (Note 6) . . . . .	(21,423)	(27,610)
Accumulated other comprehensive income (Note 1) . . . . .	8,925	7,595
Retained earnings . . . . .	1,739,321	1,144,522
<b>Total shareholders' equity</b> . . . . .	<u>2,331,629</u>	<u>1,723,910</u>
<b>Total liabilities and shareholders' equity</b> . . . . .	<u>\$4,865,698</u>	<u>\$4,225,351</u>

See notes to condensed consolidated financial statements.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (UNAUDITED)**  
**(Amounts in thousands of U.S. dollars, except share and per share amounts)**

	<b>Nine months ended September 30,</b>	
	<b>2004</b>	<b>2003</b>
<b>NET OPERATING REVENUES:</b>		
Services revenue and connection fees . . . . .	\$ 2,741,553	\$ 1,715,749
Sales of handsets and accessories . . . . .	65,785	58,748
	<u>2,807,338</u>	<u>1,774,497</u>
<b>OPERATING EXPENSES:</b>		
Cost of services, exclusive of depreciation and amortization shown separately below (including related party amounts of \$46,566 and \$26,032, respectively) . . . . .	335,480	210,199
Cost of handsets and accessories, exclusive of depreciation and amortization shown separately below . . . . .	149,272	112,996
Sales and marketing expenses (including related party amounts of \$31,069 and \$15,649, respectively) . . . . .	298,401	219,352
General and administrative expenses (including related party amounts of \$12,663 and \$7,439, respectively) . . . . .	406,593	281,555
Depreciation and amortization expenses . . . . .	450,742	288,112
Other operating expenses . . . . .	20,667	12,460
<b>Net operating income</b> . . . . .	<u>1,146,183</u>	<u>649,823</u>
<b>FOREIGN CURRENCY EXCHANGE GAINS</b> . . . . .	(2,647)	(4,841)
Interest income (including related party amounts of \$5,928 and \$2,737, respectively) . . . . .	(18,577)	(11,743)
Interest expense . . . . .	78,828	70,013
Other (income)/expense, net . . . . .	(22,006)	12,251
Total other expenses, net . . . . .	<u>38,245</u>	<u>70,521</u>
<b>Income before provision for income taxes and minority interest</b> . . . . .	<u>1,110,585</u>	<u>584,143</u>
<b>PROVISION FOR INCOME TAXES</b> . . . . .	269,590	160,514
<b>MINORITY INTEREST</b> . . . . .	27,372	59,139
<b>NET INCOME</b> . . . . .	<u>\$ 813,623</u>	<u>\$ 364,490</u>
Weighted average number of common shares outstanding . . . . .	1,983,958,588	1,983,359,507
Earnings (net income) per share, basic and diluted . . . . .	\$ 0.41	\$ 0.18

See notes to condensed consolidated financial statements.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (UNAUDITED)**  
**(Amounts in thousands of U.S. dollars)**

	<b>Nine months ended September 30,</b>	
	<b>2004</b>	<b>2003</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 813,623	\$ 364,490
<b>Adjustments to reconcile net income to net cash provided by operating activities:</b>		
Minority interest	27,372	59,139
Depreciation and amortization	450,742	288,112
Amortization of deferred connection fees	(36,509)	(24,945)
Equity in net (income)/loss of associates	(17,631)	1,557
Inventory obsolescence expense	2,611	4,767
Provision for doubtful accounts	17,429	28,694
Deferred taxes	(44,517)	(29,094)
Non-cash expenses associated with stock bonus and stock options	533	—
<b>Changes in operating assets and liabilities:</b>		
Increase in accounts receivable	(80,556)	(75,026)
Increase in inventory	(2,396)	(8,597)
(Increase)/Decrease in prepaid expenses and other current assets	(19,323)	6,274
Decrease/(Increase) in VAT receivable	13,746	(39,962)
Increase in accounts payable, accrued liabilities and other current liabilities	156,097	92,357
<b>Net cash provided by operating activities</b>	<u>1,281,221</u>	<u>667,766</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>		
Payment for the TAIF Telcom call option	(63,034)	—
Acquisitions of subsidiaries, net of cash acquired	(172,202)	(629,306)
Purchases of property, plant and equipment	(697,318)	(560,927)
Purchases of intangible assets	(82,894)	(74,725)
Purchases of short-term investments	(42,392)	—
Proceeds from sale of short-term investments	236,806	—
Investments in and advances to associates	(2,237)	(50,310)
<b>Net cash used in investing activities</b>	<u>(823,271)</u>	<u>(1,315,268)</u>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>		
Proceeds from notes issue	—	697,000
Repayment of notes	(300,000)	—
Proceeds from loans	412,600	222,903
Loans principal paid	(295,653)	(52,298)
Debt issuance cost	(10,215)	(5,884)
Proceeds from exercise of stock options	4,049	—
Capital lease obligation principal paid	(7,656)	(10,467)
Dividends paid including taxes	(166,893)	(96,701)
Payments from Sistema	7,008	6,146
<b>Net cash (used in)/provided by financing activities</b>	<u>(356,760)</u>	<u>760,699</u>
Effect of exchange rate changes on cash and cash equivalents	978	(589)
<b>NET INCREASE IN CASH AND CASH EQUIVALENTS</b>	<u>102,168</u>	<u>112,608</u>
<b>CASH AND CASH EQUIVALENTS, at the beginning of period</b>	<u>90,376</u>	<u>34,661</u>
<b>CASH AND CASH EQUIVALENTS, at the end of period</b>	<u>\$ 192,544</u>	<u>\$ 147,269</u>
<b>SUPPLEMENTAL INFORMATION:</b>		
Income taxes paid	\$ 217,475	\$ 136,617
Interest paid	\$ 97,007	\$ 52,848
<b>Non-cash investing activities:</b>		
Additions to network equipment and software under capital lease	\$ 2,861	\$ 9,045
Payable related to the acquisition of UMC	\$ —	\$ 27,500

See notes to condensed consolidated financial statements.



**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (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 its accounting books and records in Russian rubles for its subsidiaries located in the Russian Federation (“RF”), in Ukrainian hryvnias for Ukrainian Mobile Communications (“UMC”) and Uzbek som for Uzdurobita based on local accounting and tax legislation. The accompanying consolidated financial statements have been prepared in order to present MTS’ financial position and its results of operations and cash flows in accordance with accounting principles generally accepted in the United States (“U.S. GAAP”) and expressed in terms of U.S. dollars.

The accompanying condensed consolidated financial statements differ from the financial statements used for statutory purposes in that they reflect various adjustments, not recorded on the entities’ books, which are appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP. The principal adjustments are related to revenue recognition, foreign currency translation, deferred taxation, consolidation, depreciation and amortization and valuation of property, plant and equipment and intangible assets.

**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 condensed consolidated 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 U.S. GAAP 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, 2003 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, 2003 and the related notes as filed on Form 20-F with the Securities and Exchange Commission.

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As of September 30, 2004 and December 31, 2003, MTS has investments in the following significant legal entities:

	Accounting Method	September 30, 2004	December 31, 2003
ACC . . . . .	Consolidated	100.0%	100.0%
Telecom XXI . . . . .	Consolidated	100.0%	100.0%
Telecom-900 . . . . .	Consolidated	100.0%	100.0%
SCS-900 . . . . .	Consolidated	99.5%	88.5%
FECS-900 . . . . .	Consolidated	100.0%	60.0%
Uraltel . . . . .	Consolidated	99.8%	99.8%
MTS Finance <sup>(1)</sup> . . . . .	Consolidated	100.0%	100.0%
BM Telecom . . . . .	Consolidated	100.0%	100.0%
Kuban-GSM . . . . .	Consolidated	100.0%	100.0%
Dontelecom . . . . .	Consolidated	100.0%	100.0%
MTS-Barnaul . . . . .	Consolidated	100.0%	100.0%
BIT . . . . .	Consolidated	100.0%	100.0%
MTS-Capital . . . . .	Consolidated	100.0%	100.0%
UMC . . . . .	Consolidated	100.0%	100.0%
Sibchallenge . . . . .	Consolidated	100.0%	100.0%
TSS . . . . .	Consolidated	100.0%	100.0%
Volgograd Mobile . . . . .	Consolidated	100.0%	50.0%
Astrakhan Mobile . . . . .	Consolidated	100.0%	50.0%
Mar Mobile GSM . . . . .	Consolidated	100.0%	100.0%
Primtelefon . . . . .	Consolidated	100.0%	50.0%
MSS . . . . .	Consolidated	91.0%	83.5%
ReCom . . . . .	Consolidated	53.9%	53.9%
TAIF Telecom . . . . .	Consolidated	52.7%	52.7%
UDN-900 . . . . .	Consolidated	100.0%	51.0%
Novitel . . . . .	Consolidated	100.0%	51.0%
Uzdunrobita . . . . .	Consolidated	74.0%	—
MTS Belarus . . . . .	Equity	49.0%	49.0%

<sup>(1)</sup> Represents beneficial ownership.

**Translation methodology**—MTS OJSC and most of its subsidiaries use the U.S. dollar as its functional currency because the majority of their revenues, costs, purchases, property, plant and equipment and intangible assets, and debt are either priced, incurred, payable or otherwise measured in U.S. dollars. Each of the legal entities domiciled in Russia, Ukraine, Uzbekistan and Belarus maintains its records and prepares its financial statements in the local currency, either Russian ruble, Ukrainian hryvnia, Uzbek som or Belarusian ruble, in accordance with the requirements of local statutory accounting and tax legislation.

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Translation (re-measurement) of financial statements denominated in local currencies into U.S. dollars has been performed in accordance with the provisions of Statement of Financial Accounting Standard ("SFAS") No. 52 "Foreign currency translation":

- For subsidiaries of the Group where functional currency is the U.S. dollar, monetary assets and liabilities have been translated at the period end exchange rates. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows have been translated at historical rates. Translation differences resulting from the use of these rates have been accounted for as foreign currency exchange gains and losses in the accompanying condensed consolidated statements of operations.
- For UMC and Kuban-GSM where functional currency is the local currency, Ukrainian hryvnia and Russian ruble, respectively, all year end balance sheet items have been translated into U.S. dollars at the period end exchange rate. Revenues and expenses have been translated at the average exchange rate for the period. In addition, a "new cost basis" for all non-monetary assets of Kuban-GSM has been established as of January 1, 2003, when the Russian economy ceased to be considered hyperinflationary. Cumulative translation adjustment, related to the translation of UMC and Kuban-GSM, in the amount of \$8,925, net of income taxes, was reported as accumulated other comprehensive income in the accompanying consolidated condensed balance sheet at September 30, 2004.

**Change in estimate**—MTS defers initial connection fees paid by subscribers for the activation of network service as well as one time activation fees received for connection to various value added services. These fees are recognized as revenue over the estimated average subscriber life.

Effective January 1, 2004 the Group has changed its estimates of average subscriber lives. The effect of this change in estimate in 2004 was an increase in net income of approximately \$8.5 million, net of income tax, or \$0.004 per share.

**Stock-based compensation**—MTS accounts for stock options issued to employees, non-employee directors and consultants following the requirements of SFAS No. 123, "*Accounting for Stock-Based Compensation*" and SFAS No. 148 "*Accounting for Stock Based Compensation—Transition and Disclosure, an amendment to FASB Statement No. 123.*" Under the requirements of these statements, the Company elected to use the intrinsic method to value options on the measurement date as a method for accounting for compensation to employees and non-employee directors. Starting January 1, 2004, the Group uses the binomial model to calculate the pro-forma effect of the application of the fair value method of accounting for stock options. The effect of the change of the method of calculation from the Black-Scholes model to the binomial model did not have a material effect on the pro forma numbers.

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If the Group had elected to recognize compensation costs based on the fair values of options at the date of the grant, net income and earnings per share amounts would have been as follows:

	September 30,	
	2004	2003
Net income as reported . . . . .	\$813,623	\$364,490
Pro-forma effect of the application of fair value method of accounting . . . . .	(704)	(774)
Pro-forma net income . . . . .	<u>\$812,919</u>	<u>\$363,716</u>
Earnings per share—basic and diluted		
As reported . . . . .	\$ 0.41	\$ 0.18
Pro-forma . . . . .	\$ 0.41	\$ 0.18

**Comparative information**—Certain prior period amounts have been reclassified to conform to the current period presentation.

**New Accounting Pronouncements**—In December 2004, the Financial Accounting Standards Board (“FASB”) issued SFAS No. 123R, “Share-Based Payment”, a revision of FAS No. 123, “Accounting for Stock-Based Compensation”. SFAS No. 123R supersedes Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees” and requires all entities to recognize compensation cost in an amount equal to the fair value of share-based payments granted to employees. That cost will be recognized over the period during which an employee is required to provide service in exchange for an award of equity instruments. SFAS No. 123R is effective for interim periods beginning after June 15, 2005, at which time companies can select whether they will apply the standard retroactively by restating their historical financial statements or prospectively for new stock-based compensation arrangements and the unvested portion of existing arrangements. The Group is evaluating whether the adoption of SFAS No. 123R will have a material impact on its financial position and results of operations.

In September 2004, the Emerging Issues Task Force (“EITF”) issued a final consensus on EITF Issue No. 04-1, “Accounting for Preexisting Relationships between the Parties to a Business Combination” (“EITF Issue No. 04-1”). In this issue the EITF reached a consensus that a business combination between two parties having a preexisting relationship is a multiple-element transaction with one element being the business combination and the other element being the settlement of the preexisting relationship. This Issue requires certain additional disclosures for business combinations between parties with a preexisting relationship. EITF Issue No. 04-1 is effective for reporting periods beginning after October 13, 2004. The Group does not anticipate that the adoption of EITF Issue No. 04-1 will have a material impact on its financial position or results of operations.

At the September 2004 meeting of the EITF, the U.S. Securities and Exchange Commission (“SEC”) staff announced that companies must use the direct value method to determine the fair value of their intangible assets acquired in business combinations completed after September 29, 2004.

Historically, MTS used the residual method to determine the fair value of the telecommunication licenses acquired in business combinations, except for the purchase of Uzdunrobita, where the fair value of licenses acquired was determined using the direct method. Under the new accounting guidance, MTS will use the direct method to measure the fair value of licenses acquired in the future

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business combinations. The Group does not anticipate the impact from adoption of the above SEC guidance to be material to our consolidated results of operations or financial position.

In July 2004, EITF issued No. 02-14, "Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock." A consensus was reached regarding an investor that has the ability to exercise significant influence over the operating and financial policies of the investee. This type of investor should apply the equity method of accounting only when it has an investment(s) in common stock and/or an investment that is in-substance common stock. The Task Force also reached a consensus on the definition of in-substance common stock and related guidance. The guidance of this EITF issue is effective for reporting periods beginning after September 15, 2004. The Group is currently evaluating the impact of this pronouncement on its financial position and results of operations.

In December 2003, FASB issued a revision to Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46R" or the "Interpretation"). FIN 46R clarifies the application of ARB No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both.

Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. Following the requirements of FIN 46R the Group has adopted the provisions of the Interpretation in the first quarter of 2004. As the Group was not a primary beneficiary in any VIE during the nine months ended September 30, 2004, the adoption of FIN 46R did not have a material effect on its financial position or results of operations.

## **2. BUSINESSES ACQUIRED**

### *Uzdunrobita acquisition*

In July 2004, MTS entered into an agreement to acquire 74.0% of the outstanding common shares of Uzbekistan mobile operator JV Uzdunrobita ("Uzdunrobita") for a cash consideration of \$121.2 million, including transaction costs of \$0.2 million. The acquisition was completed on August 1, 2004 and starting from this date Uzdunrobita's financial results are consolidated. Uzdunrobita holds licenses to provide GSM-1800 mobile communication services in the whole territory of Uzbekistan, which has a population of approximately 25.2 million. Uzdunrobita's subscriber base as of the date of acquisition was approximately 230,000 people.

MTS also entered into call and put option agreements with the existing shareholders of Uzdunrobita to acquire the remaining 26.0% of common shares of the company. The exercise period for the call and put option is 48 months from the acquisition date. The call and put option agreements stipulate a minimum purchase price of \$37.7 million plus 5% per annum commencing from the

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acquisition date. Combined fair value of these options was an asset of \$3.6 million at September 30, 2004.

The acquisition was accounted for using the purchase method of accounting. The purchase price allocation for the acquisition was as follows:

Current assets . . . . .	\$ 5,950
Non-current assets . . . . .	67,293
License costs . . . . .	40,861
Acquired customer base . . . . .	958
Trademark . . . . .	3,622
Goodwill . . . . .	41,290
Current liabilities . . . . .	(14,705)
Non-current liabilities . . . . .	(1,356)
Deferred taxes . . . . .	(6,384)
Minority interest . . . . .	(16,308)
Purchase price . . . . .	<u>\$121,221</u>

Goodwill is mainly attributable to economic potential of the market assuming low penetration level as of the date of acquisition. License costs are amortized over the remaining contractual terms of the licenses of approximately 12 years and customer base is amortized over the average remaining subscriber's life of approximately 39 months. Trademark will be amortized based on the estimated useful life of approximately 53 months.

*Primtelefon acquisition*

In June 2004, MTS purchased 50.0% of Far-Eastern operator CJSC Primtelefon ("Primtelefon") for a cash consideration of \$31.0 million, increasing its effective ownership to 100%, as 50% of Primtelefon's shares were controlled through Vostok Mobile, a wholly-owned subsidiary of MTS. Commencing from the date of acquisition of the second stake, MTS consolidates financial results of Primtelefon. Primtelefon holds licenses to provide GSM-900/1800 mobile cellular communications in the Far-East region of Russia. The company's subscriber base as of June 2004 was approximately 216,000 people.

The acquisition was accounted for using the purchase method of accounting. The purchase price allocation was as follows:

Current assets . . . . .	\$11,041
Non-current assets . . . . .	16,809
License costs . . . . .	21,891
Current liabilities . . . . .	(7,488)
Non-current liabilities . . . . .	(5,671)
Deferred taxes . . . . .	(5,582)
Purchase price . . . . .	<u>\$31,000</u>



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License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 7 years and customer base is amortized over the average remaining subscriber's life of approximately 41 months.

*TAIF Telcom acquisition*

In September 2004, MTS notified the holder of the remaining 47.3% stake in TAIF Telcom, regarding its intent to exercise the option to buy this stake and paid \$63.0 million in cash. The transaction has been completed and the Group received legal title to the acquired shares, increasing its ownership in TAIF Telcom to 100%, in October 2004 and thus did not consolidate 100% of TAIF Telcom in its September 30, 2004 statements. Cash consideration paid is included in other assets on the accompanying condensed consolidated balance sheet as of September 30, 2004.

*Acquisitions of various regional companies*

In August 2004, MTS acquired from OJSC UTK, a third party, the remaining 50% stakes in Astrakhan Mobile and Volgograd Mobile, increasing its ownership to 100%. The acquisition prices were \$1.1 million and \$2.9 million, respectively. Starting from August 2004 financial results of both companies are consolidated into MTS financial statements. Astrakhan Mobile holds AMPS/DAMPS-800 and GSM-1800 licenses covering Astrakhan region (population of approximately 1 million) and Volgograd Mobile holds AMPS/DAMPS-800 and GSM-1800 licenses covering Volgograd region (population of approximately 2.7 million). As of July 31, 2004, the two companies provided AMPS/DAMPS services to around 10,000 subscribers. As the result of the allocation of purchase price for the first and second stakes in both companies the Group recorded license cost of \$16.5 million.

In August 2004, MTS acquired from OJSC Volgatelecom, a third party, the remaining 49% stake in UDN-900 for \$6.4 million in cash. This acquisition increased MTS's ownership in UDN to 100%. The allocation of purchase price increased recorded license cost by \$0.3 million. UDN-900 provides GSM-900 services under the MTS brand in Udmurtia Republic (population 1.6 million). UDN's subscriber base as of July 31, 2004 was approximately 220,000 customers.

In April 2004, MTS acquired from OJSC Sibirtelecom, a third party, additional 7.5% stake in MSS, a company, which operates in the Omsk region, for \$2.2 million in cash. This acquisition increased MTS's ownership in MSS to 91%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by \$1.1 million.

In April 2004, the Group acquired 40% stake in FECS-900 from OJSC Dalnevostochnaya Kompaniya Electrosvyazi, a third party, for a cash consideration of \$8.3 million, increasing its ownership in FECS-900 to 100.0%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by \$4.1 million.

In April and May of 2004, MTS acquired the remaining stakes in the following subsidiaries:

- 35% of MTS-NN (a service provider in Nizhny Novgorod) for \$0.5 million in cash, and
- 49% of Novitel (handsets dealer in Moscow) for \$1.3 million in cash.

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Both acquisitions increased MTS's share in the respective companies to 100%. The acquisitions were accounted for using the purchase method of accounting. The allocation of purchase price increased recorded goodwill by \$1.8 million.

In March 2004, the Group acquired 11% stake in SCS-900 from CJSC Sibirskie Zvezdy for a cash consideration of \$8.5 million, increasing its ownership in SCS-900 to 99.5%. The acquisition was accounted for using the purchase method of accounting. The allocation of purchase price increased recorded license cost by \$2.6 million.

*Pro-forma results of operations*

The following unaudited pro-forma financial data for the nine months ended September 30, 2004 and 2003, give effect to the acquisitions of Uzdunrobita, Primtelefon and other various regional companies as if they had occurred as of January 1, 2003:

	Nine months ended September 30,	
	2004	2003
Pro-forma:		
Net revenues . . . . .	\$2,865,097	\$1,822,065
Net operating income . . . . .	\$1,169,127	\$ 673,397
Net income . . . . .	\$ 817,305	\$ 368,280
Earnings per share, basic and diluted . . . . .	\$ 0.41	\$ 0.19

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.

**3. DIVIDENDS**

On June 24, 2004, MTS' shareholders approved cash dividends totaling 6.4 billion rubles or \$220.0 million at exchange rate as of the date of the declaration (\$2.2 per ADS), including \$1.1 million related to treasury stock, to be paid by December 31, 2004. At September 30, 2004, approximately \$156.0 million of dividends were paid and \$64.0 million are due to shareholders and included in accrued expenses current portion of deferred revenues and other current liabilities in the accompanying condensed consolidated balance sheet as of September 30, 2004.

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**4. PROPERTY, PLANT AND EQUIPMENT**

The net book value of property, plant and equipment as of September 30, 2004 and December 31, 2003 was as follows:

	September 30, 2004	December 31, 2003
Network and base station equipment (including leased network and base station equipment of \$71,611 and \$66,311, respectively) . . . . .	\$2,330,199	\$1,775,180
Leasehold improvements . . . . .	6,113	6,582
Office equipment, computers, software and other (including leased office equipment, computers and software of \$1,923 and \$1,923, respectively) . .	202,436	147,395
Buildings . . . . .	183,603	144,680
Vehicles . . . . .	14,295	11,611
Property, plant and equipment, at cost . . . . .	2,736,646	2,085,448
Accumulated depreciation (including accumulated depreciation on leased equipment of \$30,304 and \$23,343) . . . . .	(766,930)	(532,268)
Equipment for installation . . . . .	308,263	334,264
Construction in-progress . . . . .	530,594	368,632
Property, plant and equipment, net . . . . .	<u>\$2,808,573</u>	<u>\$2,256,076</u>

Depreciation expenses during the nine months ended September 30, 2004 and 2003 amounted to \$245.7 and \$158.0 million, respectively, including depreciation expenses for leased property, plant and equipment in the amount of \$6.8 and \$5.7 million, respectively.

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**5. LICENSES AND OTHER INTANGIBLE ASSETS**

Intangible assets as of September 30, 2004 and December 31, 2003 comprised of the following:

		September 30, 2004			December 31, 2003		
	Useful lives	Gross carrying value	Accumulated amortization	Net carrying value	Gross carrying value	Accumulated amortization	Net carrying value
<b>Amortized intangible assets:</b>							
	20 to 76 months						
Acquired customer base . . .		\$ 87,779	\$ (42,355)	\$ 45,424	\$ 81,289	\$ (18,307)	\$ 62,982
Rights to use premises . . .	10 years	19,638	(11,949)	7,689	19,638	(10,476)	9,162
Numbering capacity with finite contractual life, software and other . . . . .	3 to 10 years	415,472	(184,047)	231,425	338,222	(119,269)	218,953
Licenses . . . . .	3 to 13 years	1,089,148	(371,718)	717,430	960,127	(257,024)	703,103
		<u>1,612,037</u>	<u>(610,069)</u>	<u>1,001,968</u>	<u>1,399,276</u>	<u>(405,076)</u>	<u>994,200</u>
<b>Unamortized intangible assets:</b>							
Numbering capacity with indefinite contractual life .		13,047	—	13,047	13,047	—	13,047
Goodwill . . . . .		<u>51,165</u>	<u>—</u>	<u>51,165</u>	<u>8,533</u>	<u>—</u>	<u>8,533</u>
Total licenses and other intangible assets . . . . .		<u>\$1,676,249</u>	<u>\$ (610,069)</u>	<u>\$1,066,180</u>	<u>\$ 1,420,856</u>	<u>\$ (405,076)</u>	<u>\$1,015,780</u>

As a result of a limited availability of local telephone numbering capacity in Moscow and the Moscow region, MTS has been required to enter into agreements for the use of telephone numbering capacity with several telecommunication operators in Moscow. Costs of acquiring numbering capacity with finite contractual life are amortized over period of three to ten years in accordance with the terms of the respective contract. Numbering capacity with indefinite contractual life is not amortized.

A part of MTS' right to use premises was obtained in the form of contributions to its charter capital in 1993. These premises included MTS' administrative offices and facilities utilized for mobile switching centers.

Amortization expense for the nine months ended September 30, 2004 and 2003 amounted to \$205.0 million and \$130.1 million, respectively. Based on the amortizable intangible assets existing at September 30, 2004, the estimated amortization expense for the remainder of 2004 is \$75.0 million (totaling \$280.0 million during 2004), \$265.5 million during 2005, \$222.1 million during 2006, \$161.4 million during 2007, \$99.4 million during 2008, \$40.1 million during 2009 and \$138.5 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

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**6. DEBT**

At September 30, 2004 and December 31, 2003, debt comprised of the following:

	Currency	Annual interest rate (Actual rate at September 30, 2004)	September 30, 2004	December 31, 2003
9.75% Notes due 2008 . . . . .	USD	9.75%	\$ 400,000	\$ 400,000
8.38% Notes due 2010 . . . . .	USD	8.375%	400,000	400,000
10.95% Notes due 2004 . . . . .	USD	10.95%	299,928	299,640
Floating Rate Notes due 2004 . . . . .	USD	—	—	298,196
Syndicated loan . . . . .	USD	LIBOR+2.5% (4.70%)	200,000	—
Hermes Credit Facility . . . . .	EUR	EURIBOR+0.65% (2.86%)	56,578	55,550
ING Bank (Eurasia) . . . . .	USD	LIBOR+2.25% - 4.15% (4.27% - 6.17%)	53,333	60,000
HSBC . . . . .	USD	LIBOR+2.75% (4.66%)	20,000	25,000
Ericsson . . . . .	USD	LIBOR+4% (6.02%)	17,100	23,400
Dresdner Bank . . . . .	USD	LIBOR+3.35% (5.37%)	10,000	15,400
Nordea Bank Sweden . . . . .	USD	LIBOR+0.40% (2.60%)	8,124	—
West LB . . . . .	EUR	EURIBOR+2% (4.21%)	5,039	5,092
KfW . . . . .	EUR	EURIBOR+0.95% (3.16%)	1,338	4,313
AVAL Bank . . . . .	UAH	—	—	10,890
International Moscow Bank . . . . .	RUR	—	—	10,864
Citibank . . . . .	USD	—	—	10,000
Deutsche Telekom AG . . . . .	USD	—	—	7,981
TDC Mobile International A/S . . . . .	USD	—	—	6,838
MBRD . . . . .	RUR	15%	243	1,220
Other ruble denominated debt . . . . .	RUR	15.5% - 16.5%	1,703	5,860
Other debt . . . . .	USD	LIBOR+1.15% - 6.55% (3.17% - 8.57%)	1,149	3,322
<b>Total debt . . . . .</b>			<b>\$1,474,535</b>	<b>\$1,643,566</b>
<b>Less current portion . . . . .</b>			<b>375,520</b>	<b>701,148</b>
<b>Total long-term debt . . . . .</b>			<b>\$1,099,015</b>	<b>\$ 942,418</b>

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*The Notes*

On December 21, 2001, MTS Finance S.A. ("MTS Finance"), a 100% beneficially owned subsidiary of MTS, registered under the laws of Luxembourg, issued \$250.0 million 10.95% (effective interest rate of 11.25%) notes at the price of 99.254%. Proceeds received from the notes, net of underwriting discount, were \$248.1 million. Related debt issuance costs in the amount of \$3.9 million were capitalized. On March 20, 2002, MTS Finance issued additional \$50.0 million 10.95% (effective interest rate of 10.25%) notes at a price of 101.616%. Proceeds received from these notes, including the offering premium, were \$50.8 million. Related debt issuance costs in the amount of \$0.6 million were capitalized. All the notes are fully and unconditionally guaranteed by MTS OJSC. 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. The notes were fully paid in December, 2004.

On January 30, 2003, MTS Finance issued \$400.0 million 9.75% notes at par. These notes are fully and unconditionally guaranteed by MTS OJSC and mature on January 30, 2008. MTS Finance is required to make interest payments on the notes semi-annually in arrears on January 30 and July 30, commencing on July 30, 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes were \$400.0 million and related debt issuance costs of \$3.9 million were capitalized.

On August 5, 2003, MTS Finance issued \$300.0 million notes bearing interest at floating rate of 3 months LIBOR + 4% at the price of 99%. These notes were fully and unconditionally guaranteed by MTS OJSC and matured on August 7, 2004. MTS Finance was required to make interest payments on the notes quarterly, commencing on November 5, 2003. The notes were listed on the Luxembourg Stock Exchange. Proceeds received from the notes, net of underwriting discount, were \$297.0 million and related debt issuance costs of \$1.8 million were capitalized. On May 5, 2004 the Group redeemed all outstanding floating rate notes, mentioned above, in the principal amount plus accrued interest thereon to the date of redemption.

On October 14, 2003, MTS Finance issued \$400.0 million notes bearing interest at 8.375% at par. The cash proceeds, net of issuance costs of approximately \$4.6 million, amounted to \$395.4 million. These notes are fully and unconditionally guaranteed by MTS OJSC and mature on October 14, 2010. MTS Finance is required to make interest payments on the notes semi-annually in arrears on April 14 and October 14 of each year, commencing on April 14, 2004. The notes are listed on the Luxembourg Stock Exchange.

These notes are subject to certain restrictive covenants including, but not limited to, limitations on the incurrence of additional indebtedness, limitations on the Group's ability to enter into sale-leaseback transactions, restriction on any merger, consolidation or disposition of assets, restrictions on the sales of any licenses. In addition, these notes provide the holders a right to require MTS Finance to redeem all of the notes outstanding at 101% of the principal amount of the notes plus accrued interest upon any change in control, as defined. As of September 30, 2004, management believes that the Group is in compliance with all existing covenants.



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*Syndicated Loan*

In July 2004, MTS OJSC entered into a \$500.0 million syndicated loan agreement (“the Agreement”) with international financial institutions: ING Bank N.V., ABN AMRO Bank N.V., HSBC Bank PLC, Raiffeisen Zentralbank Oesterreich AG ZAO, Bank Austria Creditanstalt AG, Commerzbank Aktiengesellschaft and others. The credit facility bears interest LIBOR + 2.5% per annum and matures in 3 years. In September 2004 MTS extended total amount available under the syndicated loan facility for an additional \$100.0 million to the total amount of \$600.0 million. Issuance cost in the amount of \$10.2 million related to the syndicated loan facility have been capitalized. At September 30, 2004, \$200.0 million was outstanding under this credit facility. According to the loan agreement MTS OJSC is liable for a commitment fee charged on the undrawn amount of the syndicated loan facility of 0.25% from July 26, 2004 till October 1, 2004 and 0.50% from October 1, 2004 and forward. As of September 30, 2004, OJSC MTS incurred a total of approximately \$0.2 million in commitment fees. The loan facilities are subject to certain restrictive covenants including, but not limited to, the requirement to maintain certain financial ratios. As of September 30, 2004, management believes that the Group is in compliance with all existing covenants.

*ING Bank (Eurasia)*

In September 2003, UMC entered into a \$60.0 million syndicated credit facility with ING Bank (Eurasia) ZAO, ZAO Standard Bank and Commerzbank Aktiengesellschaft with an interest rate of LIBOR + 2.25%–4.15%. The loan is guaranteed by MTS OJSC. The proceeds were used by UMC to refinance its existing indebtedness. The loan is payable in 8 equal quarterly installments starting from September 2004. As of September 30, 2004 and December 31, 2003, \$53.3 million and \$60.0 million were outstanding, respectively, under this credit facility.

*Dresdner Bank credit facilities*

In December 2001 and April 2002, UDN-900 entered into credit agreements with Dresdner Bank, expiring on April 2004. As of December 31, 2003 the amount outstanding under these agreements was \$5.4 million. These borrowings bear interest at LIBOR + 3.2% per annum and are guaranteed by MTS OJSC. In April 2004, both loans were fully repaid.

In October 2002, MSS entered into a credit agreement with Dresdner Bank to borrow up to \$10.0 million. As of September 30, 2004 and December 31, 2003, \$10.0 million was outstanding under this agreement. Borrowings under this agreement bear interest of LIBOR + 3.35% per annum and mature in October 2004. The loan is guaranteed by MTS OJSC. In October 2004, the loan was fully repaid.

*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 \$60.0 million and had a maximum term of five years (the “Ericsson Loan”). The loan was repayable in ten equal consecutive quarterly payments of \$6.0 million commencing in 1999. On July 24, 2001, MTS, Rosico and Ericsson signed an amendment to the credit agreement rescheduling Rosico principal payments in

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nineteen consecutive quarterly installments. The amounts advanced under the agreement bear interest of LIBOR + 4% (6.02% at September 30, 2004). If Rosico fails to pay any amount under this facility, the overdue interest would bear interest at a rate of additional 6% per annum. The credit agreement contains covenants restricting Rosico's ability to encumber its present and future assets and revenues without lender's express consent.

Concurrent with the Group's acquisition of Rosico, Sistema agreed to fund the full and timely repayment of the Ericsson Loan and to indemnify Rosico and MTS for any costs incurred by either Rosico or MTS in connection with the repayment of the Ericsson Loan. During 2000, Sistema and MTS agreed on a method that would allow Sistema to fund its obligation in a manner that minimizes the total costs of meeting this obligation (including related tax costs). Under this method, MTS enters into a long-term, ruble-denominated promissory notes with 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 September 30, 2004 and December 31, 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. Through September 30, 2004, Sistema has made payments under this obligation in the amount of \$60.0 million, \$42.9 million 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.

On February 25, 2003, Ericsson assigned all of its rights and obligations under the Ericsson Loan to Salomon Brothers Holding Company, Inc.

At September 30, 2004 and December 31, 2003, \$17.1 million and \$23.4 million were outstanding, respectively, under the Ericsson Loan.

*Deutsche Telekom AG and TDC Mobile International A/C*

The credit facilities with Deutsche Telekom AG and TDC Mobile International A/C bear interest at LIBOR + 5%–7% and are redeemable in five equal quarterly installments commencing April 2003. The \$14.8 million outstanding under these credit facilities as of December 31, 2003 was fully repaid during the nine months ended September 30, 2004.

*Nordea Bank Sweden loan*

In September 2003, Primtelefon entered into a long-term loan facility with Nordea Bank Sweden for the total amount of \$9.8 million. Amounts outstanding under the loan agreement bear interest at LIBOR + 0.40% and mature in October 2006. The loan is guaranteed by MTS OJSC. As of September 30, 2004, the amount outstanding under the loan was \$8.1 million.

*Citibank credit facility*

In November 2002, Telecom XXI entered into a credit facility with Citibank. Amounts borrowed under the credit facility bear interest of LIBOR + 3.5% per annum. Overdue amounts bear an additional 3% per annum. The \$10.0 million outstanding under this facility as of December 31, 2003 was fully repaid by July 1, 2004.

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*WestLB International loan*

In July 2002, MTS-P entered into a credit facility agreement with WestLB International S.A. As of December 31, 2003 the amount of borrowings under this agreement was \$5.0 million. Amounts outstanding under this agreement bear interest of EURIBOR + 2% per annum for the first two years for each advance and 4% per annum for the remaining interest periods for each advance until maturity. The final maturity of this agreement is December 28, 2006. The loan is guaranteed by MTS OJSC. As of September 30, 2004 and December 31, 2003, the balance outstanding under the loan was \$5.0 million.

*KfW loan*

On December 21, 1998, UMC entered into two loan agreements with KfW, a German bank, for EUR 1.9 million and EUR 10.9 million. These loans bear interest at EURIBOR + 0.95% per annum and mature on March 31, 2004 and February 28, 2005, respectively. At September 30, 2004 and December 31, 2003, \$1.3 million and \$4.3 million were outstanding, respectively, under the loan.

*HSBC Bank LLC*

In October 2003, TAIF Telcom entered into a \$25.0 million credit facility with HSBC Bank LLC, which is guaranteed by MTS OJSC. The facility bears interest at LIBOR + 2.75% and is payable in ten equal quarterly installments commencing on June 2004. The loan is subject to certain restrictive covenants including, but not limited to, restriction on the amount of dividends paid by TAIF Telcom until MTS owns 100% of TAIF Telcom's outstanding common stock. At September 30, 2004 and December 31, 2003, \$20.0 million and \$25.0 million were outstanding, respectively, under this credit facility.

*Hermes Credit Facility (HECF)*

On December 30, 2003, UMC entered into Hermes Credit Facility with ING BHF Bank and Commerzbank Aktiengesellschaft to finance the acquisition of GSM equipment from Siemens AG. The aggregate amount available under this credit facility is EUR 47.4 million (\$58.4 million at September 30, 2004). The loan is guaranteed by MTS OJSC and bears interest at EURIBOR + 0.65%. In July 2004, EUR 4.7 million (\$5.8 million as of September 30, 2004) was paid. In September 2004, the agreement was amended to increase the amount available under the facility by EUR 4.3 million (\$5.3 million as of September 30, 2004). The amount outstanding is payable in 10 equal semi-annual installments starting on July 31, 2004. At September 30, 2004 and December 31, 2003, \$56.6 million and \$55.5 million were outstanding, respectively, under the credit facility. As of September 30, 2004, the available credit facility was \$1.3 million.

*AVAL Bank*

On December 31, 2003, UMC had the balance of \$10.9 million of overdraft with AVAL Bank. The short-term overdraft facility was limited to 110.0 million hryvnias (\$20.6 million at December 31, 2003), bore interest at 10-16% per annum and matured on June 30, 2004. The balance of overdraft was fully repaid in January 2004.

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*International Moscow Bank*

On June 9, 2003, Kuban-GSM entered into a 350.0 million ruble (\$12.0 million at September 30, 2004) credit facility with International Moscow Bank. Amounts borrowed under this facility matured in June 2005 and had an interest rate of 13.4% per annum, and were collateralized by equipment with a book value of 458.1 million rubles (approximately \$15.7 million at September 30, 2004). As of December 31, 2003, approximately \$10.9 million was outstanding under this facility. The loan was fully repaid by March 31, 2004. As of September 30, 2004, the available credit facility was 350.0 million ruble (\$12.0 million).

*Moscow Bank of Reconstruction and Development (MBRD)*

In August 2004, Novitel entered into ruble-denominated credit facility with MBRD, a related party. The facility allows borrowings of up to 60.0 million rubles (approximately \$2.1 million at September 30, 2004). The amount outstanding under the agreement bears interest at 15% per annum and are collateralized by equipment with a book value of 63.0 million rubles (approximately \$2.2 million at September 30, 2004). Facility matures in December 2004. As of September 30, 2004, the amount payable under this agreement was \$0.2 million, and available balance was \$1.9 million.

In 2003, Dontelecom entered into a ruble-denominated loan agreement with MBRD, a related party. The amounts borrowed bear interest at 18.5% and are payable in June 2004. As of December 31, 2003, \$1.2 million was outstanding under the facility. The loan was fully repaid by June 2004.

In 2003, MTS OJSC signed several short-term loan agreements with MBRD. Amounts borrowed were payable during the period of one to two months. Interest expense on these loans in 2003 was approximately \$0.3 million.

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

Payments due in the year ended September 30,	
2005 .....	\$ 375,520
2006 .....	60,847
2007 .....	219,266
2008 .....	412,573
2009 .....	6,329
Thereafter .....	400,000
	<u>\$1,474,535</u>

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**7. 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 September 30, 2004:

Payments due in the year ended September 30,	
2005 .....	\$10,226
2006 .....	4,610
2007 .....	1,048
2008 .....	67
2009 .....	66
Thereafter .....	<u>262</u>
Total minimum lease payments (undiscounted) .....	16,279
Less amount representing interest .....	<u>(3,565)</u>
Present value of net minimum lease payments .....	12,714
Less current portion of lease payable .....	<u>(7,653)</u>
Non-current portion of lease payable .....	<u>\$ 5,061</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 September 30, 2004, see Note 8 "Related Parties".

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**8. RELATED PARTIES**

Related party accounts receivable and payable balances as of September 30, 2004 and December 31, 2003 comprised of the following:

	September 30, 2004	December 31, 2003
<b>Accounts receivable:</b>		
Maxima, for advertising . . . . .	\$14,318	\$ 83
MTS-Komi Republic . . . . .	4,990	144
MTS-Tver . . . . .	4,093	436
T-Mobile for roaming . . . . .	1,611	853
MTT for interconnection . . . . .	1,065	822
Other . . . . .	2,806	1,923
Total accounts receivable, related parties . . . . .	<u>\$28,883</u>	<u>\$ 4,261</u>
<b>Accounts payable:</b>		
Cetel B.V. for UMC shares . . . . .	\$ —	\$27,500
T-Mobile for roaming . . . . .	1,164	—
MTT for interconnection . . . . .	4,179	1,825
MGTS for interconnection . . . . .	1,791	704
MTU-Inform for interconnection . . . . .	2,405	2,398
Other . . . . .	2,391	1,302
Total accounts payable, related parties . . . . .	<u>\$11,930</u>	<u>\$33,729</u>

Transactions with major related parties are described below.

*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 September 30, 2004, MTS' cash position at MBRD amounted to \$100.3 million including \$81.1 million in time deposits and \$19.2 million in current accounts.

As of December 31, 2003, MTS' cash position at MBRD amounted to \$279.7 million including \$265.2 million in time deposits and \$14.5 million in current accounts. The related interest accrued and collected on the deposits for nine months ended September 30, 2004 and 2003, amounted to \$5.9 million and \$2.4 million, respectively, and was included as a component of interest income in the accompanying consolidated statements of operations.

Borrowing transactions with MBRD are described in Note 6 "Debt".

*Rosno OJSC*

MTS arranged medical insurance for its employees and insured its property in the amounts of approximately \$993.3 million and \$784.7 million for the nine months ended September 30, 2004 and 2003, respectively, with Rosno OJSC, whose significant shareholder is Sistema. Insurance premiums



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paid to Rosno OJSC for nine months ended September 30, 2004 and 2003, amounted to \$5.2 million and \$5.3 million, respectively. Management believes that all of the insurance contracts with Rosno OJSC have been entered at market terms.

*Maxima Advertising Agency (Maxima)*

In 2004 and 2003, MTS had agreements for advertising services with Maxima, a subsidiary of Sistema. Advertising fees paid to Maxima for nine months ended September 30, 2004 and 2003 were \$50.9 million and \$20.7 million, respectively. Management believes that these agreements are at market terms.

*Telmos*

In 2004, 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 nine months ended September 30, 2004 and 2003 were approximately \$1.3 million and \$1.4 million, respectively. Management believes that these arrangements are at market terms.

*Moscow City Telephone Network (MGTS)*

In 2004 and 2003, 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 nine months ended September 30, 2004 and 2003 were approximately \$4.6 million and \$3.6 million, respectively. Management believes that all these transactions were made at market terms. Sistema is the majority shareholder of MGTS.

*MTU-Inform*

In 2004 and 2003, MTS had interconnection and line rental agreements with MTU-Inform, a subsidiary of Sistema. Amounts paid under these agreements for nine months ended September 30, 2004 and 2003 were approximately \$21.4 million and 24.2 million, respectively. In 2003, MTS also purchased telephone numbering capacity from MTU-Inform. Payments under these agreements for the nine months ended September 30, 2004 and 2003, amounted to \$nil and \$0.5 million, respectively. Management believes that these agreements are at market terms.

*Comstar*

In 2004 and 2003, MTS had interconnection and line rental agreements with Comstar, a subsidiary of Sistema. Amounts paid under these agreements for nine months ended September 30, 2004 and 2003 amounted to approximately \$2.6 million and \$3.5 million, respectively. Management believes that these agreements are at market terms.

*T-Mobile*

In 2004 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

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\$2.1 million and \$1.1 million for the nine months ended September 30, 2004 and 2003, respectively. Management believes that these agreements are at market terms.

*MTT*

In 2004, MTS had interconnection and line rental agreements with MTT, a subsidiary of Sistema, acquired in September 2004. Amounts paid under these agreements for nine months ended September 30, 2004 were approximately \$15.0 million.

*Invest-Svyaz-Holding*

In 2004 and 2003, MTS entered into agreements with Invest-Svyaz-Holding, a shareholder of MTS and a wholly-owned subsidiary of Sistema, for leasing of network equipment and billing system. These leases were recorded as capital leases in compliance with requirements of SFAS No. 13, "Accounting for Leases." The present value of future lease payments 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 14% 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 September 30, 2004:

Payments due in the nine months ended September 30,	
2005 .....	\$ 8,584
2006 .....	4,469
2007 .....	<u>979</u>
Total minimum lease payments (undiscounted) .....	14,032
Less amount representing interest .....	<u>(3,204)</u>
Present value of net minimum lease payments .....	10,828
Less current portion of lease obligations .....	<u>(6,001)</u>
Non-current portion of lease obligations .....	<u>\$ 4,827</u>

For the nine months ended September 30, 2004 and 2003, principal and interest paid to Invest-Svyaz-Holding were \$8.4 million and \$5.3 million, respectively.

In addition to the above lease transactions, the Group guarantees debt of Invest-Svyaz-Holding in the amount of \$21.6 million to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to the Group.

*Strom Telecom*

During 2004 and 2003, the Group entered into a number of agreements with Strom Telecom, a subsidiary of Sistema for a total amount up to \$80.8 million and \$32.3 million, respectively. Pursuant to these contracts, the Group purchased during the nine months ended September 30, 2004 and 2003,

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respectively, billing systems and communication software support systems for approximately \$9.1 and \$18.2 million.

**9. COMMITMENTS AND CONTINGENCIES**

**Capital Commitments**—As of September 30, 2004, the Group had executed non-binding purchase agreements in the amount of approximately \$331.0 million to subsequently acquire property, plant and equipment.

**Operating lease**—The Group has entered into lease agreements of space for telecommunication equipment and offices, which expire in various years up to 2053. Rental expenses under these operating leases of \$35.0 million for the nine months ended September 30, 2004 are included in operating expenses in the accompanying statements of operations. Future minimum lease payments due under non-cancelable leases at September 30, 2004 are as follows:

Payments due in the 12 months ended September 30,	
2005 .....	\$33,923
2006 .....	15,809
2007 .....	12,332
2008 .....	8,975
2009 .....	7,005
Thereafter .....	<u>21,436</u>
Total .....	<u>\$99,480</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's licenses received prior to 2002 contained a clause on fees to be made to finance telecommunication infrastructure improvements, which in the aggregate could total approximately \$103.6 million, as of September 30, 2004 and December 31, 2003. However, a decision on the terms and conditions of such payments has not been finalized. Accordingly, MTS has not made any payments to date pursuant to any of current operating licenses. Further, management believes that MTS will not be required to make any such payments. If such payments would be required in the future, management believes that it would be limited to purchasing certain equipment for its own use in the related license area. In relation to these uncertainties, MTS has not recorded any liabilities in the accompanying financial statements.

**Provision for doubtful accounts**—In 2003, MTS incurred a loss of \$16.7 million due to dealers and subscriber fraud. In March 2003, the Group's management took measures to prevent further fraud of that nature. No significant losses from the dealers' fraud were incurred during nine months ended September 30, 2004.

**Issued guarantees**—As of September 30, 2004, the Group has issued guarantees to third party banks for the loans taken by Invest-Svyaz-Holding, a shareholder of the Group for a total amount of \$21.6 millions (see also Note 8 "Related Parties"). The Group issued additional guarantees on behalf of MTS-Belarus, an equity investee, for the total amount of \$25.0 million. Under these guarantees the

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Group could be potentially liable for a maximum amount of \$46.6 million in case of the borrower's default under the obligations. The guarantees expire by April 2007.

As of September 30, 2004, no event of default has occurred under any of the guarantees issued by the Group.

*Contingencies*—The Russian economy, while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of an emerging market. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be subject to the government's continued actions with regard to supervisory, legal, and economic reforms.

On January 1, 2004, a new Law on telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. The Group cannot predict with any certainty how the new law will affect MTS. The new law creates a new interconnect pricing regime in 2004 that should be more transparent and unified and it creates a universal service charge calculated as a percentage of revenue which will be introduced from 2005. The new law may increase the regulation of the MTS' operations and until the time when appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax ("VAT"), corporate income tax (profits tax), a number of turnover-based taxes, and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that are more significant than typically found in countries with more developed tax systems.

In recent years, the Russian government has initiated revisions of the Russian tax system. Effective January 1, 1999, the first part of the Tax Code was enacted. Effective January 1, 2001, the second part of the Tax Code was enacted and effective January 1, 2002 new regulations, relating to federal income tax were enacted. The new tax system is generally intended to reduce the number of taxes, the overall tax burden on businesses, and to simplify the tax laws.

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of September 30, 2004, tax declarations of the Group for the preceding three fiscal years were open to further review.

In the ordinary course of business, MTS may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which MTS operates. In the opinion of management, the MTS's liability, if any, in all

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (UNAUDITED)**

**(Amounts in thousands of U.S. dollars,  
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pending litigation, other legal proceeding or other matters, will not have a material effect upon the financial condition, results of operations or liquidity of MTS.

Management believes that it has adequately provided for tax liabilities in the accompanying condensed 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.

**UMC**—On June 7, 2004, the General Prosecutor of Ukraine filed a claim against MTS and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to MTS. The complaint also seeks an order that would prohibit MTS from alienating 51% of its stake in UMC until the claim is resolved.

On August 12, 2004, the Kiev Commercial Court rejected a claim of General Prosecutor of Ukraine against MTS. No appeal was filed to the Court by the office of General Prosecutor of Ukraine within an established period. As of the date of these statements an office of General Prosecutor of Ukraine filed a request to the Constitutional Court of Ukraine to clear out terms of the State Privatization Plan for 2000-2002 and respond whether Ukrtelecom had a right to sell 51% stake in UMC.

MTS believes that it acquired this stake in UMC in full compliance with Ukrainian law and, if required, intends to vigorously defend its acquisition of UMC.

**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.

Intercompany eliminations presented below consist primarily of the following items: intercompany sales transactions, elimination of gross margin in inventory and other intercompany transactions conducted under the normal course of operations.

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (UNAUDITED)**

(Amounts in thousands of U.S. dollars,  
except share and per share amounts or if otherwise stated)

At September 30, 2004, the Group has several operating segments, of which three are reportable segments—MTS OJSC, UMC and Telecom XXI.

	Nine months ended September 30,	
	2004	2003
<b>Net operating revenue:</b>		
MTS OJSC . . . . .	\$1,544,845	\$1,065,798
UMC <sup>(1)</sup> . . . . .	586,445	251,549
Telecom XXI . . . . .	219,799	147,498
Other regions . . . . .	723,826	402,654
Intercompany eliminations . . . . .	(267,577)	(93,002)
Total net operating revenue . . . . .	<u>\$2,807,338</u>	<u>\$1,774,497</u>
<b>Depreciation and amortization:</b>		
MTS OJSC . . . . .	\$ 178,003	\$ 140,541
UMC <sup>(1)</sup> . . . . .	82,221	45,437
Telecom XXI . . . . .	35,143	25,669
Other regions . . . . .	157,670	78,101
Intercompany eliminations . . . . .	(2,295)	(1,636)
Total depreciation and amortization . . . . .	<u>\$ 450,742</u>	<u>\$ 288,112</u>
<b>Operating income:</b>		
MTS OJSC . . . . .	\$ 579,715	\$ 381,300
UMC <sup>(1)</sup> . . . . .	245,762	85,478
Telecom XXI . . . . .	90,303	55,935
Other regions . . . . .	236,684	136,568
Intercompany eliminations . . . . .	(6,281)	(9,458)
Total operating income . . . . .	<u>\$1,146,183</u>	<u>\$ 649,823</u>
Total operating income . . . . .	\$1,146,183	\$ 649,823
Foreign currency exchange gains . . . . .	(2,647)	(4,841)
Interest income . . . . .	(18,577)	(11,743)
Interest expense . . . . .	78,828	70,013
Other (income)/expenses . . . . .	(22,006)	12,251
Income before provision for income taxes and minority interest . . . . .	<u>\$1,110,585</u>	<u>\$ 584,143</u>



**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (UNAUDITED)**

(Amounts in thousands of U.S. dollars,  
except share and per share amounts or if otherwise stated)

	September 30, 2004	December 31, 2003
<b>Total assets:</b>		
MTS OJSC .....	\$3,532,791	\$3,245,545
UMC <sup>(1)</sup> .....	570,909	394,470
Telecom XXI .....	293,410	296,042
Other regions .....	836,071	558,091
Intercompany eliminations .....	(367,483)	(268,797)
Total assets .....	<u>\$4,865,698</u>	<u>\$4,225,351</u>

<sup>(1)</sup> Acquired in March 2003.

The Group's total revenue from external customers, earned outside of RF (in the Ukraine and Uzbekistan) amounted to \$588.9 and \$247.9 for the nine months ended September 30, 2004 and 2003, respectively. The Group's total long-lived assets located outside of RF (in the Ukraine and Uzbekistan) amounted to \$895.2 and \$554.1 as of September 30, 2004 and December 31, 2003, respectively.

## **11. SUBSEQUENT EVENTS**

### ***Acquisitions***

In November 2004, MTS won a government tender to acquire 76% stake in Gorizont RT, a cellular operator in the Republic of Saha (Yakutia) in the Far-East region of Russia, for a cash consideration of \$52.2 million. Gorizont RT is the sole mobile services provider in the region with a population of 949.3 thousands. The company's subscriber base is approximately 100 thousands people.

In November 2004, MTS signed an agreement to acquire from MCT Corp. a 93.5% stake in Sibintertelecom, mobile phone operator in the Chita region and Aginsk-Buryatsk Autonomous District in the Far-East region of Russia, for a cash consideration of \$37.3 million. Sibintertelecom is the sole mobile services provider in two regions with a total population of 1.23 million. The company's subscriber base is approximately 100 thousands people.

In December 2004, MTS signed an agreement to acquire from OJSC UTK a 52.5% stake in Telesot-Alania, mobile phone operator in the Republic of North Ossetia in the Southern part of Russia, for a cash consideration of \$6.2 million. Telesot-Alania is the mobile services provider in the region with a total population of 710 thousands. The company's subscriber base is approximately 54 thousands people.

The purchase price allocation for these acquisitions has not been finalized at the date of these statements.

***New credit facilities***—In October 2004, MTS obtained two committed credit facilities in an aggregate amount of approximately \$121.0 million to finance further expansion of the Group's network. These funds will be used to purchase telecommunication equipment and software from Siemens AG and Alcatel SEL AG for the technical upgrade and expansion of the network. The arrangers and lenders of the credit facility are HSBC Bank plc and ING BHF-BANK AG. Euler Hermes Kreditversicherungs-AG, the German credit export agency, is providing export credit cover in respect to

**OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**FOR THE NINE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003 (UNAUDITED)**

**(Amounts in thousands of U.S. dollars,  
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both facilities. The facilities mature in approximately 9 years and have cost of financing of LIBOR + 0.425% (effective rate 2.65% for October 2004) per annum.

**EBRD loan**—In December 2004, we signed an agreement with EBRD for \$150.0 million loan. The loan has a term of 7 years repayable from December 15, 2005 on a biannual basis in equal installments. Interest rate is LIBOR + 3.1% per annum (effective rate 5.81% as of December 15, 2004). The proceeds of the loan will be used by MTS to finance regional expansion in Russia.

**ABN AMRO loan**—In November 2004, MTS signed a loan agreement with ABN AMRO Bank N.V. (Stockholm branch) for \$56.6 million and EUR 8.4 million. These funds will be used to purchase telecommunication equipment from Ericsson AB for expansion of the network. The loan is payable on a biannual basis in equal installments over 9 years and has an interest rate of LIBOR/EURIBOR + 0.35% per annum (effective rate 2.76/2.52% for November 2004).

**Credit Suisse First Boston (“CSFB”) loan**—In October 2004 MTS Finance signed a loan agreement with CSFB (London branch) for \$140.0 million loan facility. These funds will be used for general corporate purposes. The loan is payable in two instalments of \$70 million each due in three and six months after the draw date *i.e.*, in January and April 2005, respectively. Loan bears an interest rate at LIBOR plus 2.20% (4.44% at September 30, 2004). The loan is fully and unconditionally guaranteed by OJSC MTS.

**Reorganization of MTS OJSC in the form of merger**—In November 2004, the extraordinary general meeting of MTS OJSC shareholders approved a reorganization of MTS OJSC in the form of merger of Telecom XXI, Kuban-GSM, UDN-900, Dontelecom, MTS Barnaul, MTS-NN and Telecom-900.

**Interest rate swap agreements**—In December 2004, MTS signed two interest rate swap agreements with ABN AMRO Bank N.V and with HSBC Bank PLC. MTS agreed with ABN AMRO to pay a fixed rate of 3.27% and receive a variable interest of LIBOR on \$100.0 million for the period from October 7, 2004 up to July 27, 2007. MTS agreed with HSBC Bank PLC to pay a fixed rate of 3.25% and receive a variable interest of LIBOR on \$150.0 million for the period from October 7, 2004 up to July 27, 2007. These instruments are used to hedge MTS’ exposure to variability of future cash flows caused by the change in LIBOR related to the syndicated loan described in Note 6.

**ADS Ratio Change**—In December 2004, the Group announced that it will be changing its current ADS ratio effective January 3, 2005, the first trading day in 2005. The ratio will change from the current 1 ADS per 20 ordinary shares to 1 ADS per 5 ordinary shares, a 1:4 ADS split.

**Change in ownership structure**—In December 2004 our shareholder—T-Mobile Worldwide Holding GMBH sold 15.09% stake in MTS on the open market in form of GDRs.

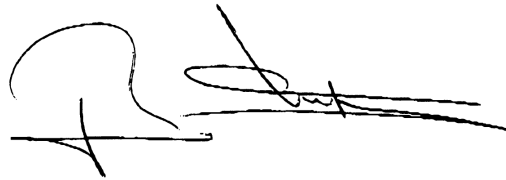
## REPORT OF THE STATUTORY AUDITOR

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, 2003 and 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, 2003 and 2002, showing a balance sheet total of USD 1,433,849,483 and of USD 304.128.212, respectively, and a 2003 and a 2002 year's profit of USD 509.402 and USD 134.883, respectively, 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, May 18, 2004

A handwritten signature in black ink, consisting of a large, stylized 'F' followed by a horizontal line and a small flourish.

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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, 2003 and 2002**  
**(Amounts in U.S. dollars, except share and per share amounts)**

	<u>December 31,</u> <u>2003</u>	<u>December 31,</u> <u>2002</u>
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents . . . . .	\$ 1,960,567	\$ 815,156
Other current assets (Note 4) . . . . .	27,149,465	964,033
<b>Total current assets</b> . . . . .	<u>29,110,032</u>	<u>1,779,189</u>
<b>DEBT ISSUANCE COSTS</b> (Note 3) . . . . .	7,739,451	2,349,023
<b>RECEIVABLES FROM RELATED PARTIES</b> (Note 5) . . . . .	1,397,000,000	300,000,000
<b>TOTAL ASSETS</b> . . . . .	<u>\$1,433,849,483</u>	<u>\$ 304,128,212</u>
<b>CURRENT LIABILITIES:</b>		
Taxes payable . . . . .	\$ 323,000	\$ 105,109
Accounts payable . . . . .	291,501	389,031
Accrued liabilities (Note 6) . . . . .	26,411,427	913,002
Notes payable, current portion (Note 8) . . . . .	597,835,183	—
Deferred income, current portion (Note 7) . . . . .	3,721,354	1,598,034
<b>Total current liabilities</b> . . . . .	<u>628,582,465</u>	<u>3,005,176</u>
<b>NOTES PAYABLE, NET OF CURRENT PORTION</b> (Note 8) . . . . .	800,000,000	299,304,065
<b>DEFERRED INCOME</b> , net of current portion (Note 7) . . . . .	4,497,733	1,559,088
<b>COMMITMENTS AND CONTINGENCIES</b> (Note 12)		
<b>SHAREHOLDERS' EQUITY:</b>		
Common stock (1,000 shares with a par value of \$125 authorized, issued and outstanding) (Note 9) . . . . .	125,000	125,000
Legal reserve . . . . .	6,744	
Retained earnings . . . . .	128,139	
Results for the period . . . . .	509,402	134,883
<b>Total shareholders' equity</b> . . . . .	<u>769,285</u>	<u>259,883</u>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b> . . . . .	<u>\$1,433,849,483</u>	<u>\$ 304,128,212</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 YEAR ENDED DECEMBER 31, 2003 AND**  
**FOR THE PERIOD FROM DECEMBER 10, 2001 (DATE OF INCORPORATION)**  
**TO DECEMBER 31, 2002**  
**(Amounts in U.S. dollars)**

	<u>2003</u>	<u>2002</u>
<b>OPERATING EXPENSES</b> . . . . .	\$ —	\$ 148,000
<b>Operating loss</b> . . . . .		(148,000)
Interest income (Note 10) . . . . .	86,451,373	34,308,054
Interest expense (Note 11) . . . . .	(85,723,971)	(33,967,094)
<b>Income before provision for income taxes</b> . . . . .	<u>727,402</u>	<u>192,960</u>
<b>PROVISION FOR INCOME TAXES</b> . . . . .	(213,000)	(58,077)
<b>PROVISION FOR OTHER TAXES</b> . . . . .	(5,000)	
<b>NET INCOME</b> . . . . .	<u>\$ 509,402</u>	<u>\$ 134,883</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, 2003 and 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***

At December 31, 2003, the fair value of the notes payable (see Note 5), calculated based on quoted market prices was approximately \$1,474 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, 2003 and 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, 2003 and 2002, debt issuance costs are comprised of commissions and fees incurred related to the issue of the notes payable amounting to \$7,739,451 and \$2,349,023 after amortization of \$3,365,654 and \$1,086,016, respectively.

**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 current assets as of December 31, 2003 and 2002 include accrued interest related to the loan receivable from MTS OJSC (see Note 5) of \$27,102,432 and \$917,000, respectively, and deferred tax assets for the amount of \$47,033 and 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, 2003 and 2002 are comprised of loans to MTS OJSC for the amounts of \$1,397 million and 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.

On January 30, 2003 the Company entered into a \$400 million loan agreement with MTS OJSC that bears interest at the rate of 9.84%, payable semi-annually in arrears. The loan matures on January 29, 2008.

On August 5, 2003, the Company entered into a \$297 million loan agreement with MTS OJSC that bears interest at LIBOR plus 5.095% payable quarterly in arrears. The loan matures on August 4, 2004.

On October 15, 2003, the Company entered into a \$400 million loan agreement with MTS OJSC that bears interest at 8.47% payable semi-annually in arrears. The loan matures on October 14, 2008.

Accrued interest on these loans at December 31, 2003 and 2002 amounted to \$27,102,432 and \$917,000, respectively.

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. For the year ended December 31, 2003 the Company received interest payments under these loan agreements of \$57,450,000.

**6. ACCRUED LIABILITIES**

As of December 31, 2003 and 2002, accrued liabilities are comprised of accrued interest on notes payable of \$26,411,427 and of \$913,002, respectively.

**7. DEFERRED INCOME**

In 2003 and 2002 The Company charged \$7,800,000 and \$4,800,000, respectively, to MTS OJSC to reimburse the debt issuance costs and issue discount incurred in originating the loans 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, 2003 and 2002 the balance on this account is \$8,219,087 and \$3,157,122, respectively, net of accumulated amortization of \$4,380,913 and \$1,642,878, respectively.

**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)**

**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. 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 Luxembourg Stock Exchange. In May 2002, these notes were registered with the U.S. Securities and Exchange Commission 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 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.

On January 30, 2003, the Company issued \$400.0 million 9.75% notes at par. Related debt issuance costs in the amount of \$3,400,000 were capitalized. 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% (5.15% on December 31, 2003) with a 1.0% discount. The cash proceeds, net of issuance costs of approximately \$1.0 million, amounted to \$296.0 million. Related debt issuance costs in the amount of \$950,000 were capitalized. 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 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.

On October 14, 2003, the Company issued \$400.0 million notes bearing interest at 8.375% at par. Related debt issuance costs in the amount of \$3,320,000 were capitalized. The cash proceeds, net of issuance costs of approximately \$3.3 million, amounted to \$396.7 million. These notes are fully and unconditionally guaranteed by MTS OJSC and will mature on October 14, 2010. The Company is required to make interest payments on the notes semi-annually in arrears on April 14 and October 14 of each year, commencing on April 14, 2004. The notes are listed on the Luxembourg Stock Exchange.

**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.

**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)**

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, 2003 was \$6,744.

**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).

For the year ended December 31, 2003, interest income comprises of \$83,635,432, of interest income from MTS OJSC (see Note 5); interest income on bank deposits of \$77,906, \$2,738,035, 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.

For the year ended December 31, 2003 interest expense comprised of \$81,791,510, of interest expense, related to notes payable (see Note 8), \$3,810,326, relating to the amortization of debt issuance costs and debt issue discount and premium (see Notes 3 and 8), and \$122,135, 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, 2003 and 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 March 15, 2004 the Board of Directors of MTS OJSC approved the redemption of all of the outstanding \$300.0 million floating rate Notes, issued on August 5, 2003. The Notes will be redeemed on May 5, 2004, at 100% of their principal amount, plus accrued interest thereon to the date of redemption.

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# **Mobile TeleSystems Finance S.A.**

**\$400,000,000**

**8.00% notes due 2012**

**Guaranteed by Mobile TeleSystems OJSC**

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## **OFFERING MEMORANDUM**

January 27, 2005

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*Joint Lead Managers*

**Credit Suisse First Boston**

**Goldman Sachs International**

*Co-Managers*

**CITIGROUP**

**HSBC**

**Commerzbank Corporates & Markets**

**ING Financial Markets**

**Barclays Capital**

**Bank Austria**