## 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, 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, 2003 and 2004, including the notes to those financial statements. In addition, this discussion contains forward-looking statements that involve risk and uncertainties. Our actual results may differ materially from those discussed in forward-looking statements as a result of various factors. Our reporting currency is the U.S. dollar and our consolidated financial statements have been prepared in accordance with U.S. GAAP.

### Overview

We are the largest private sector consumer services group of companies in Russia and the CIS. Our business is developing, managing and realizing the value of market-leading businesses in fast-growing service-based industries. 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). Given the scale, scope and market position of our existing operations, we are uniquely positioned to exploit the growth in consumer and corporate purchasing power in the countries in which we operate. Our consolidated revenues reached $5,711.3 million for the year ended December 31, 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 $446.7 million for the year ended December 31, 2004 as compared to $230.7 million for the year ended December 31, 2003.

Our revenues have increased through organic growth, as well as through acquisitions. Our major acquisitions during the years ended December 31, 2003 and 2004 included cellular operators in the CIS and various regions in Russia (UMC, TAIF Telcom, Sibchanllenge, TSS, Kuban-GSM, Primtelefon, Uzdunrobita), as well as the purchase of 10% share in MTS and of controlling stakes in fixed-line operator Comstar and Ukrainian hardware distributor and system integrator Kvazar-Micro. Revenue growth in existing businesses for the year ended December 31, 2004 was $1,536.5 million, or 41%. The consolidation of Kvazar-Micro, Primtelefon, Uzdunrobita and others in the year ended December 31, 2004 contributed a total of $414.9 million to the increase. The Telecommunications segment's share of the Group's revenues continued to decline, from 86% to 81% year on year, as the Group benefited from continued growth across its non-telecom businesses.

We require substantial funds to support our operations, primarily for increasing network capacity and developing networks in our Telecommunications segment. Our cash outlays for capital expenditures in 2004 and 2003 were $2,009.5 million (including $338.9 million paid for purchase of businesses) and $2,190.3 million (including $1,005.5 million paid for purchase of businesses), respectively. We have financed our cash requirements through our operating cash flows and borrowings. Net cash provided by operating activities in 2004 and 2003 was $1,904.1 million, and $986.4 million, respectively. Since 2002, we have raised over $2.5 billion through several U.S. dollar-denominated and rouble-denominated notes offerings in both international and Russian capital markets. We, together with our subsidiaries, have also attracted a number of bank loans to finance our operations. As of December 31, 2004, we had indebtedness of $3,064.9 million, including capital lease obligations, and our interest expense for the year ended December 31, 2004 was $213.9 million, net of amounts capitalized.

We strive to capitalize on our competitive advantages to build market-leading businesses in select sectors which exploit the growth in consumer and corporate purchasing power in the Russian and CIS markets. We employ a disciplined approach to our investment decisions with the aim of maximizing returns for our shareholders. Our internal performance benchmarks require that our businesses achieve certain operational, revenue and profitability targets, which also reflect the nature of these individual businesses. Progress against these targets is monitored and used to develop annual budgets, long-term business plans and capital allocation strategies. Companies that fail to achieve their objectives in a specified time frame generally cease to be beneficiaries of direct investments from Sistema and, should they continue to fall short of our objectives, may be sold. Similarly, we may dispose of businesses in industries that have largely fulfilled their growth potential. As of December 31, 2004, all our business segments were in line with their respective targets.

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

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

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

As the largest private sector consumer services company in Russia and the CIS, we believe our businesses present certain cross-selling opportunities, as well as the potential to benefit from economies of scale in their purchasing and selling activity. We also endeavor to capitalize on our vertical integration capabilities and exploit synergy opportunities, for example, by taking advantage of our combined customer base of over 45 million customers in Russia and the CIS.

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% | 76% |
| | STROM telecom | 52% | 67% |
| | Sitronics | 78% | 100% |
| Insurance | ROSNO | 49% | 51% |
| Banking | MBRD | 82% | 86% |
| | 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 (1.6%), MBRD (15.1%), 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.

### 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, | |
|---|---|---|
| | 2003 | 2004 |
| GDP growth | 7.3% | 7.1% |
| Consumer price index | 12.0% | 11.7% |
| Unemployment rate | 8.9% | 8.2% |
| Nominal exchange rate (rubles per U.S. dollar) (1) | 30.6 | 28.7 |
| Real ruble appreciation against U.S. dollar(2) | 20.9% | 18.6% |

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.

Below is a list of our major acquisitions during two last fiscal years.

| 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 |
| **Year ended December 31, 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 | 121.2 |
| UDN-900 | Mobile operator in Udmurtia Republic | August 2004 | 49.0% | MTS | 6.4 |
| TAIF Telcom | Mobile operator in the Tatarstan Republic and Volga region | September 2004 | 47.3% | MTS | 63.0 |
| MTT | Nationwide transit network operator | September 2004 | 29.8% | ECU GEST, Hurdsfield | 39.8 |
| MTT | Nationwide transit network operator | October 2004 | 0.2% | Sistema | 0.1 |
| Sibintertelecom | Mobile operator in Far East region | November 2004 | 93.53% | MTS | 37.4 |
| Telesot Alania | Mobile operator in the Republic of North Osetia (south of Russia) | December 2004 | 52.5% | MTS | 6.2 |
| Gorizont-RT | Mobile operator in the Republic of Sakha (Yakutia) | December 2004 | 76.0% | MTS | 53.2 |
| | | | | | $403.1 |

(1) Excluding acquisition-related costs.

## Recent Acquisitions

In February 2005, we acquired an additional 20% equity stake in Telmos from Rostelecom for a cash consideration of $8.5 million, which increased our voting power in Telmos to 100%.

In February 2005, MTS purchased an additional 74% stake in MTS-Komi Republic, a provider of mobile telecommunication services in the Komi Republic, increasing our voting power in the company to 100%. The value of consideration paid equaled $1.2 million.

In February 2005, we signed an agreement to acquire a 74.9% stake in Sweet-Com LLC, a holder of 3.5GHz radio frequency allocation for Moscow region, for a cash consideration of $2.0 million. Sweet-Com LLC provides wide-range radio access services for the "last mile" based on the Radio-Ethernet technology.

In February 2005, we acquired an additional 5% equity stake in MTT for a cash consideration of $6.4 million, increasing our voting share in MTT to 50%. In May 2005, MTT was issued one of the first long-distance telephony licenses in the process of liberalization of the long-distance market, which we expect to provide a significant effect on the growth of MTT business.

In February 2005, we completed the acquisition of 13.3% stake in MBRD. The total consideration amounted to $10.0 million, including cash payment of $2.1 million and promissory notes in the amount of $7.9 million. As a result of this transaction, our voting share in MBRD increased to 98.9%.

In April 2005, we acquired an additional 53% stake in Kvant, a personal computers and components manufacturer located in Zelenograd, for a total consideration of $6.0 million, increasing our voting power in Kvant to 88%. We plan to utilize Kvant's facilities to enhance our home-appliance and computer assembling activity as a part of the Technology business segment.

**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 year ended December 31, 2004 and the year ended December 31, 2003, MTS accounted for approximately $3,918.2 million and $2,638.2 million, or 68.6% and 70.2% of our net revenues. MTS share in our revenues continues to decrease as we benefit from the growth of our non-telecom businesses and acquisitions in non-telecom segments.

**Other Acquisitions**

Below is a discussion of our other acquisitions during the fiscal years ended December 31, 2003 and December 31, 2004.

In October 2003, MTS completed the purchase of Vostok Mobile South and thus acquired a 50% stake in Volgograd Mobile and Astrakhan Mobile and an 80% stake in Mar Mobile GSM. Also, in a separate transaction, MTS completed the acquisition of the remaining 20% stake in Mar Mobile GSM from existing shareholders unrelated to MCT Corporation, thus consolidating a 100% ownership in the company. In August 2004, MTS acquired the remaining stakes in Astrakhan Mobile and Volgograd Mobile, increasing our voting power in these subsidiaries to 100%. The acquisition price equaled to $1.1 million and $2.9 million, respectively. Astrakhan Mobile holds a AMPS/DAMPS-800 and GSM-1800 licenses covering Astrakhan region (population of approximately 1.0 million) and Volgograd Mobile holds a AMPS/DAMPS-800 and GSM-1800 licenses covering Volgograd region (population of approximately 2.7 million). As of July 31, 2004, the two companies provided AMPS/DAMPS services to around 10 thousand subscribers. As a result of the allocation of the purchase price for these transactions, we increased license cost for $16.5 million

During the year ended December 31, 2003, we increased our ownership interest in MBRD from 52% to 59%, in DM-Center from 53% to 100% and in Bolshaya Ordynka from 0% to 70% by acquiring their shares from related parties for an aggregate cash consideration of less than $0.1 million. The aggregate effect of such transactions on the Group's equity amounted to a net decrease of $2.7 million, which was charged to additional paid-in capital.

In April 2004, MTS acquired additional 7.5% stake in MSS, a mobile operator in the Omsk region, for $2.2 million in cash. This acquisition increased our voting power in MSS to 91%. The acquisition was accounted for using the purchase method of accounting, whereas the allocation of purchase price increased recorded license cost by $1.1 million.

In April and May 2004, MTS acquired the remaining stakes in the following subsidiaries: 35% of MTS-NN, a telecommunications service provider in Nizhny Novgorod, for $0.5 million, and 49% of Novitel, a handsets dealer in Moscow, for $1.3 million. Both acquisitions increased the Group's voting power in the respective companies to 100%. The transactions were accounted for using the purchase method of accounting, with an increase of recorded goodwill by $1.8 million as a result of the purchase price allocation.

During the year ended December 31, 2004, ROSNO repurchased 3.4% of its outstanding shares from a director of the Group for cash consideration of $5.6 million. The transaction resulted in a reduction of additional paid-in capital by $1.3 million, net of minority interest of $2.6 million. Later in the same period we acquired from ROSNO 1.75% of its shares for $2.8 million in cash. The remaining treasury shares were sold by ROSNO to a subsidiary of Allianz AG. In December 2004, ROSNO issued 10.9 million new shares, 5.6 million of which were purchased by the Group for a cash payment of $9.8 million. The rest of the newly issued shares were sold to Allianz AG. As a consequence of these transactions, the Group's ownership interest in ROSNO reached 49.0%.

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

In October 2004, ROSNO acquired 100% stake in Deutsche Investment Trust for cash consideration of $2.4 million. The allocation of purchase price increased goodwill by $1.3 million.

In June 2004, we acquired 5% share in East-West United Bank for cash consideration of $1.7 million. In November 2004, we acquired from Vneshtorgbank an additional 14% stake in East-West United Bank, increasing our ownership to 49%. The value of consideration equaled $5.3 million. East West United Bank is a bank incorporated in Luxembourg.

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 2003, we continued to dispose 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 year ended December 31, 2003 and amounted to $143.6 million.

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 recognition of a loss on disposal 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 recognition of a loss on disposal of $1.9 million. The revenues of P-Com were excluded from our consolidated revenues from January 1, 2004, and our share in earnings of P-Com for the year ended December 31, 2004 was accounted for under equity method of accounting.

In October 2004, we disposed of our 24% shareholding in MCC to Sky-Link for cash consideration of $0.7 million.

During 2003 and 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, 2004 and 2003. This financial information should be read in conjunction with our consolidated financial statements.

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | 2003 | % of revenue | 2004 | % of revenue |
| | (Amounts in thousands, except percentages) | | | |
| Revenues | $ 3,759,915 | 100.0% | $ 5,711,286 | 100.0% |
| Costs of sales, exclusive of depreciation and amortization shown separately below | (1,388,027) | (36.9) | (2,221,755) | (38.9) |
| Selling, general and administrative expenses | (689,057) | (18.3) | (1,009,716) | (17.7) |
| Depreciation and amortization | (520,976) | (13.9) | (799,885) | (14.0) |
| Goodwill impairment | (19,251) | (0.5) | - | 0.0 |
| Net other operating expenses | (37,326) | (1.0) | (44,529) | (0.8) |
| Income from equity investees | 465 | 0.0 | 27,121 | 0.5 |
| Net gain on disposal of subsidiaries | - | 0.0 | 2,184 | 0.0 |
| Operating income [1] | $ 1,105,743 | 29.4% | $ 1,664,706 | 29.1% |
| Interest income | 19,341 | 0.5 | 18,061 | 0.3 |
| Interest expense | (198,346) | (5.3) | (213,943) | (3.7) |
| Income tax | (290,933) | (7.7) | (445,731) | (7.8) |
| Foreign exchange (loss)/gain | (3,015) | (0.1) | 12,620 | 0.2 |
| Income from continuing operations before minority interests and cumulative effect of accounting changes | $ 632,790 | 16.8% | $ 1,035,713 | 18.1% |
| Minority interests | (402,120) | (10.7) | (589,014) | (10.3) |
| Gain from discontinued operations | 156,377 | 4.2 | - | 0.0 |
| Cumulative effect of a change in accounting principle | - | 0.0 | (35,472) | (0.6) |
| Net income | $ 387,047 | 10.3% | $ 411,227 | 7.2% |
| OIBDA [2] | $ 1,626,719 | 43.3% | $ 2,464,591 | 43.2% |

(1) Operating income is calculated as revenues less operating costs, plus income from equity investees and net gain 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, 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:

| | Years ended December 31, | | | |
|---|---|---|---|---|
| | 2003 | % of revenue | 2004 | % of revenue |
| | (Amounts in thousands, except percentages) | | | |
| Telecommunications | $ 3,247,568 | 86.4% | $ 4,616,702 | 80.8% |
| Technology | 85,942 | 2.3 | 498,427 | 8.7 |
| Insurance | 187,929 | 5.0 | 300,194 | 5.3 |
| Banking | 57,513 | 1.5 | 65,738 | 1.2 |
| Other Businesses [1] | 249,658 | 6.6 | 385,259 | 6.7 |
| Aggregated revenue | $ 3,828,610 | 101.8% | $ 5,866,320 | 102.7% |
| Eliminations [2] | (68,695) | (1.8)% | (155,034) | (2.7)% |
| Total | $ 3,759,915 | 100.0% | $ 5,711,286 | 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, | | | |
|---|---|---|---|---|
| | 2003 | % of operating income | 2004 | % of operating income |
| | (Amounts in thousands, except percentages) | | | |
| Telecommunications | $ 1,103,282 | 99.8% | $ 1,630,305 | 97.9% |
| Technology | (3,348) | (0.3) | 45,918 | 2.8 |
| Insurance | 17,111 | 1.5 | 30,168 | 1.8 |
| Banking | 2,567 | 0.2 | 11,691 | 0.7 |
| Other Businesses [(1)] | (16,131) | (1.5) | (32,600) | (2.0) |
| Aggregated revenue | $ 1,103,481 | 99.8% | $ 1,685,482 | 101.2% |
| Eliminations [(2)] | 2,262 | 0.2% | (20,776) | (1.2)% |
| Total | $ 1,105,743 | 100.0% | $ 1,664,706 | 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.

### Year ended December 31, 2004 compared to year ended December 31, 2003

***Revenues***

Our consolidated revenues increased by 51.9% to $5,711.3 million for the year ended December 31, 2004 from $3,759.9 million for the year ended December 31, 2003.

The growth in our revenues was attributable to the growth in our Telecommunications Segment of $1,369.1 million, in our Technology Segment of $412.5 million, in our Insurance Segment of $112.3 million, in our Banking Segment of $8.2 million and in our Other Businesses Segment of $135.6 million.

Growth in revenues for the year ended December 31, 2004 compared with the year ended December 31, 2003 was primarily due to organic growth, as well as to acquisitions made subsequent to December 31, 2003, including Primtelefon, Kvazar-Micro and Uzdunrobita, the results of which are only reflected in the current period. The consolidation of Primtelefon, Kvazar-Micro and Uzdunrobita contributed $69.4 million, $293.5 million, and $58.0 million, respectively, to the increase in aggregated revenues for the year ended December 31, 2004. P-Com had revenues of $51.3 million in the year ended December 31, 2003, which is not included in aggregated revenues in the year ended December 31, 2004. From our existing businesses, growth in our consolidated revenues for the year ended December 31, 2004 was $1,536.5 million, or 78.7% of the overall growth.

The Telecommunications Segment continued to be the largest revenue contributor for the year ended December 31, 2004, though its share of the aggregated revenues decreased to 80.8% from 86.4% for the year ended December 31, 2003 due to accelerated growth and significant acquisitions in our other segments. In the year ended December 31, 2004, MTS and MGTS were the largest contributors to the growth of the Telecommunications Segment revenue. Revenues of MTS and MGTS grew by $1,280.0 million (inclusive of the effects of the acquisitions of Primtelefon and Uzdunrobita), and $101.2 million, or by 48.5% and 26.6%, respectively, over the year ended December 31, 2003. This increase was primarily due to the significant growth in MTS' subscriber base from 16.7 million as of December 31, 2003 to 34.2 million as of December 31, 2004. The increase in MGTS' revenues was primarily due to increases in subscription fees for residential and government subscribers that took effect in June 2003, August 2003 and October 2004.

The increase in revenues of our Technology Segment was 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 year ended December 31, 2004 increased by $57.6 million and $27.4 million, or by 154.2% and 816.5%, respectively, compared with the year ended December 31, 2003. Revenues of STROM telecom increased mainly due to sales 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 $293.5 million to the increase in revenues of our Technology Segment for the year ended December 31, 2004.

Revenues from our Insurance Segment grew by 60.0% for the year ended December 31, 2004, compared with the year ended December 31, 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 $51.3 million, $34.5 million and $23.8 million, respectively, for the year ended December 31, 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 tourists, both inbound and outbound, served 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 year ended December 31, 2004, our cost of sales increased as a percentage of revenues to 38.9% from 36.9% for the year ended December 31, 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, from 29.6% to 28.8%. This slight decrease in MTS' cost of sales was due to lower interconnection and line rental charges payable to other operators for access to their networks relative to MTS' increasing revenues because, as MTS has expanded its 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.

Our selling, general and administrative expenses decreased to 17.7% of revenue for the year ended December 31, 2004 from 18.3% of revenue for the year ended December 31, 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 increased slightly to 14.0% of revenues for the year ended December 31, 2004 from 13.9% of revenues for the year ended December 31, 2003.

An impairment provision of $19.3 million was recorded for the year ended December 31, 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 on disposal of subsidiaries.

Our consolidated operating income margin comprised 29.1% of revenues for the year ended December 31, 2004, compared with 29.4% of revenues for the year ended December 31, 2003. MTS continued to be the main contributor to the operating margin with $1,453.7 million, or 87.3% of aggregated operating income, for the year ended December 31, 2004.

***Interest***

Our consolidated interest expense for the year ended December 31, 2004 increased by 7.9% to $213.9 million from $198.3 million for the year ended December 31, 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 for the amount of $300.0 million. In July 2004, MTS entered into a $500.0 million syndicated loan agreement with international financial institutions. In September 2004, MTS extended total amount available under the syndicated loan facility for an additional $100.0 million to total amount of $600.0 million.

***Income tax***

Our consolidated provision for income taxes for the year ended December 31, 2004 increased by 53.2% to $445.7 million from $290.9 million for the year ended December 31, 2003 following the increase of our pre-tax income. Our effective tax rate for the year ended December 31, 2004 decreased to 30.1%, compared to 31.5% for the year ended December 31, 2003 mainly as a result of the relatively lower amount of non-deductible expenses as a percentage of pre-tax income incurred during the year ended December 31, 2004 as compared with the year ended December 31, 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 63.7% to $1,035.7 million for the year ended December 31, 2004 from $632.8 million for the year ended December 31, 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 from continuing operations prior to minority interests and cumulative effect of accounting changes was 18.1% for the year ended December 31, 2004, compared with 16.8% for the year ended December 31, 2003.

***Minority interests***

Minority interests in net income of our subsidiaries for the year ended December 31, 2004 increased to $589.0 million from $402.1 million for the year ended December 31, 2003 primarily due to the increase of net income attributable to MTS.

## 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 businesses 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, Comstar UTS and our affiliate MTT).

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

| | Year ended December 31, | | | | | |
|---|---|---|---|---|---|---|
| | | 2003 | % of revenues | | 2004 | % of revenues |
| Revenues | $ | 3,247,568 | 100.0% | $ | 4,616,702 | 100.0% |
| Costs of sales, exclusive of depreciation and amortization shown separately below | | (1,059,315) | (32.6) | | (1,443,974) | (31.3) |
| Selling, general and administrative expenses | | (539,010) | (16.6) | | (763,011) | (16.5) |
| Depreciation and amortization | | (506,644) | (15.6) | | (783,668) | (17.0) |
| Goodwill impairment | | (19,251) | (0.6) | | - | 0.0 |
| Net other operating income/(expenses) | | (20,505) | (0.6) | | (23,068) | (0.5) |
| Income from equity investees | | 439 | 0.0 | | 27,324 | 0.6 |
| Operating income | $ | 1,103,282 | 34.0% | $ | 1,630,305 | 35.3% |
| OIBDA [(1)] | $ | 1,609,926 | 49.6% | $ | 2,413,973 | 52.3% |

(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.

### Year ended December 31, 2004 compared to year ended December 31, 2003

*Revenues*

Telecommunications Segment revenues increased by 42.2% for the year ended December 31, 2004 to $4,616.7 million compared to $3,247.6 million for the year ended December 31, 2003. MTS and MGTS were the principal contributors to the growth, with an increase in revenues of $1,280.0 million and $101.2 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 earnings of P-Com for the year ended December 31, 2004 was recorded using the equity method of accounting. P-Com's revenues for the year ended December 31, 2003 were $51.3 million.

*Wireless services*

Revenues of MTS for the year ended December 31, 2004 were $3,918.2 million, an increase of 48.5% compared to $2,638.2 million for the year ended December 31, 2003. This increase was primarily due to the significant growth in MTS' subscriber base from 16.7 million as of December 31, 2003 to 34.2 million as of December 31, 2004, including 26.5 million in Russia, 7.4 million in Ukraine and 0.3 million in Uzbekistan. A portion of the growth in the subscriber base was due to acquisitions during the year ended December 31, 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 29.4% from $17 per subscriber for the year ended December 31, 2003 to $12 per subscriber for the year ended December 31, 2004.

For the year ended December 31, 2004, MTS' service revenues and connection fees increased by $1,274.4 million, or by 49.8%, to $3,831.5 million from $2,557.1 million for the year ended December 31, 2003 due to growth in the number of its subscribers, as explained above. Revenues from sales of handsets and accessories increased by $5.6 million, or 6.9%, for the year ended December 31, 2004, compared to the year ended December 31, 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 year ended December 31, 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 Sky-Link brand name. As of December 31, 2004, Sky-Link had 213,100 subscribers (including subscribers of MCC and Delta Telecom). Our share in Sky-Link earnings for the year ended December 31, 2004 was insignificant.

*Fixed line communications*

MGTS' revenues grew by 26.6% in the year ended December 31, 2004 to $481.6 million, compared to $380.4 million for the year ended December 31, 2003. Revenues from monthly subscription fees increased by 19.5% in the year ended December 31, 2004, compared to the same period in 2003, and reached $244.1 million. This increase was primarily due to an increase in monthly subscription fees for residential and government subscribers effective June 2003, August 2003 and October 2004 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 38.3% compared to the year ended December 31, 2003, to $144.7 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 $28.8 million for the year ended December 31, 2004, compared to $24.7 million for the year ended December 31, 2003.

Revenues of MTU-Inform did not change in the year ended December 31, 2004 compared to the year ended December 31, 2003 and remained at $101.3 million, as a result of a moderate growth of business offset by a decrease in tariffs on services provided to mobile operators.

Telmos' revenues grew by 26.1%, to $47.3 million, for the year ended December 31, 2004, compared with $37.5 million for the year ended December 31, 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 57,175 as of December 31, 2004, from 55,548 as of December 31, 2003.

MTU-Intel's revenues increased for the year ended December 31, 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 December 31, 2004 by

525.0% to 112,332, compared to December 31, 2003. As a result, MTU-Intel's revenues grew by 37.5% from $46.1 million for the year ended December 31, 2003 to $63.4 million for the same period in 2004.

Comstar's revenues increased by 22.3% to $81.3 million for the year ended December 31, 2004 from $66.5 for the year ended December 31, 2003 as a result of growth in the number of active subscribers.

*Operating income*

The operating income margin of the Telecommunications Segment was 35.3% in the year ended December 31, 2004, compared to 34.0% in the year ended December 31, 2003. This growth was primarily attributable to the increase in the operating income margin of MTS.

*Wireless services*

MTS' operations contributed $1,453.7 million to our operating income from wireless services for the year ended December 31, 2004.

MTS' operating income margin was 37.1% for the year ended December 31, 2004, compared to 36.2% for the year ended December 31, 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 $7.6 million to our operating income for the year ended December 31, 2003.

*Fixed line communications*

MGTS' operating income margin for the year ended December 31, 2004 was 20.7%, compared to 21.7% for the year ended December 31, 2003, primarily due to an additional property tax payable on its cable network assets as a result of changes in Russian tax legislation effective January 1, 2004. Operating costs increased by $84.1 million, or 28.2%, for the year ended December 31, 2004.

MTU-Inform's operating income margin decreased to 40.5% for the year ended December 31, 2004, compared with 48.3% in the same period in 2003. The lower operating income margin in the year ended December 31, 2004 was attributable primarily to the decreased tariffs charged to mobile operators forced by competition.

Comstar incurred operating loss of $1.8 million for the year ended December 31, 2004 compared to operating income of $4.8 million for the year ended December 31, 2003.

Telmos' operating income increased to $7.6 million for the year ended December 31, 2004, compared to an operating loss of $2.4 million in the same period of 2003 owing to damage to its equipment and temporary disruption of services caused by a fire in 2003. Telmos' operating margin was 16.1% in the year ended December 31, 2004.

The increase in the number of MTU-Intel subscribers was offset by a continued reduction in tariffs in 2004 for corporate and residential subscribers. Operating costs were $63.9 million in the year ended December 31, 2004, or 100.8% of revenues, compared with $46.5 million, or 100.9% of revenues, in the same period in 2003.

*Income from equity investees*

Income from equity investees accounted for $27.1 million and $0.5 million for the years ended December 31, 2004 and 2003, respectively. The increase in income from equity investees is primarily caused by the increase in the net income of MTS Belarus and MTT, contributing $23.2 and $8.6 million, respectively, for the year ended December 31, 2004, partially offset by losses from other equity investments.

### Technology

As of December 31, 2004, our subsidiaries in the Technology Segment operated along four main divisions: telecommunications equipment manufacturing and software (STROM telecom, its subsidiaries and Mediatel), 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 year ended December 31, 2004.

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

| | Year ended December 31, | | | |
|---|---|---|---|---|
| | 2003 | % of revenue | 2004 | % of revenue |
| Revenues | $ 85,942 | 100.0% | $ 498,427 | 100.0% |
| Costs of sales, exclusive of depreciation and amortization shown separately below | (64,162) | (74.7) | (406,621) | (81.6) |
| Selling, general and administrative expenses | (20,269) | (23.6) | (39,657) | (8.0) |
| Depreciation and amortization | (2,862) | (3.3) | (3,484) | (0.7) |
| Net other operating expenses | (1,997) | (2.3) | (2,747) | (0.5) |
| Operating income | (3,348) | (3.9)% | 45,918 | 9.2% |
| OIBDA [1] | (486) | (0.6)% | 49,402 | 9.9% |

[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.

### Year ended December 31, 2004 compared to year ended December 31, 2003

*Revenues*

The revenues of our Technology Segment increased by $412.5 million, or by 480.2%, to $498.4 million during the year ended December 31, 2004. The acquisition of a controlling stake and consolidation of Kvazar-Micro revenues effective January 1, 2004 contributed $293.5 million to the increase of our Technology Segment revenues. Exclusive of the effects of the Kvazar-Micro acquisition, segment revenues would have increased by $119.0 million, or 138.5%, for the year ended December 31, 2004. Revenues of the telecommunications equipment manufacturing and software division grew by 201.5% to $112.6 million, or 55.0% of the total segment revenues, net of the effects of the Kvazar-Micro acquisition, in the year ended December 31, 2004, compared to $37.3 million, or 43.5% of the segment revenues in the year ended December 31, 2003. Revenues of the telecommunications equipment manufacturing and software division for the year ended December 31, 2004 include revenues of Mediatel, which was part of Telecommunications Segment in the year ended December 31, 2003. Mediatel contributed $17.6 million to revenues of telecommunications equipment manufacturing and software division for the year ended December 31, 2004. Revenues of the semiconductor design and manufacturing division grew by 16.3% to $47.9 million, or 23.4% of segment revenues, net of the effects of the Kvazar-Micro acquisition and intra-segment sales, in the year ended December 31, 2004 compared to $41.2 million, or 48.0% of the segment revenues in the year ended December 31, 2003. The electronic devices and consumer electronics division demonstrated considerable growth in the year ended December 31, 2004, with revenues increasing to $43.9 million, or 21.4% of the segment revenues, net of the effects of the Kvazar-Micro acquisition, from $7.4 million, or 8.6% of the segment revenues, for the same period in 2003. The increase of revenues in the electronic devices and consumer electronics division was a result of the increased production of consumer electronics under the Sitronics umbrella brand during the year ended December 31, 2004, following the rise of demand in the market for Sitronics products due to the extensive advertising campaign.

*Operating income*

Operating income increased to $45.9 million, or 9.2% of segment revenues, for the year ended December 31, 2004 from an operating loss of $3.3 million in the same period of 2003. The consolidation of the low-margin Kvazar-Micro business contributed $1.5 million to the operating income for the year ended December 31, 2004. The increase in operating income was primarily attributable to the sales of telecommunications equipment to our Telecommunication Segment. Net of the effects of the Kvazar-Micro acquisition, cost of sales increased by 93.6%, to $124.3 million, for the year ended December 31, 2004 compared to $64.2 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 14.8% for the year ended December 31, 2004 from 23.6% for the same period in 2003 mainly due to the increased volume of production and sales and improved cost efficiency.

**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, | | | |
|---|---|---|---|---|
| | 2003 | % of revenues | 2004 | % of revenues |
| Revenues from financial services | $ 187,929 | 100% | $ 300,194 | 100% |
| Financial services related costs, exclusive of depreciation and amortization shown separately below | (118,805) | (63.2) | (192,338) | (64.1) |
| Selling, general and administrative expenses | (48,280) | (25.7) | (76,408) | (25.5) |
| Depreciation and amortization | (3,115) | (1.7) | (3,378) | (1.1) |
| Other operating (expenses)/income | (109) | (0.1) | 1,907 | 0.6 |
| (Loss)/gain from equity investees | (509) | (0.3) | 191 | 0.1 |
| Operating income | $ 17,111 | 9.1% | $ 30,168 | 10.0% |

Voluntary medical insurance, motor own damage insurance and property insurance historically have been the largest contributors to our gross premiums written, or GPW. However, the share of voluntary medical insurance, a major component of the total GPW, was decreasing throughout the years 2003 and 2004, from 29% in 2003 to 25% in 2004, respectively. Simultaneously, revenues from obligatory motor third party liability policies, the line of business launched by ROSNO in 2003, has considerably developed and reached 12% of total GPW in 2004. Motor own damage insurance also slightly increased from 15% to 17% of total GPW in 2004 as compared to 2003. GPW 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 GPW 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 GPW 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, | |
|---|---|---|
| | 2003 | 2004 |
| | (Amounts in thousands) | |
| Voluntary medical insurance | 62,223 | 90,704 |
| Motor third-party liability | 3,168 | 1,946 |
| Motor own damage insurance | 33,503 | 62,458 |
| Property | 25,462 | 40,563 |
| General third-party liability | 3,201 | 8,359 |

| | | |
|---|---|---|
| Marine, aviation and transport | 7,838 | 19,871 |
| Personal accident | 7,044 | 6,634 |
| Other non-life liability | 2,988 | 7,556 |
| Life insurance | 1,710 | 1,767 |
| Obligatory motor third-party liability | 14,993 | 43,080 |
| Reinsurance inward | 56,117 | 84,622 |
| Total gross premiums written | 218,247 | 367,560 |
| Reinsurance outwards | (46,580) | (40,105) |
| Change in provision in unearned premiums, net of reinsurance | (8,355) | (49,921) |
| Net premiums earned | 163,312 | 277,534 |
| Commission income | 8,225 | 4,507 |
| Medical services income | 5,278 | 6,396 |
| Net gains/(loss) on operations with securities | 1,867 | (1,865) |
| Interest income | 6,143 | 7,282 |
| Other income | 3,104 | 6,339 |
| Total revenue | $187,929 | $300,194 |

**Year ended December 31, 2004 compared to year ended December 31, 2003**

*Revenues*

In the year ended December 31, 2004, our Insurance Segment revenues grew by $112.3 million, or 59.8%, compared to the year 2003, as we continued to expand our client base. Voluntary medical insurance, motor own damage and property insurance together accounted for $193.7 million, or 52.7%, of GPW for the year ended December 31, 2004. GPW on obligatory motor third-party liability insurance, which we commenced writing in July 2003, accounted for $43.1 million, or 11.7%, of our GPW for the year 2004.

GPW on property insurance increased to $40.6 million for the year ended December 31, 2004, or by 59.2%, compared to $25.5 million for the year ended December 31, 2003, primarily due to the consolidation in the year ended December 31, 2004 of operations of Leader which we acquired from RAO UES in October 2004.

Overall, GPW increased by 68.4%, to $367.6 million, in the year ended December 31, 2004, in comparison to $218.2 million in the year 2003 following the insurance business expansion.

*Operating income*

As a result of ROSNO's expansion of its operations, the operating income of our Insurance Segment increased to $30.2 million in the year ended December 31, 2004 from $17.1 million in the year ended December 31, 2003. The operating income margin increased to 10.0% in the year ended December 31, 2004 from 9.1% in the year ended December 31, 2003. General and administrative expenses of the segment increased to $76.4 million in the year ended December 31, 2004 from $48.2 million in the year ended December 31, 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 $421.0 million as of December 31, 2004 from $265.7 million as of December 31, 2003, or by 58.4%. This increase is primarily attributable to an increase in cash and bank deposits of $79.4 million, in receivables from insurance operations of $33.8 million, and in loans and notes receivable of $32.0 million.

### Banking

Our Banking Segment is represented by MBRD, which provides a broad range of services. Historically, MBRD 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. We are currently focusing on developing and expanding MBRD's retail banking business in Moscow and major cities throughout Russia. As of December 31, 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, 2004 | | | |
|---|---|---|---|---|
| | 2003 | % of revenues | 2004 | % of revenues |
| | (Amounts in thousands, except percentages) | | | |
| Revenues from financial services | $ 57,513 | 100% | $ 65,738 | 100% |
| Including: | | | | |
| Revenues from consolidated companies | 10,321 | 17.9 | 22,788 | 34.7 |
| Revenues from related parties | 11,730 | 20.4 | 1,971 | 3.0 |
| Financial services related costs, exclusive of depreciation and amortization shown separately below[1] | (27,635) | (48.1) | (31,075) | (47.3) |
| Selling, general and administrative expenses | (27,180) | (47.3) | (22,950) | (34.9) |
| Depreciation and amortization | (620) | (1.1) | (1,119) | (1.7) |
| Income from equity investees | 490 | 0.9 | 1,097 | 1.7 |
| Operating income | $ 2,568 | 4.5% | $ 11,691 | 17.8% |

(1) Includes interest expense on deposits.

### Year ended December 31, 2004 compared to year ended December 31, 2003

*Revenues*

For the year ended December 31, 2004, compared with the year ended December 31, 2003, MBRD's revenues increased by 14.3%, to $65.7 million. Interest income grew by $8.6 million in the year ended December 31, 2004 and amounted to $57.2 million. This growth was mainly attributable to interest on loans to customers. As of December 31, 2004, loans to customers, net of allowances for loan losses, increased by 44.0% to $444.3 million, including $238.1 million, or 53.6%, of inter-company loans and $23.5 million, or 5.3%, of loans to our related parties. As of December 31, 2004, the weighted average interest on inter-company loans was 12.0% on U.S. dollar-denominated loans (which totaled $109.5 million) and 11.0% for ruble-denominated loans (which totaled $128.5 million). The weighted average interest rate on U.S. dollar-denominated loans to related parties was 10.0%. Loans to third-party customers, net of allowance for loan losses, increased by $115.1 million to $182.7 million in 2004. The weighted average interest rate on loans to third-party customers was 9.6% for ruble-denominated loans and 7.5% for U.S. dollar-denominated loans as of December 31, 2004.

Non-interest income decreased to $8.5 million in the year ended December 31, 2004 from $11.0 million in the year ended December 31, 2003 primarily due to decrease in gain from trading securities.

*Operating income*

Banking Segment's operating income amounted to $11.7 million in the year ended December 31, 2004, compared to $2.6 million for the same period in 2003, mostly due to an increase in the volume of MBRD's lending operations in 2004.

Selling, general and administrative expenses as a percent of revenues decreased to 34.9% in 2004 from 47.3% in 2003 as a result of a decrease in allowances for loan losses.

*Income from equity investees*

Income from equity investees of $1.1 million recorded in the operating income of the segment in the year ended December 31, 2004 represents our share of the net income of East-West United Bank. We continued to increase our share in the EWUB during the year 2004 up to 49% as of December 31, 2004.

*Total assets*

Total assets of the Banking Segment decreased to $519.8 million as of December 31, 2004 from $595.5 million as of December 31, 2003 mainly due to the decrease of loans issued to related parties to $23.5 million as of December 31, 2004 compared to $151.6 million as of December 31, 2003.

**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 $41.7 million for the year ended December 31, 2004, compared to $21.4 million in 2003.

| | Year ended December 31, | | | |
|---|---|---|---|---|
| | 2003 | % of revenues | 2004 | % of revenues |
| | (Amounts in thousands, except percentages) | | | |
| Revenues | $ 249,658 | 100.0% | $ 385,259 | 100.0% |
| Cost of sales, exclusieve of depreciation and amortization shown separately below | (170,789) | (68.4) | (268,320) | (69.6) |
| Selling, general and administrative expenses | (75,564) | (30.3) | (127,638) | (33.1) |
| Depreciation and amortization | (7,735) | (3.1) | (8,236) | (2.1) |
| Net other operating income/(expenses) | (11,746) | (4.7) | (14,358) | (3.8) |
| Income/(loss) from equity investees | 45 | 0.0 | (1,491) | (0.4) |
| Net gain/(loss) on disposal of subsidiaries | - | - | 2,184 | 0.5 |
| Operating income/(loss) | $ (16,131) | (6.5)% | $ (32,600) | (8.5)% |

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 December 31, 2004, we operated nine stores in Moscow, including the flagship Detsky Mir store in central Moscow, and four stores outside of Moscow with a total retail space of 42,868 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 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.

**Year ended December 31, 2004 compared to the year ended December 31, 2003**

*Revenues*

Total operating revenues of the Other Businesses Segment increased to $385.3 million for the year ended December 31, 2004, compared to $249.7 million for the year ended December 31, 2003.

Real estate revenues increased by $51.3 million, to $90.4 million, for the year ended December 31, 2004 over the year ended December 31, 2003. The increase is primarily attributable to the completion and sale of real estate projects during the year ended December 31, 2004, including two residential properties and two office buildings in Moscow.

In our retail business, revenues increased by 42.9%, to $79.3 million, for the year ended December 31, 2004 from $55.5 million for the year ended December 31, 2003. The increase was mostly generated by revenues of our new retail outlets.

Mass media revenues increased to $36.2 million, or by 2.8%, during the year ended December 31, 2004 compared to $35.2 million in the year ended December 31, 2003, primarily due to an increase in print distribution revenues.

The total operating revenues of our travel services business for the year ended December 31, 2004 were $96.6 million compared with $62.1 million for the year ended December 31, 2003, representing growth of 55.6%. During the year ended December 31, 2004, the number of inbound tourists served increased to 164,259 or by 16.0% compared to the year ended December 31, 2003, while the number of outbound tourists increased to 78,348, or by 45.2%, compared to the year ended December 31, 2003.

*Operating loss*

For the Other Businesses Segment, operating losses increased during the year ended December 31, 2004 to $38.3 million from $16.1 million in the year ended December 31, 2003, mostly due to charity expenses of $17.1 million paid by our corporate office and bonuses of $19.4 million accrued during the year ended December 31, 2004, which was partially offset by improved financial results in our real estate, media and travel services business.

In the real estate business, operating income for 2004 increased to $23.5 million, from $10.3 million for 2003. The increase resulted from the completion and sale of four real estate projects in 2004.

In our retail business, operating income during the year ended December 31, 2004 increased to $8.8 million, compared with $6.8 million in the year ended December 31, 2003, as a result of an increase in the number of retail outlets.

In the media business, we reduced operating losses during 2004 to 2.6% of total revenue, or $0.9 million, from an operating loss of $4.4 million in the year ended December 31, 2003.

In our travel services business, operating income, as a percentage of revenues, increased to 2.9% during the year ended December 31, 2004, compared to an operating loss of 3.1% in the year ended December 31, 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.

## Telecommunications Operating Data

Our revenues and operating income for the years ended December 31, 2004 and 2003 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, | | |
|---|---|---|---|
| | 2002 | 2003 | 2004 |
| | (Amounts in thousands, except average monthly service revenue per subscriber) | | |
| **Subscribers** [1] | | | |
| Russia | 6,644 | 13,370 | 26,540 |
| MTS OJSC | 3,746 | 6,529 | 13,398 |
| Moscow license area | 3,082 | 4,936 | 7,516 |
| Telecom XXI | 854 | 1,666 | 2,733 |
| Kuban-GSM | 844 | 1,396 | 2,543 |
| Russian regions | 1,200 | 3,779 | 7,866 |
| UMC | n/a | 3,350 | 7,373 |
| Uzbekistan (Uzdunrobita) | n/a | n/a | 311 |
| Total | 6,644 | 16,720 | 34,224 |
| **Average monthly service revenue per subscriber** | | | |
| Russia | $ 23 | $ 17 | $ 12 |
| Ukraine | n/a | $ 15 [2] | $ 13 |

(1) MTS defines a ''subscriber'' as an individual or organization whose account shows chargeable activity within 61 days (or 183 days in the case of the "Jeans" and "SIM-SIM" brand tariffs) and whose account does not have a negative balance for more than this period. Prior to October 1, 2004, UMC used a 90-day period for such purposes with respect to its "Jeans" and "SIM-SIM" subscribers.

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

In 2003, the subscriber base increased by 151.7% from 6.6 million as of December 31, 2002 to 16.7 million as of December 31, 2003. These trends continued in 2004, with MTS' subscriber base increasing by 104.7%, from 16.7 million as of December 31, 2003 to 34.2 million as of December 31, 2004. A portion of the growth in the subscriber base was due to acquisitions during the year ended December 31, 2004, including Uzdunrobita, Primtelefon, Gorizont RT, Telesot Alania with 0.3, 0.2, 0.1 and 0.1 million subscribers, respectively. MTS' organic growth in revenues amounted to $1,148.1 million, or 43.52% in the year 2004 as compared to the year 2003, while MTS acquisitions in the year 2004 contributed $131.9 million to our revenues for the year ended December 31, 2004.

Average monthly service revenue per subscriber in Russia fell from $23 in 2002 to $17 in 2003, due to the decrease in tariffs in the Moscow license area, an increase of mass-market subscribers in MTS' subscriber mix and its continued expansion into the regions of Russia outside of the Moscow license area where tariffs are lower. This trend continued in 2004. Average monthly service revenue per subscriber in Russia in 2004 decreased to $12. In 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 3.4 million subscribers at December 31, 2003 to 7.4 million subscribers at December 31, 2004, and we expect this trend to continue, assuming the Ukrainian economy continues to grow. Average monthly service revenue per subscriber decreased in 2004 as a result of an extensive marketing campaign focused on penetration to the mass-market.

| | Year ended December 31, | | |
|---|---|---|---|
| | 2002 | 2003 | 2004 |
| **Subscriber churn** [3] | | | |
| Russia | 33.9% | 47.3% | 27.5% |
| Ukraine[1] | n/a | 23.8% | 15.8% [2] |

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

(2) In the fourth quarter of 2004, UMC changed its subscriber base calculation method. From October 1, 2004, the subscriber churn period is set at 61 day for UMC subscribers, as opposed to 90-day period prior to October 1, 2004, consistent with the churn period MTS use with respect to its subscribers in Russia. Under the previous churn policy, the 2004 churn rate in 2004 was 23%.

(3) MTS defines churn as the total number of subscribers who cease to be a subscriber (as defined above) during the period (whether involuntarily due to non-payment or voluntarily, at such subscriber's request), expressed as a percentage of the average number of our subscribers during that period.

MTS' subscriber churn in Russia increased from 33.9% in 2002 to 47.3% in 2003. This trend was reversed in 2004 as a result of MTS marketing initiatives, targeted to raise subscriber loyalty. MTS' subscriber churn for the year ended December 31, 2004 was 27.5%. Although its subscriber churn in Russia decreased for the year ended December 31, 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 January 1, 2002 to December 31, 2004.

| Service | Jan 1, 2002 | Nov 1, 2002 | June 1, 2003 | Aug 1, 2003 | Oct 1, 2004 |
|---|---|---|---|---|---|
| **Monthly subscription fee** | | | | | |
| Residential subscribers [1] | 2.7 | 3.5 | 4.1 | 4.6 | 5.8 |
| Public sector subscribers [2] | 3.3 | 3.9 | 4.1 | 4.6 | 5.8 |
| Corporate subscribers [2] | 5.5 | 5.2 | 5.4 | 5.5 | 6.8 |
| **Local call charges** | | | | | |
| Public sector subscribers [3] | 0.005 | 0.004 | 0.005 | 0.005 | 0.005 |
| Corporate subscribers [3] | 0.013 | 0.013 | 0.013 | 0.013 | 0.014 |
| Exchange rate (rubles per U.S. dollar) [4] | 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 and public 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, | |
|---|---|---|
| | 2003 | 2004 |
| Corporate and public voice services | 206,175 | 216,970 |
| Comstar | 55,896 | 57,128 |
| Telmos | 35,361 | 36,988 |
| MTU-Inform | 114,918 | 122,854 |
| Corporate data services (Golden Line) | 3,375 | 3,944 |
| Internet services (MTU-Intel) | 471,124 | 415,280 |
| Dial-up subscribers | 453,150 | 302,948 |
| ADSL subscribers | 17,974 | 112,332 |
| Carrier and operator services | 303,571 | 313,574 |
| Comstar | 13,993 | 23,993 |
| Telmos | 20,187 | 20,187 |
| MTU-Inform | 269,391 | 269,394 |

The number of subscribers for corporate and public voice and data services increased during the years 2003 and 2004. The increase in the total number of subscribers equaled to 11.5% and 5.2% for the years ended December 31, 2003 and 2004, respectively.

The total number of subscribers for our Internet services increased by 29.1% for the year ended December 31, 2003 and decreased by 11.9% for the year ended December 31, 2004. For the year ended December 31, 2004 the number of dial-up subscribers decreased by 150,202, or by 33.1%, while the number of ADSL subscribers increased by 94,358, or by 525.0%.

The total number of active lines for carrier and operator services increased by 3.3% for the year ended December 31, 2004, while was approximately the same for the years ended December 31, 2002 and December 31, 2003.

## 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 10.95% notes due 2004 in principal amount of $300 million from drawings on the syndicated loan facility, which significantly improved our working capital position as the notes were included in short-term liabilities.

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. In February 2005, Sistema completed its initial public offering on the London Stock Exchange. The amount of proceeds, net of related expenses, equaled to $1,284.6 million. We plan to invest the proceeds from the offering primarily in the purchase of long-term assets.

We expect to repay all long-term debts as they become due from our operating cash flows or through re-financings. See Notes 20, 21 and 22 to our audited consolidated financial statements for a description of our indebtedness.

### 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 December 31, 2004, we had a positive working capital of $10.3 million, compared to a deficit of $541.1 million as of December 31, 2003.

Our working capital turned to positive as we refinanced a portion of our short-term debt with the proceeds from long-term borrowings during the year ended December 31, 2004. Following the receipt of proceeds from our initial public offering in February 2005, our positive working capital significantly increased further.

### 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 | March 24, 2005 | BB- | Stable |
| Sistema ......... | Fitch | February 17, 2005 | B+ | Stable |
| Sistema ......... | Moody's | November 19, 2003 | B1 | Stable |
| MTS ........... | Moody's | December 10, 2001 | Ba3 | Stable |
| MTS ........... | Standard & Poor's | March 24, 2005 | BB- | Stable |
| MGTS .......... | Standard & Poor's | March 24, 2005 | BB- | Stable |
| MBRD ......... | Fitch | February 17, 2005 | B | Stable |
| MBRD ......... | Moody's | December 14, 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;
- changes in working capital; and
- general corporate activities, including dividends.

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.

Our capital expenditures in 2003 and 2004 were $1,212.9 million and $1,627.0 million, respectively. We expect to continue to finance most of our capital expenditure needs through our operating cash flows, and to the extent required, to incur additional indebtedness through borrowings or additional capital raising activities. Historically, a significant portion of our capital expenditures have been related to the installation and build out of our telecommunication networks and expansion into new license areas. Our future expenditures may be 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.

In addition to our capital expenditures, we spent $1,005.5 million, and $338.9 million in 2003 and 2004, respectively, to acquire businesses. We may continue to expand our business through acquisitions. Our cash requirements relating to potential acquisitions can vary significantly based on market opportunities.

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

**Capital Resources**

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

At December 31, 2004, our debt was comprised of the following:

| | Currency | Annual interest rate (Actual at December 31, 2004) | | December 31 2004 |
|---|---|---|---|---|
| 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% | | 400,000 |
| MGTS Bonds | RUR | 10%-12.3% | | 90,094 |
| Micron Bonds | RUR | 15.0% | | 6,293 |
| **Total Corporate Bonds** | | | | **1,595,195** |
| Syndicated Loan | USD | LIBOR+2.5% (5.3%) | | 600,000 |
| EBRD | USD | LIBOR+3.1% (5.9%) | | 150,000 |
| Credit Suisse First Boston | USD | LIBOR+2.2% (4.8%) | | 140,000 |
| HSBC Bank plc and ING-BHF-Bank | USD | LIBOR+0.4% (3.2%) | | 77,003 |
| Hermes Credit Facility | EUR | EURIBOR+0.7% (2.9%) | | 63,851 |
| ING-Bank (Eurasia) | USD | LIBOR+2.3%-4.2% (4.8%-6.7%) | | 46,667 |
| Vendor Financing | Various | Various | | 33,181 |
| Commerzbank (Eurasia) | USD | LIBOR+1.4%-5.0% (4.0%-7.4%) | | 47,213 |
| Raiffeisenbank | USD | LIBOR+5.0%-7.0% (7.6%-9.6%) | | 19,684 |
| HSBC | USD | LIBOR+2.8% (5.2%) | | 17,500 |
| Ericsson Project Finance | USD | LIBOR+4.0% (6.6%) | | 14,850 |
| Sberbank | RUR | 10.0%-20.3% | | 27,547 |
| Vneshtorgbank | USD, EUR | LIBOR+4.9% (7.3%), EURIBOR+5.6% (7.8%), 11.0%-13.0% | | 24,482 |
| Citibank | USD | LIBOR+1.6% (4.2%) | | 15,144 |
| Nordea Bank Sweden | USD | LIBOR+0.4% (3.0%) | | 6,500 |
| West LB | USD, EUR | LIBOR+6.8% (9.4%) EURIBOR+2% (4.2%) | | 9,000 |
| Loans from related parties | Various | Various | | 107,854 |
| Other | Various | Various | | 60,892 |
| | | | | 3,056,563 |
| Less amounts maturing within one year | | | | (562,041) |
| **Total** | | | $ | **2,494,522** |

The following table presents the aggregate scheduled maturities of debt principal outstanding as of December 31, 2004:

| Payments due in the year ended December 31, | | (In thousands) |
|---|---|---|
| 2005 | $ | 562,041 |
| 2006 | | 432,315 |
| 2007 | | 333,029 |
| 2008 | | 799,834 |
| 2009 | | 97,943 |
| Thereafter | | 831,401 |
| **Total** | **$** | **3,056,563** |

In addition, we had capital lease obligations in the amount of $8.3 million as of December 31, 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, | |
|---|---|---|
| | **2003** | **2004** |
| | **(Amounts in thousands)** | |
| **Cash flows** | | |
| Net cash provided by operating activities | $ 986,402 | $ 1,904,071 |
| Net cash used in investing activities | (2,365,236) | (2,064,436) |
| Net cash provided by financing activities | 1,504,732 | 380,947 |
| Net increase in cash | 125,898 | 220,582 |
| **Cash outlays for** | | |
| Capital expenditures[1] | (1,184,828) | (1,670,599) |
| Acquisition of subsidiaries, net of cash acquired | (1,005,451) | (338,906) |

(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 use cash in 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.

**Liquidity**

As of December 31, 2004 and 2003, we had total cash and cash equivalents of $503.7 million and $283.2 million, respectively. In addition, as of December 31, 2004 and 2003, we had short-term investments of $207.3 million and $278.9 million, respectively, mostly in corporate and municipal bonds and bank deposits.

For details of external financing refer to Notes 20, 21 and 22 to our audited consolidated financial statements. For subsequent events related to our external financing, refer to Note 31 to our audited consolidated financial statements.

Because most of our operating subsidiaries are incorporated in Russia, their ability to pay dividends to us is limited by provisions of Russian law. For example, Russian law requires that, among other things, dividends can only be paid in an amount not exceeding net profits as determined under Russian accounting standards. In addition, dividends may only be paid if the value of the company's net assets is not less than the sum of the company's charter capital, the company's reserve fund and the difference between the liquidation value and the par value of the issued and outstanding preferred stock of the company, if any, as determined under Russian accounting standards. In May 2005, MTS's Board of directors recommended to the shareholders to approve cash dividends of RUR 5.75 (equivalent of $0.21 as of the announcement date) per share for the year 2004, for the total of approximately $402.6 million, which was approved by the Shareholders' meeting on June 21, 2005. This is an almost two-times increase from $218.8 million announced and paid for the year 2003.

In June 2005, the shareholders of JSFC Sistema approved cash dividends of RUR 26.0 (equivalent of $0.91 as of the announcement date) per share for the year ended December 31, 2004, for the total of approximately $8.8 million. Whereas the dividends paid by JSFC Sistema for the year ended December 31, 2003 amounted to $5.2 million.

## 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

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

| | Rubles per U.S. dollar | | | |
|---|---|---|---|---|
| | High | Low | Average[1] | Period End |
| **Year ended December 31,** | | | | |
| 2000 | 28.87 | 26.90 | 28.13 | 28.16 |
| 2001 | 30.30 | 28.16 | 29.22 | 30.14 |
| 2002 | 31.86 | 30.14 | 31.39 | 31.78 |
| 2003 | 31.88 | 29.25 | 30.61 | 29.45 |
| 2004 | 29.45 | 27.75 | 28.73 | 27.75 |

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

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

| | Hryvnias per U.S. dollar | | | |
|---|---|---|---|---|
| | High | Low | Average[1] | Period End |
| **Year ended December 31,** | | | | |
| 2000 | 5.60 | 5.22 | 5.44 | 5.43 |
| 2001 | 5.43 | 5.27 | 5.37 | 5.30 |
| 2002 | 5.33 | 5.30 | 5.33 | 5.33 |
| 2003 | 5.33 | 5.33 | 5.33 | 5.33 |
| 2004 | 5.33 | 5.31 | 5.32 | 5.31 |

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

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 because settlements denominated in euros are not significant.

### Inflation and Exchange Rates

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

| Year | Inflation rate |
|---|---|
| 2000 | 20.2% |
| 2001 | 18.6% |
| 2002 | 15.1% |
| 2003 | 12.0% |
| 2004 | 11.7% |

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

| Year | Inflation rate |
|---|---|
| 2000 | 25.8% |
| 2001 | 6.1% |
| 2002 | (0.6)% |
| 2003 | 8.2% |
| 2004 | 12.3% |

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 year ended December 31, 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 December 31, 2004, approximately $1,217.2 million, or 39.7% of our total indebtedness, including capital leases, was variable interest rate debt, while $1,847.7 million, or 60.3% 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 December 31, 2004.

Contractual Maturity Dates as of December 31, 2004:

| | Currency | December 31, 2005 | 2006 | 2007 | 2008 | 2009 | Thereafter | Total | Average rate at December 31, 2004 |
|---|---|---|---|---|---|---|---|---|---|
| | | (Amounts in thousands) | | | | | | | |
| Syndicated Loan. . . . . . . . . . . . . | USD | 140,000 | 280,000 | 180,000 | – | – | – | 600,000 | LIBOR+2.5% (5.3%) |
| EBRD. . . . . . . . . . . . . . . . . . . . | USD | 11,538 | 23,077 | 23,077 | 23,077 | 23,077 | 46,154 | 150,000 | LIBOR+3.1% (5.9%) |
| HSBC Bank plc and ING-BHF-Bank | USD | 9,929 | 9,929 | 9,929 | 9,929 | 9,928 | 27,359 | 77,003 | LIBOR+0.4% (3.2%) |
| ING-Bank (Eurasia). . . . . . . . . . . . | USD | 26,667 | 20,000 | – | – | – | – | 46,667 | LIBOR+2.3%-4.2% (4.8%-6.7%) |
| Commerzbank (Eurasia). . . . . . . . | USD | 1,192 | 592 | – | – | – | – | 1,784 | LIBOR+1.4% (3.8%) |
| Commerzbank (Eurasia). . . . . . . . | USD | 16,929 | 8,500 | – | – | – | – | 25,429 | LIBOR+3.5% (5.9%) |
| Raiffeisenbank. . . . . . . . . . . . . . | USD | 3,750 | – | – | – | – | – | 3,750 | LIBOR+5.0% (7.6%) |
| Raiffeisenbank. . . . . . . . . . . . . . | USD | 2,291 | 2,291 | 2,501 | 2,691 | 2,916 | 3,244 | 15,934 | LIBOR+7.0% (9.6%) |
| HSBC. . . . . . . . . . . . . . . . . . . . | USD | 10,000 | 7,500 | – | – | – | – | 17,500 | LIBOR+2.8% (5.2%) |
| Ericsson Project Finance. . . . . . . . | USD | 11,700 | 3,150 | – | – | – | – | 14,850 | LIBOR+4.0% (6.6%) |
| Vneshtorgbank. . . . . . . . . . . . . . | USD | 872 | – | – | – | – | – | 872 | LIBOR+8.0% (10.4%) |
| Vneshtorgbank. . . . . . . . . . . . . . | USD | 3,702 | 1,961 | 959 | – | – | – | 6,622 | LIBOR+4.9% (7.1%) |
| Citibank. . . . . . . . . . . . . . . . . . . | USD | 2,548 | 4,012 | 3,450 | 3,450 | 1,684 | – | 15,144 | LIBOR+1.6% (4.2%) |
| Nordea Bank Sweden. . . . . . . . . . | USD | 3,250 | 3,250 | – | – | – | – | 6,500 | LIBOR+0.4% (3.0%) |
| Credit Suisse First Boston. . . . . . . | USD | 140,000 | – | – | – | – | – | 140,000 | LIBOR+2.2% (4.8%) |
| Commerzbank (Eurasia). . . . . . . . | USD | 20,000 | – | – | – | – | – | 20,000 | LIBOR+5.0% (7.4%) |
| Total USD variable debt | | 404,368 | 364,262 | 219,916 | 39,147 | 37,605 | 76,757 | 1,142,055 | |
| Weighted average USD interest rate | | 5,3% | 5,3% | 5,3% | 5,2% | 5,2% | 5,1% | 5,3% | |
| Hermes Credit Facility. . . . . . . . . | EUR | 14,189 | 14,189 | 14,189 | 14,189 | 7,095 | – | 63,851 | EURIBOR+0.7% (2.9%) |
| Vneshtorgbank. . . . . . . . . . . . . . | EUR | 1,454 | 1,455 | 1,454 | 1,454 | 1,454 | – | 7,271 | EURIBOR+5.6% (7.8%) |
| West LB International S.A.. . . . . . | EUR | – | 4,000 | – | – | – | – | 4,000 | EURIBOR+2.0% (4.2%) |
| Total EUR variable debt | | 15,643 | 19,644 | 15,643 | 15,643 | 8,549 | – | 75,122 | |
| Weighted average EUR interest rate | | 3,5% | 3,5% | 3,5% | 3,6% | 3,7% | 0,0% | 3,5% | |

We would experience an additional interest expense of approximately $10.1 million in 2005, $6.1 million in 2006, $3.0 million in 2007, $1.5 million in 2008 and $1.0 million in 2009 on an annual basis as a result of a hypothetical increase in the LIBOR/EURIBOR by 1% over the current rate as of December 31, 2004. The fair value of our publicly traded long-term notes as of December 31, 2004 ranged from 100.9% to 106.0% of the principal amount. At December 31, 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 December 31, 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, Financial Accounting Standards Board ("FASB") issued a revision to Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN 46R" or the "Interpretation"). FIN 46R clarifies the application of Accounting Research Bulletin ("ARB") No. 51, "Consolidated Financial Statements", to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support. FIN 46R requires the consolidation of these entities, known as variable interest entities ("VIEs"), by the primary beneficiary of the entity. The primary beneficiary is the entity, if any, that will absorb a majority of the entity's expected losses, receive a majority of the entity's expected residual returns, or both. Among other changes, the revisions of FIN 46R (a) clarified some requirements of the original FIN 46, which had been issued in January 2003, (b) eased some implementation problems, and (c) added new scope exceptions. FIN 46R deferred the effective date of the Interpretation for public companies, to the end of the first reporting period ending after March 15, 2004, except that all public companies must at minimum apply the provisions of the Interpretation to entities that were previously considered “special-purpose entities” under the FASB literature prior to the issuance of FIN 46R by the end of the first reporting period ending after December 15, 2003.

Following the adoption of FIN 46R, the Group reevaluated the relationships with its related parties: Promtorgcenter, Notris, Laminea, Finescort-M, Kuntsevo-Invest, Putney Assets and Mosdachtrest. Kuntsevo-Invest and Mosdachtrest are engaged in construction activities of the Group; Promtorgcenter, Notris, Laminea, Finescort-M and Putney Assets possess shareholdings and provide financing through intercompany loans to other entities of the Group. Mosdachtrest was accounted for under equity method for the periods prior to January 1, 2004. The Group determined these entities were variable interest entities and that it was their primary beneficiary. Accordingly, the Group has consolidated these companies effective January 1, 2004. All intercompany balances have been eliminated in consolidation and the results of these VIEs have been included in the Group’s consolidated statement of operations and statement of cash flows for the year ended December 31, 2004. In accordance with the provisions of FIN 46R, the Group recorded a charge for the cumulative effect of this accounting change of $35.5 million, net of income tax of nil, in the year ended December 31, 2004. This charge reflects the cumulative impact to the Group’s 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 December 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% and 6% of our consolidated revenues for the year ended December 31, 2004 and the year ended December 31, 2003, 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 $103.0 million, as of December 31, 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 $30.0 million, net of minority interest of $28.6 million, are recorded as a separate component of other comprehensive income for the year ended December 31, 2003 and the year ended December 31, 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 November 2003, the Emerging Issues Task Force ("EITF") reached a final consensus on Issue No. 03-10, "Application of EITF Issue No. 02-16, 'Accounting by a Customer (Including a Reseller) for Certain Consideration Received from a Vendor', by Resellers to Sales Incentives Offered to Consumers by Manufacturers." The consensus was reached that consideration received by a reseller from the vendor in exchange for vendor sales incentives tendered by consumers should not be reported as a reduction of the cost of the reseller's purchases from the vendor but instead should be shown as revenue. EITF Issue No. 03-10 is effective for reporting periods beginning after November 25, 2003. The adoption of Issue No. 03-10 did not have a material impact on 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 July 2004, the EITF issued EITF No. 02-14, "Whether an Investor Should Apply the Equity Method of Accounting to Investments Other Than Common Stock." A consensus was reached regarding an investor that has the ability to exercise significant influence over the operating and financial policies of the investee. This type of investor should apply the equity method of accounting only when it has an investment(s) in common stock and/or an investment that is in-substance common stock. The Task Force also reached a consensus on the definition of in-substance common stock and related guidance. EITF No. 02-14 is effective for reporting periods beginning after September 15, 2004. The adoption of EITF Issue No. 02-14 did not have a material impact on our financial position or results of operations.

In September 2004, the U.S. Securities and Exchange Commission ("SEC") staff issued the EITF Topic D-108, "Use of the Residual Method to Value Acquired Assets Other Than Goodwill", which requires the companies to use the direct value method to determine the fair value of their intangible assets acquired in business combinations completed after September 29, 2004. The SEC staff also announced that companies that currently apply the residual value approach for valuing intangible assets with indefinite useful lives for purposes of impairment testing, must use the direct value method by no later than the beginning of their first fiscal year after December 15, 2004.

As of December 31, 2004, MTS performed the annual impairment test to measure the fair value of its 900 and 1800 MHz licenses in its national footprint using the residual value approach. Under this new accounting guidance, MTS performed an impairment test to measure the fair value of its 900 and 1800 MHz licenses as of January 1, 2005 using the direct value method. Based on the assessment no impairment charge as of December 31, 2004 is required.

In September 2004, the 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 October 2004, the EITF reached a consensus on EITF Issue No. 04-10, "Determining Whether to Aggregate Operating Segments that Do Not Meet the Quantitative Thresholds". EITF No. 04-10 provided additional guidance on when operating segments that are below the 10% threshold can be aggregated. EITF Issue No. 04-10 states that segments can only be aggregated if they have similar economic characteristics and if they are similar in areas such as production processes, types of customers, distribution channels and the products themselves are similar. The consensus reached by EITF No. 04-10 is effective for fiscal years ending after October 13, 2004. The adoption of Issue No. 04-10 did not have a material impact on our results of operations or financial position.

In November 2004, the Financial Accounting Standards Board ("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 December 2004, the 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 as of the beginning of the first fiscal year 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 March 2005, the FASB issued Interpretation No. 47, “Accounting for Conditional Asset Retirement Obligations - an interpretation of FASB Statement No. 143.” This Interpretation clarifies that the term “conditional asset retirement obligation” as used in FASB Statement No. 143, “Accounting for Asset Retirement Obligations”, refers to a legal obligation to perform an asset retirement activity, in which the timing and (or) method of settlement are conditional on a future event that may or may not be within the control of the entity. The obligation to perform the asset retirement activity is unconditional even though uncertainty exists about the timing and (or) method of settlement. Uncertainty about the timing and (or) method of settlement of a conditional asset retirement obligation should be factored into the measurement of the liability when sufficient information exists to make a reasonable estimate of the fair value of the obligation. Interpretation 47 is effective for us beginning January 1, 2006. We are currently in the process of assessing effects of Interpretation 47 on our consolidated financial position and result of operations.

In March 2005, the SEC released Staff Accounting Bulletin 107, “Share-Based Payments”, or SAB 107. The interpretations in SAB 107 express views of the SEC staff regarding the interaction between FAS No. 123R and certain SEC rules and regulations, and provide the SEC staff's views regarding the valuation of share-based payment arrangements for public companies. In particular, SAB 107 provides guidance related to share-based payment transactions with nonemployees, the transition from nonpublic to public entity status, valuation methods (including assumptions such as expected volatility and expected term), the accounting for certain redeemable financial instruments issued under share-based payment arrangements, the classification of compensation expense, non-GAAP financial measures, first-time adoption of FAS No. 123R in an interim period, capitalization of compensation cost related to share-based payment arrangements, the accounting for income tax effects of share-based payment arrangements upon adoption of FAS No. 123R, the modification of employee share options prior to adoption of FAS No. 123R.

**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 December 31, 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 $25.0 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 $7.4 million as of December 31, 2004.

In July 2004, MTU-Inform issued guarantees to MBRD on behalf of Sky Link for the total amount of $21.1 million.

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 $57.5 million in the case of the borrower’s default under the obligations. As of December 31, 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 December 31, 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 December 31, 2004:

| | January 1, 2005 - December 31, 2005 | January 1, 2006 - December 31, 2006 | January 1, 2007 - December 31, 2007 | January 1, 2008 - December 31, 2008 | January 1, 2009 - December 31, 2009 | January 1, 2010 - thereafter | Total |
|---|---|---|---|---|---|---|---|
| | (Amounts in thousands) | | | | | | |
| Contractual obligations: | | | | | | | |
| Notes payable | 222 593 | 177 821 | 177 821 | 889 065 | 153 772 | 1 245 562 | 2 866 634 |
| Bank loans | 617 877 | 486 653 | 364 993 | 215 108 | 49 318 | 85 822 | 1 819 771 |
| Capital lease | 5 289 | 2 228 | 746 | 171 | 169 | 451 | 9 054 |
| Operating leases and services agreements | 54 074 | 26 625 | 22 597 | 18 626 | 14 812 | 59 037 | 195 771 |
| Committed Investments: | | | | | | | |
| Purchases of property, plant and equipment | 164 700 | – | – | – | – | – | 164 700 |
| Construction contracts | 34 600 | – | – | – | – | – | 34 600 |
| Total | 1 099 133 | 693 327 | 566 157 | 1 122 970 | 218 071 | 1 390 872 | 5 090 530 |

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

### Initial Public Offering

On February 11, 2005, we completed an initial public offering of 1,550,000 common shares, with a nominal value of 90 rubles per share in the form of 77,500,000 global depositary receipts ("GDRs"), with 50 GDRs representing one share. On February 14, 2005, our GDRs were admitted to trade on the London Stock Exchange. Proceeds from the offering, net of underwriting discount and other direct costs, were $1,284.6 million.

Simultaneously, certain our shareholders sold 42,663 common shares in the form of 2,133,150 GDRs. In addition, shareholders exercised their option to sell additional 238,900 shares in the form of 11,945,000 GDRs.

### Financings

In January 2005, MTS Finance issued $400.0 million 8.0% unsecured notes at 99.736%. These notes are fully and unconditionally guaranteed by OJSC MTS and mature on January 28, 2012. MTS Finance is required to make interest payments on the notes semi-annually in arrears on January 28 and July 28, commencing on July 28, 2005. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes were $398.9 million.

In February 2005, MBRD entered into a loan facility with Standard Bank London and Standard Bank Moscow, pursuant to which the banks agreed to make available to MBRD a loan facility in the amount of $16.0 million, secured by a pledge of MBRD's rights under its loan to Sky-Link. The loan was guaranteed by MTU-Inform.

In March 2005, MBRD entered into a loan agreement with Dresdner Bank AG for the amount of $150.0 million. The loans bears interest of 8.625% and is due in March 2008. To finance the loan to MBRD, Dresdner Bank AG issued Loan Participation Notes that were admitted to trade on the Luxembourg Stock Exchange. Interest payments on the loan are due semi-annually in March and September of each year, commencing in September 2005. Loan agreement contains certain restrictive covenants including, but not limited to, limitations on mergers, liens and dispositions of assets and transactions with the Group's subsidiaries and affiliates.