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

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

### Overview

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

Our revenues for the nine months ended September 30, 2004 increased by 58.5% to $4,135.9 million, compared with $2,608.6 million in the nine months ended September 30, 2003. We have increased our revenues through organic growth, as well as through acquisitions. Net income from continuing operations before cumulative effect of accounting changes in the nine months ended September 30, 2004 increased by 158.6% to $372.2 million, compared with $143.9 million in the nine months ended September 30, 2003.

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

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

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

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

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

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

**Macroeconomic Factors Affecting Our Results of Operations**

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

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

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

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

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

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

**Acquisitions and Divestitures**

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

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

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

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

(1) Excluding acquisition-related costs.

### Recent Acquisitions

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

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

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

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

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

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

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

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

**Consolidation of MTS**

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

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

**Other Acquisitions**

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

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

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

In addition, during the periods under review we acquired controlling and non-controlling stakes in several small regional companies. Moreover, we increased our shareholdings in several subsidiaries by acquiring stakes from minority shareholders and related parties.

**Divestitures**

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

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

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

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

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

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

## Consolidated Financial Results Overview

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

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

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

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

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

**Revenues by segment:**

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

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

[2] Eliminations of inter-segment revenue.

**Operating income by segment:**

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

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

[2] Eliminations of inter-segment operating income.

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

***Revenues***

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

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

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

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

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

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

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

***Operating costs***

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

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

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

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

***Operating income***

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

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

***Interest***

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

***Income tax***

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

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

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

***Minority interests***

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

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

***Revenues***

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

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

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

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

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

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

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

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

***Operating costs***

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

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

***Income from equity investees***

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

***Operating income***

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

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

***Interest***

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

***Income tax***

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

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

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

***Minority interests***

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

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

***Revenues***

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

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

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

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

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

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

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

***Operating costs***

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

***Income from equity investees***

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

***Net gain/loss on disposal of subsidiaries***

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

***Operating income***

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

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

### *Interest*

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

### *Income tax*

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

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

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

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

### *Minority interests*

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

## Segment Financial Results Overview

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

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

### Telecommunications

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

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

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

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

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

*Revenues*

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

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

*Wireless services*

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

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

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

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

*Fixed line communications*

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

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

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

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

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

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

*Operating income*

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

*Wireless services*

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

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

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

*Fixed line communications*

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

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

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

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

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

*Income from equity investees*

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

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

*Revenues*

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

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

*Wireless services*

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

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

*Fixed line communications*

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

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

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

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

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

*Income from equity investees*

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

*Operating income*

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

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

*Wireless services*

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

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

*Fixed line communications*

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

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

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

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

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

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

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

*Revenues*

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

*Wireless services*

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

*Fixed line communications*

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

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

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

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

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

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

*Income from equity investees*

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

*Operating income*

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

*Wireless services*

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

*Fixed line communications*

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

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

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

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

**Technology**

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

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

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

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

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

*Revenues*

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

*Operating income*

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

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

*Revenues*

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

*Operating income*

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

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

*Revenues*

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

*Operating income/(loss)*

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

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

**Insurance**

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

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

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

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

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

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

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

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

*Revenues*

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

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

*Operating income*

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

*Total assets*

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

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

*Revenues*

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

*Operating income*

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

*Total assets*

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

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

*Revenues*

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

*Operating income*

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

*Total assets*

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

**Banking**

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

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

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

(1) Includes interest expense on deposits.

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

*Revenues*

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

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

*Operating income*

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

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

*Income from equity investees*

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

*Total assets*

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

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

*Revenues*

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

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

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

*Income from equity investees*

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

*Operating income*

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

*Total assets*

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

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

*Revenues*

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

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

*Income from equity investees*

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

*Operating income*

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

*Total assets*

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

**Other Businesses**

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

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

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

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

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

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

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

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

*Revenues*

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

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

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

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

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

*Operating loss*

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

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

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

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

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

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

*Revenues*

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

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

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

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

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

*Operating loss*

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

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

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

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

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

*Revenues*

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

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

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

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

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

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

*Operating income/(loss)*

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

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

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

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

**Telecommunications Operating Data**

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

**MTS**

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

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

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

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

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

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

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

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

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

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

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

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

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

**MGTS**

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

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

(1) Includes value added tax.

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

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

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

### Comstar UTS

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

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

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

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

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

### Liquidity and Capital Resources

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

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

**Working capital**

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

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

**Credit Ratings**

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

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

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

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

**Capital Requirements**

We need funding to finance the following:

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

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

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

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

**Capital Resources**

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

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

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

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

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

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

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

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

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

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

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

**Competition**

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

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

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

**Market risks**

**Foreign Currency Risk**

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

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

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

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

### Inflation and Exchange Rates

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

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

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

### Interest Rate Risk

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

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

Contractual Maturity Dates as of September 30, 2004:

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

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

**Critical accounting policies**

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

### Consolidation of variable interest entities

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

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

### Revenue recognition

#### *Telecommunications*

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

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

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

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

*Technology*

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

*Insurance*

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

*Banking*

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

*Other businesses*

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

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

**Management estimates**

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

**License Costs and Other Intangible Assets**

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

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

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

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

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

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

**Impairment of Long-Lived Assets**

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

### Translation Methodology

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

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

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

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

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

## Taxation

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

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

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

**Income taxes**

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

**Value-added tax**

During the years ended December 31, 2001, 2002 and 2003 the VAT rate in Russia was 20%. Effective January 1, 2004, it decreased to 18%.

**New accounting pronouncements**

In December 2004, the Financial Accounting Standards Board ("FASB") issued FAS No. 123R, "Share-Based Payment" ("FAS No. 123R"), a revision of FAS No. 123, "Accounting for Stock-Based Compensation." FAS No. 123R supersedes Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and requires all entities to recognize compensation cost in an amount equal to the fair value of share-based payments granted to employees. That cost will be recognized over the period during which an employee is required to provide service in exchange for an award of equity instruments. FAS No. 123R is effective for interim periods beginning after June 15, 2005, at which time companies can select whether they will apply the standard retroactively by restating their historical financial statements or prospectively for new stock-based compensation arrangements and the unvested portion of existing arrangements. We do not anticipate the adoption of FAS No. 123R will have a material impact on our financial position, cash flows and results of operations.

In December 2004, the FASB issued FAS No. 153, "Exchanges of Nonmonetary Assets," an amendment of APB Opinion No. 29, "Accounting for Nonmonetary Transactions." FAS No. 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets set in the APB Opinion No. 29 and replaces it with a general exception for exchanges that do not have commercial substance. FAS No. 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. FAS No. 153 is effective prospectively for nonmonetary exchanges occurring after June 15, 2005. We do not anticipate the adoption of FAS No. 153 to have a material impact on our results of operations or financial position.

In November 2004, the FASB issued FAS No. 151, "Inventory Costs," an amendment of ARB No. 43, Chapter 4. FAS No. 151 clarifies that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on the normal capacity of the production facility. FAS No. 151 is effective prospectively for inventory costs incurred during fiscal years beginning after June 15, 2005. We do not anticipate the adoption of FAS No. 151 to have a material impact on our results of operations or financial position.

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

In November 2003, the EITF reached a final consensus on Issue No. 03-10, "Application of EITF Issue No. 02-16, "Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor, by Resellers to Sales Incentives Offered to Consumers by Manufacturers." A consensus was reached that consideration received by a reseller from the vendor in exchange for vendor sales incentives tendered by consumers should not be reported as a reduction of the cost of the reseller's purchases from the vendor but instead should be shown as revenue. EITF Issue No. 03-10 is effective for reporting periods beginning after November 25, 2003. The adoption of Issue No. 03-10 did not have a material impact on our results of operations or financial position.

In March 2004, the EITF reached a consensus on Issue No. 03-6, "Participating Securities and the Two-Class Method under FASB Statement No. 128, Earnings per Share." This Issue defines participating security and clarifies some practical issues related to including participating securities in the calculation of EPS. EITF Issue No. 03-6 is effective for reporting periods beginning after March 31, 2004. The adoption of Issue No. 03-6 did not have a material impact on our financial position or results of operations.

In September 2004, the SEC staff issued the EITF Topic D-108, Use of the Residual Method to Value Acquired Assets Other Than Goodwill," which requires the companies to use the direct value method to determine the fair value of their intangible assets acquired in business combinations completed after September 29, 2004.

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

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

In October 2004, the EITF reached a consensus on EITF Issue No. 04-10, "Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds." EITF Issue

No. 04-10 provided additional guidance on when operating segments that are below the 10% threshold can be aggregated. EITF Issue No. 04-10 states that segments can only be aggregated if they have similar economic characteristics and if they are similar in areas such as similar production processes, types of customers, distribution channels and the products themselves are similar. The consensus reached by EITF Issue No. 04-10 is effective for fiscal years ending after October 13, 2004. We are currently considering the impact of this pronouncement on our financial statement disclosures.

**Income from equity investees**

Our share in net assets and net income of certain entities, in which we hold 20% to 50% of the share capital and have the ability to exercise significant influence over the operations and financial policies, is included in our financial accounts using the equity method. Where we are active in day-to-day management of our equity investees and their businesses are considered core assets, we include income from equity investees in the determination of operating income.

**Off-balance sheet arrangements**

**Obligations under guarantee contracts**

In December 2002, MTU-Inform and Alfabank signed a guarantee agreement. According to the agreement, MTU-Inform guaranteed a loan of $4.0 million provided to Golden Line by Alfabank. The loan matures in November, 2005. In addition, MTU-Inform pledged equipment with a fair value of $4.7 million as security for the loan.

As of September 30, 2004, MTS has issued guarantees on behalf of MTS Belarus, an equity investee, for the total amount of $25.0 million. Under these guarantees, we could potentially be liable for a maximum amount of $46.6 million if MTS Belarus defaults on its obligations. The guarantees expire by April 2007.

Additionally, MBRD guaranteed loans for several companies, including related parties, which totaled $1.4 million as of September 30, 2004.

These guarantees would require payment by us only in the event of default on payment by the respective debtor. Under these guarantees, we could be potentially liable for a maximum amount of $49.9 million in the case of the borrower's default under the obligations. As of September 30, 2004, no event of default has occurred under any of the guarantees issued by us.

**Obligations under derivative contracts**

In October 2004, MTS exercised its call option in respect of 47.3% of common shares and 50% of preferred shares of TAIF Telcom, increasing our voting power in TAIF Telcom to 100%. The value of consideration equaled $63.0 million. TAIF Telcom provides GSM 900/1800 services under the MTS brand in the Republic of Tatarstan (population 3.8 million), located in the Volga region of Russia.

In connection with MTS' acquisition of 74% of the shares in Uzdunrobita in August 2004, it entered into call and put option agreements with the existing shareholders of the company to acquire the remaining 26% of the shares. The exercise period for the option is 48 months from the acquisition date. The call and put option agreements stipulate a minimum purchase price of $37.7 million plus 5% per annum commencing from the acquisition date. The fair value of the put option was approximately $3.6 million as of September 30, 2004.

### Tabular Disclosure of Contractual Obligations

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

| | October 1, 2004-September 30, 2005 | October 1, 2005-September 30, 2007 | October 1, 2007-September 30, 2009 | October 1, 2009-thereafter | Total |
|---|---|---|---|---|---|
| | | | (Amounts in thousands) | | |
| **Contractual obligations:** | | | | | |
| Notes payable | 538,393 | 639,293 | 948,453 | 433,600 | 2,559,739 |
| Bank loans | 140,358 | 393,025 | 39,998 | 27,052 | 600,433 |
| Capital lease | 4,937 | 2,284 | 133 | 262 | 7,616 |
| Operating leases and services agreements | 47,616 | 49,555 | 28,469 | 24,997 | 150,637 |
| **Committed Investments:** | | | | | |
| Purchases of property, plant and equipment | 331,000 | — | — | — | 331,000 |
| Construction contracts | 25,200 | — | — | — | 25,200 |
| Total | 1,087,504 | 1,084,157 | 1,017,053 | 485,911 | 3,674,625 |

In December 2003, MGTS announced its long-term investment program for the period from 2004 through 2012. The program was approved by a resolution of the Moscow City Government in December 2003 and provides for total capital expenditures of approximately $1.6 billion, including for the expansion and full digitalization of the Moscow telephone network, the reconstruction of 350 local telephone stations and the installation of 4.3 million new phone numbers. We expect to finance approximately 50% of the capital expenditures under the investment program.

### Recent Financing Activities

#### MTS Financings

In October 2004, MTS obtained two committed credit facilities in an aggregate amount of approximately $121.0 million to finance the technological upgrade and expansion of its network. The arrangers and lenders of the credit facility are HSBC Bank plc and ING BHF-BANK AG. Euler Hermes Kreditversicherungs-AG, the German credit export agency, is providing export credit cover in respect to both facilities. The facilities mature in approximately 9 years and have a cost of financing of LIBOR plus 1.9% per annum.

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

In December 2004, MTS signed an agreement with EBRD for a $150.0 million loan. The loan has a term of 7 years repayable starting from December 2005 on a biannual basis in equal installments. The interest rate is LIBOR plus 3.1%. The proceeds of the loan will be used by MTS to finance regional expansion in Russia.

In November 2004, MTS signed a loan agreement with ABN AMRO Bank N.V. (Stockholm branch) for $56.6 million and EUR 8.4 million. These funds will be used to purchase telecommunications equipment for the expansion of MTS' network. The loan is repayable on a biannual basis in equal installments over 9 years and has an interest rate of USD LIBOR/EURIBOR plus 0.35% per annum.

In January 2005, Mobile TeleSystems Finance S.A. issued $400.0 million in aggregate principal amount of notes. The notes bear interest at a rate of 8.0% per annum and mature in January 2012. The notes are guaranteed by MTS.