MEGAFON

Interim condensed consolidated financial statements
(Unaudited)

For the nine months ended 30 September 2013

Contents

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Report on review of interim condensed consolidated financial statements

The Board of Directors and Shareholders
OJSC MegaFon

Introduction

We have reviewed the accompanying interim condensed consolidated statement of financial position of OJSC MegaFon and its subsidiaries (hereinafter collectively referred to as the "Company") as of 30 September 2013 and the related interim condensed consolidated statements of comprehensive income, changes in equity and cash flows for the three and nine-month periods then ended and explanatory notes. Management is responsible for the preparation and presentation of these interim condensed consolidated financial statements in accordance with IAS 34, *Interim Financial Reporting*. Our responsibility is to express a conclusion on these interim condensed consolidated financial statements based on our review.

Scope of review

We conducted our review in accordance with International Standard on Review Engagements 2410, *Review of Interim Financial Information Performed by the Independent Auditor of the Entity*. A review of interim financial information consists of making inquiries, primarily of persons responsible for financial and accounting matters, and applying analytical and other review procedures. A review is substantially less in scope than an audit conducted in accordance with International Standards on Auditing and consequently does not enable us to obtain assurance that we would become aware of all significant matters that might be identified in an audit. Accordingly, we do not express an audit opinion.

Conclusion

Based on our review, nothing has come to our attention that causes us to believe that the accompanying interim condensed consolidated financial statements are not prepared, in all material respects, in accordance with IAS 34.

Ernst & Young LLC

11 November 2013

MegaFon

Interim condensed consolidated statement of comprehensive income

(In millions of Rubles)

	Note	Three months ended 30 September 2013	Three months ended 30 September 2012	Nine months ended 30 September 2013	Nine months ended 30 September 2012
		(Unaudited)		(Unaudited)	
Revenues					
Wireless services		68,177	62,971	191,350	178,256
Wireline services		4,621	4,560	13,816	13,394
Sales of equipment and accessories		4,745	3,607	12,331	9,096
Total revenues		**77,543**	**71,138**	**217,497**	**200,746**
Operating expenses					
Cost of services		15,302	14,044	41,851	41,354
Cost of equipment and accessories		4,364	3,301	11,333	8,616
Sales and marketing expenses	10	4,625	5,306	11,646	15,727
General and administrative expenses	11	17,865	16,450	50,597	49,321
Depreciation		11,113	11,441	33,468	33,996
Amortisation		1,391	1,917	4,115	4,540
Loss on disposal of non-current assets	7	146	315	391	1,050
Total operating expenses		**54,806**	**52,774**	**153,401**	**154,604**
Operating profit		**22,737**	**18,364**	**64,096**	**46,142**
Finance costs	8	(3,077)	(2,680)	(8,651)	(4,942)
Finance income		449	155	1,636	1,047
Share of profit/(loss) of associates and joint ventures		98	—	(88)	—
Other non-operating (expense)/income		(103)	58	(64)	(9)
Loss on financial instruments, net	8	(619)	—	(563)	—
Foreign exchange gain/(loss), net		792	2,594	(2,252)	(8,758)
Profit before tax		**20,277**	**18,491**	**54,114**	**33,480**
Income tax expense	12	4,822	3,546	12,392	7,569
Profit for the period		**15,455**	**14,945**	**41,722**	**25,911**

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

Interim condensed consolidated statement of comprehensive income (continued)

(In millions of Rubles, except per share amounts)

	Three months ended 30 September		Nine months ended 30 September	
	2013	2012	2013	2012
	(Unaudited)		(Unaudited)	
Other comprehensive income/(loss)				
Other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods:				
Foreign currency translation difference, net of tax of nil	42	87	(140)	54
Net movement on cash flow hedges, net of tax	3	(138)	138	(306)
Net other comprehensive income/(loss) to be reclassified to profit or loss in subsequent periods	**45**	**(51)**	**(2)**	**(252)**
Total comprehensive income for the period, net of tax	**15,500**	**14,894**	**41,720**	**25,659**
Profit for the period				
Attributable to equity holders of the Company	15,321	14,893	41,526	25,818
Attributable to non-controlling interest	134	52	196	93
Total comprehensive income for the period				
Attributable to equity holders of the Company	15,357	14,820	41,560	25,552
Attributable to non-controlling interest	143	74	160	107
Earnings per share, Rubles				
Basic, profit for the period attributable to ordinary equity holders of the Company	27	28	73	45
Diluted, profit for the period attributable to ordinary equity holders of the Company	26	28	71	45

MegaFon

Interim condensed consolidated statement of financial position

(In millions of Rubles)

	Note	30 September 2013 (Unaudited)	31 December 2012 (Audited)
Assets			
Non-current assets			
Property and equipment	7	199,733	215,549
Intangible assets, other than goodwill		14,446	16,991
Goodwill		23,954	23,950
Investments in associates and joint ventures		35,574	35,662
Non-current financial assets	8	300	—
Non-current non-financial assets		1,325	1,956
Deferred tax assets		3,324	2,573
Total non-current assets		**278,656**	**296,681**
Current assets			
Inventory		7,571	5,277
Current non-financial assets		5,875	4,963
Prepaid income taxes		555	5,066
Trade and other receivables		12,014	13,542
Other current financial assets	8	39,415	23,449
Cash and cash equivalents		18,945	2,387
Total current assets		**84,375**	**54,684**
Total assets		**363,031**	**351,365**
Equity and liabilities			
Equity			
Equity attributable to equity holders of the Company		127,808	117,355
Non-controlling interests		396	518
Total equity		**128,204**	**117,873**
Non-current liabilities			
Loans and borrowings	8	138,434	125,575
Other non-current financial liabilities	8	891	501
Non-current non-financial liabilities		1,184	1,843
Provisions		6,359	5,724
Deferred tax liabilities		12,224	12,333
Total non-current liabilities		**159,092**	**145,976**
Current liabilities			
Trade and other payables		22,638	23,723
Loans and borrowings	8	11,159	20,457
Other current financial liabilities	8	20,668	23,282
Current non-financial liabilities		20,593	20,037
Income taxes payable		677	17
Total current liabilities		**75,735**	**87,516**
Total equity and liabilities		**363,031**	**351,365**

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

Interim condensed consolidated statement of changes in equity

(In millions of Rubles)

For the nine months ended 30 September 2013 and 30 September 2012

		Attributable to equity holders of the Company									
		Ordinary shares		Treasury shares							
	Note	Number of shares	Amount	Number of shares	Amount	Capital surplus	Retained earnings	Other capital reserves	Total	Non-controlling interests	Total equity
As of 1 January 2012		**620,000,200**	**526**	**—**	**—**	**12,567**	**260,957**	**(53)**	**273,997**	**523**	**274,520**
Net profit		—	—	—	—	—	25,818	—	25,818	93	25,911
Other comprehensive loss		—	—	—	—	—	—	(266)	(266)	14	(252)
Total comprehensive income							**25,818**	**(266)**	**25,552**	**107**	**25,659**
Dividends		—	—	—	—	—	(151,863)	—	(151,863)	—	(151,863)
Purchase of treasury shares		—	—	89,279,700	(63,883)	—	—	—	(63,883)	—	(63,883)
Issuance of written put option over the Company's ordinary shares		—	—	—	—	—	(46,973)	—	(46,973)	—	(46,973)
Retirement of treasury shares		(200)	—	(200)	—	—	—	—	—	—	—
As of 30 September 2012 (unaudited)		**620,000,000**	**526**	**89,279,500**	**(63,883)**	**12,567**	**87,939**	**(319)**	**36,830**	**630**	**37,460**
As of 1 January 2013		**620,000,000**	**526**	**54,690,089**	**(39,133)**	**12,567**	**143,468**	**(73)**	**117,355**	**518**	**117,873**
Net profit		—	—	—	—	—	41,526	—	41,526	196	41,722
Other comprehensive loss		—	—	—	—	—	—	34	34	(36)	(2)
Total comprehensive income							**41,526**	**34**	**41,560**	**160**	**41,720**
Dividends	5	—	—	—	—	—	(36,968)	—	(36,968)	—	(36,968)
Share-based compensation expense	9	—	—	—	—	—	—	992	992	—	992
Sale of treasury shares upon exercise of stock options	9	—	—	(7,750,000)	5,545	—	(676)	—	4,869	—	4,869
Sale of interest in Synterra-Media	4	—	—	—	—	—	—	—	—	(233)	(233)
Dividends to non-controlling interests		—	—	—	—	—	—	—	—	(49)	(49)
As of 30 September 2013 (unaudited)		**620,000,000**	**526**	**46,940,089**	**(33,588)**	**12,567**	**147,350**	**953**	**127,808**	**396**	**128,204**

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

MegaFon

Interim condensed consolidated statement of cash flows

(In millions of Rubles)

	Note	Nine months ended 30 September 2013 (Unaudited)	2012
Operating activities			
Profit before tax		54,114	33,480
Non-cash adjustments to reconcile profit before tax to net cash flows:			
Depreciation		33,468	33,996
Amortisation		4,115	4,540
Loss on disposal of non-current assets		391	1,050
Loss on financial instruments, net		563	—
Net foreign exchange loss		2,252	8,758
Share of loss of associates and joint ventures		88	—
Change in impairment allowance for receivables and other non-financial assets		1,661	1,204
Finance costs		8,651	4,942
Finance income		(1,636)	(1,047)
Share-based compensation	9	992	—
Other non-operating (expense)/income		64	9
Working capital adjustments:			
Increase in inventory		(2,300)	(463)
Decrease/(increase) in trade and other receivables		740	(5,790)
Decrease/(increase) in current non-financial assets		374	(6,549)
Increase in trade and other payables		508	7,586
(Decrease)/increase in current non-financial liabilities		(2,065)	64
Change in VAT, net		994	4,453
Income tax paid		(10,620)	(10,787)
Income tax refunded		2,360	5,895
Interest received		1,460	3,782
Interest paid, net of interest capitalised		(6,624)	(2,953)
Net cash flows from operating activities		**89,550**	**82,170**
Investing activities			
Purchase of property, equipment and intangible assets		(23,834)	(33,589)
Proceeds from sale of property and equipment	4, 7	2,427	294
Acquisitions of subsidiaries, net of cash acquired		—	(8,439)
Proceeds from sale of Synterra-Media, net of cash	4	76	—
Payment of deferred and contingent consideration	4	(5,878)	(1,490)
Net change in short-term and long-term demand deposits		(15,531)	79,381
Net cash flows (used in)/from investing activities		**(42,740)**	**36,157**
Financing activities			
Proceeds from borrowings, net of fees paid		27,749	206,556
Repayment of borrowings		(25,720)	(93,645)
Dividends paid to equity holders of the Company		(36,968)	(151,863)
Purchase of treasury shares		—	(63,883)
Payment of liability for marketing related licences		(418)	(283)
IPO transaction fees paid		(212)	—
Proceeds from exercise of stock options		4,869	—
Dividends paid to non-controlling interests		(49)	—
Other		403	—
Net cash flows from/(used in) financing activities		**(30,346)**	**(103,118)**
Net increase in cash and cash equivalents		16,464	15,209
Net foreign exchange difference		94	(1,084)
Cash and cash equivalents at beginning of period		2,387	2,887
Cash and cash equivalents at end of period		**18,945**	**17,012**

The accompanying notes are an integral part of these interim condensed consolidated financial statements.

1. General

Open Joint Stock Company MegaFon ("MegaFon", the "Company" and together with its consolidated subsidiaries the "Group") is a leading universal telecommunications operator in Russia and provides a broad range of voice, data and other telecommunications services to retail customers, businesses, government clients and other telecommunications services providers.

In November 2012, MegaFon completed an initial public offering ("IPO") and listed its ordinary shares on the Moscow Exchange and its ordinary shares represented by Global Depositary Receipts, or GDRs, on the London Stock Exchange, in each case under the symbol ''MFON''.

2. Basis of preparation

These interim condensed consolidated financial statements have been prepared in accordance with IAS 34, *Interim Financial Reporting*, and should be read in conjunction with the annual consolidated financial statements of the Group for the year ended 31 December 2012.

These interim condensed consolidated financial statements are unaudited and do not include all the information and disclosures required in the annual IFRS financial statements. The Company omitted disclosures which would substantially duplicate the information contained in its 2012 audited consolidated financial statements, such as accounting policies and details of accounts which have not changed significantly in amount or composition. Additionally, the Company has provided disclosures where significant events have occurred subsequent to the issuance of its 2012 audited consolidated financial statements. Management believes that the disclosures in these interim condensed consolidated financial statements are adequate to make the presented information not misleading if these interim condensed consolidated financial statements are read in conjunction with the Company's 2012 audited consolidated financial statements and the notes related thereto. In the opinion of management, the financial statements reflect all adjustments necessary to present fairly the Company's financial position, financial performance and cash flows for the interim reporting periods in accordance with IAS 34, *Interim Financial Reporting*.

The accompanying interim condensed consolidated financial statements are presented in millions of Rubles, except for per share amounts which are in Rubles, unless otherwise indicated.

The interim condensed consolidated financial statements were authorised for issue by the Company's Chief Executive Officer ("CEO") and Chief Accountant on 11 November 2013.

3. Significant accounting policies

The accounting policies and methods of computation applied in the preparation of these interim condensed consolidated financial statements are consistent with those disclosed in the annual consolidated financial statements of the Group for the year ended 31 December 2012, except for the adoption of new standards and interpretations effective from 1 January 2013.

Certain prior year amounts in the accompanying interim condensed consolidated statement of financial position have been reclassified to conform to the presentation adopted in the current year.

3. Significant accounting policies (continued)

In preparing the Group's annual consolidated financial statements for the year ended 31 December 2012, the Group elected to early adopt a number of new standards including IFRS 10, IFRS 11, IFRS 12 and IFRS 13.

Several other new standards and amendments apply for the first time in 2013. However, they do not impact the annual consolidated financial statements of the Group or the interim condensed consolidated financial statements of the Group.

The nature and the impact of each new standard/amendment is described below:

IAS 1 Presentation of Items of Other Comprehensive Income – Amendments to IAS 1

The amendments to IAS 1 introduce a grouping of items presented in other comprehensive income. Items that could be reclassified (or recycled) to profit or loss at a future point in time now have to be presented separately from items that will never be reclassified. The amendment affected presentation only and had no impact on the Group's financial position or performance.

IAS 1 Clarification of the Requirement for Comparative Information (Amendment)

The amendment to IAS 1 clarifies the difference between voluntary additional comparative information and the minimum required comparative information. An entity must include comparative information in the related notes to the financial statements when it voluntarily provides comparative information beyond the minimum required comparative period. The additional voluntarily provided comparative information does not need to be presented in a complete set of financial statements.

An opening statement of financial position (known as the 'third balance sheet') must be presented when an entity applies an accounting policy retrospectively, makes retrospective restatements, or reclassifies items in its financial statements, provided any of those changes has a material effect on the statement of financial position at the beginning of the preceding period. The amendment clarifies that a third balance sheet does not have to be accompanied by comparative information in the related notes. Under IAS 34, the minimum items required for interim condensed financial statements do not include a third balance sheet.

IAS 32 Tax Effects of Distributions to Holders of Equity Instruments (Amendment)

The amendment to IAS 32, *Financial Instruments: Presentation*, clarifies that income taxes arising from distributions to equity holders are accounted for in accordance with IAS 12, *Income Taxes*. The amendment removes existing income tax requirements from IAS 32 and requires entities to apply the requirements in IAS 12 to any income tax arising from distributions to equity holders. The amendment did not have an impact on the interim condensed consolidated financial statements for the Group.

IAS 19 Employee Benefits (Revised 2011) (IAS 19R)

IAS 19R includes a number of amendments to the accounting for defined benefit plans. The amendment did not have an impact on the interim condensed consolidated financial statements for the Group.

3. Significant accounting policies (continued)

IFRS 7 Financial Instruments: Disclosures - Offsetting Financial Assets and Financial Liabilities - Amendments to IFRS 7

The amendment requires an entity to disclose information about rights to set-off financial instruments and related arrangements (e.g., collateral agreements). As the Group is not setting off financial instruments in accordance with IAS 32 and does not have relevant offsetting arrangements, the amendment does not have an impact on the Group.

4. Settlement of contingent consideration

Synterra

On 2 August 2013, the Company in a series of transactions with Synterra Cyprus Limited and Burnham Advisors Limited settled the contingent consideration which was due under the sale and purchase agreement dated 2 June 2010 for the acquisition of CJSC Synterra. In full settlement of the contingent consideration due, the Group transferred to the sellers its 60% interest in CJSC Synterra-Media (a provider of telecommunication services to TV broadcasters), its 100% interest in CJSC Absolut (the owner of the Company’s office building) and a cash payment of $7 million (231 at the exchange rate as of 2 August 2013).

At the same time the Company signed an agreement with CJSC Absolut to lease the office building back for a term of three years from 2 August 2013 to 30 June 2016 for $12.6 million total rent (415 at the exchange rate as of 2 August 2013).

A gain from settlement of contingent consideration of 263 has been recognised and included in the ‘Loss on financial instruments, net’ in the accompanying interim condensed consolidated statement of comprehensive income.

Euroset

On 6 December 2012, MegaFon, through its consolidated subsidiary Lefbord, acquired 50% stake in Euroset. The sale and purchase agreement provided for the payment of additional consideration if Euroset met certain targets by 30 June 2013. On 25 September 2013, the Group paid a further $100 million (3,182 at the exchange rate as of the settlement date) cash consideration because the targets were met. This payment was partially financed by Garsdale Services Investment Limited (“Garsdale”), which holds indirectly 50% plus 100 shares in the Company, in the amount of $50 million (1,591 at the exchange rate as of the settlement date).The final amount of contingent consideration paid corresponded to the estimates made at the time of the acquisition of Euroset.

5. Dividends

On 28 June 2013, the Annual General Meeting of Shareholders of the Company approved the payment of a dividend in the amount of 54.17 Rubles per ordinary share for the second, third and fourth quarters of 2012. On the same date the shareholders also approved an interim dividend distribution for the first quarter of 2013 in the amount of 10.34 Rubles per ordinary share. The total sum allocated to the dividend payment was 36,968, and payment of the dividend was made in July 2013.

6. Segment information

The Group manages its business primarily based on eight geographical operating segments within Russia, which provide a broad range of voice, data and other telecommunication services, including wireless and wireline services to clients, interconnection services, data transmission services and value added services ("VAS"). The Chief Operating Decision Maker ("CODM") evaluates the performance of the Group's operating segments based on revenue and operating income before depreciation and amortisation. Total assets and liabilities are not allocated to operating segments and not analysed by the CODM. Operating segments with similar economic characteristics have been aggregated into an integrated telecommunication services segment, which is the only reportable segment. The remaining operating segments, including less significant subsidiaries and the retail business, do not meet the quantitative thresholds for reportable segments. Less than 1% of the Group's revenues and results are generated by segments outside of Russia. No single customer represents 10% or more of the consolidated revenues.

Seasonality of operations

The Company's services are impacted by seasonal trends throughout the year. Higher revenues and operating profits are usually expected in the second half of the year rather than in the first six months. Higher revenues during the period July to September are mainly attributed to the increased demand for telecommunication services during the peak summer holiday season, as well as in December, due to increased demand for telecommunication services and equipment from private customers in that month. Also the number of working days is significantly higher in the second half of the calendar year than in the first half of the year due to long public holidays in January and May in Russia, which contributes to higher revenues in the second half of the year. This information is provided to allow for a better understanding of the results, however management has concluded that this measure of seasonality is not 'highly seasonal' as defined in IAS 34.

7. Property and equipment

During the nine months ended 30 September 2013, the Group acquired assets with a cost of 21,429 (the nine months ended 30 September 2012: 26,052). Assets (other than those classified as held for sale) with a net book value of 3,715 were disposed of by the Group during the nine months ended 30 September 2013 (the nine months ended 30 September 2012: 1,890), resulting in a net loss on disposal of 371 (in the nine months ended 30 September 2012: 1,400).

8. Financial assets and liabilities

New derivative financial instruments

Cash flow hedge of foreign currency risk

In August 2013, the Company entered into a fixed-to-fixed rate cross-currency swap agreement with a notional amount of $107 million (3,461 at the exchange rate as of 30 September 2013) that limits the exposure from changes in US dollar exchange rates on certain long-term debt.

The swap has been designated and qualified as a cash flow hedge of foreign currency risk. The effective portion of changes in the fair value of the swap of 23 (gain) for the period ended 30 September 2013 has been recorded in other comprehensive income/(loss) and will subsequently be reclassified into earnings in the period in which the hedged forecast transaction affects earnings. There has been no ineffective portion in the reporting period.

Non-designated hedge of foreign currency risk

In May 2013, the Company entered into a cross-currency swap agreement with a notional amount of $293 million (9,477 at the exchange rate as of 30 September 2013) that limits the exposure from changes in US dollar exchange and interest rates on certain long-term debt.

The terms of the swap agreement did not meet the requirements for hedge accounting, therefore the Group has reported all gains and losses from the change in fair value of this derivative financial instrument directly in the consolidated statement of comprehensive income.

Loss on financial instruments, net

The components of net loss on financial instruments for the three and nine months ended 30 September are as follows:

	Three months ended 30 September		**Nine months ended 30 September**	
	2013	**2012**	**2013**	**2012**
Gain from settlement of Synterra contingent consideration *(Note 4)*	(263)	—	(263)	—
Change in fair value of financial assets and liabilities measured through profit or loss:				
Euroset settlement put option	685	—	742	—
Other derivative financial instruments	197	—	84	—
Total loss on financial instruments, net	**619**	**—**	**563**	**—**

8. Financial assets and liabilities (continued)

Fair values

Set out below is a comparison by class of the carrying amounts and fair values of the Group's financial instruments that are carried in the financial statements.

	Carrying amount		Fair value	
	30 September 2013 (Unaudited)	31 December 2012	30 September 2013 (Unaudited)	31 December 2012
Financial assets				
Financial assets at fair value through profit or loss:				
Euroset settlement put option	376	1,118	376	1,118
Cross-currency swap not designated as hedge	171	—	171	—
Loans and receivables	39,039	22,331	39,039	22,331
Cross-currency swap designated as cash flow hedge	129	—	129	—
Total	**39,715**	**23,449**	**39,715**	**23,449**
Financial liabilities				
Financial liabilities at amortised cost:				
Loans and borrowings	149,593	146,032	149,909	146,991
Convertible debt instrument	20,116	16,812	20,116	16,812
Liability for marketing related licences	296	682	296	682
Long-term accounts payable	580	—	580	—
Contingent consideration	—	5,806	—	5,806
Cross-currency swap designated as cash flow hedge	106	—	106	—
Interest rate swaps designated as cash flow hedges	226	261	226	261
Due to employees and related social charges, non-current portion	235	222	235	222
Total	**171,152**	**169,815**	**171,468**	**170,774**

The Group, using available market information and appropriate valuation methodologies, where they exist, has determined the estimated fair values of its financial instruments. However, judgment is necessarily required to interpret market data to determine the estimated fair value.

Accordingly, the estimates presented herein are not necessarily indicative of the amounts the Group could realise in a current market exchange. While management has used available market information in estimating the fair value of its financial instruments, the market information may not be fully reflective of the value that could be realised in the current circumstances.

The Group, in connection with its current activities, is exposed to various financial risks, such as foreign currency risks, interest rate risks and credit risks. The Group manages these risks and monitors their exposure on a regular basis.

8. Financial assets and liabilities (continued)

The following tables summarise the valuation of financial assets and liabilities measured at fair value on a recurring basis by the fair value hierarchy:

	Euroset settlement put option	Cross-currency swaps	**Total financial assets**	Contingent considera-tion	Interest rate/cross-currency swaps	**Total financial liabilities**
30 September 2013						
Level 1	—	—	—	—	—	—
Level 2	—	300	**300**	—	(332)	**(332)**
Level 3	376	—	**376**	—	—	—
Total as of 30 September 2013	**376**	**300**	**676**	—	**(332)**	**(332)**
31 December 2012						
Level 1	—	—	—	—	—	—
Level 2	—	—	—	—	(261)	**(261)**
Level 3	1,118	—	**1,118**	(5,806)	—	**(5,806)**
Total as of 31 December 2012	**1,118**	—	**1,118**	**(5,806)**	**(261)**	**(6,067)**

Valuation techniques and assumptions

The fair values of interest rate swaps and cross-currency swaps are based on a forward yield curve and represent the estimated amount the Group would receive or pay to terminate these agreements at the reporting date, taking into account current interest rates, foreign exchange spot and forward rates, creditworthiness, nonperformance risk, and liquidity risks associated with current market conditions as appropriate.

The Group estimated the fair value of the contingent consideration using a probability-weighted cash flow model and the fair value of the Euroset purchased put option using Monte Carlo simulation. The significant unobservable inputs used for contingent consideration valuation are discount rates and several probability adjusted contingent payments. The significant unobservable inputs used for the Euroset put option valuation are the expected term of the option, volatility based on the average historical volatility of publicly traded guideline companies over the period equal to the expected life of the option, dividend yield based on expected dividend payments, and the risk-free rate determined on the basis of the U.S. Treasury yield curve rates with a remaining term to maturity equal to the expected life of the option.

An increase in the risk-free rate or expected dividend yield would lead to a decrease in the fair value of the put option. An increase in the expected volatility or expected term of the option would lead to an increase in the fair value of the put option. The significant unobservable inputs are not interrelated. The fair value of the instruments is not significantly sensitive to a reasonable change in any of the significant unobservable inputs.

8. Financial assets and liabilities (continued)

Loans and borrowings

In March 2013, the Group issued two series of Ruble denominated bonds, in an aggregate principal amount of 20,000. The bonds are due for repayment in full in 2023, subject to a five-year put option. The coupon rate for both series was set at 8.0% per annum, paid semiannually, subject to revision in five years. The net proceeds of the bonds issue were applied to prepay in full the VTB Credit Facility in the amount of 11,000 and to partially prepay one of the Sberbank Credit Facilities in the amount of 9,000.

Finance costs expense increased from 4,942 for the nine months ended 30 September 2012 to 8,651 for the nine months ended 30 September 2013 due to the increase in loans and borrowings as a result of the shareholder restructuring and dividend payment in April 2012.

9. Share-based compensation

Long-term incentive programme 2012

In October 2012, the Company's Board of Directors approved a long-term motivation and retention programme for certain key executive and senior level employees under which the parties who are selected to participate are awarded phantom share options. In the aggregate, the value ascribed to the full package of phantom share options available for award is 1.1% of the share capital of the Company (equal to 7,000,000 phantom shares) at the base price of $17.86 per share. The plan has a three-year duration and the awarded share options vest in April-May 2014 and April-May 2015 and are settled in cash upon vesting, based on the difference between the base price and the weighted-average price of the Company's shares in the period between 15 January and 15 March in the relevant year of vesting. Vesting of the options is generally contingent upon the recipient's continued employment with the Group.

In February 2013, a total number of 2,133,000 phantom share options were granted to certain key executive and senior level employees under the 2012 long-term incentive programme.

The respective awards are classified as a liability. The fair value of the options has been estimated using the Monte Carlo model. The fair value of each grant is estimated at the end of each reporting period. The expected volatility is estimated based on the average historical volatility of publicly traded guideline companies over the period equal to the expected life of the options granted. The dividend yield is included in the model based on expected dividend payments. The risk free rate is determined on the basis of U.S. Treasury yield curve rates with a remaining term to maturity equal to the expected life of the options. The expected term of the options equals their vesting term as the options are settled in cash at the end of vesting period.

The fair value of options granted during the nine months ended 30 September 2013 is 483 Rubles per option. The compensation expense recognised during the nine months ended 30 September 2013 in the interim condensed consolidated statement of comprehensive income is 430, including related social charges.

9. Share-based compensation (continued)

CEO long-term incentive plan

In May 2013, a company owned by the Company's CEO, Mr Ivan Tavrin, exercised an option granted by MegaFon Investments (Cyprus) Limited, a wholly-owned subsidiary of the Company ("MICL") and acquired an additional 7,750,000 shares, or 1.25% of the total issued shares of the Company. The shares were acquired at the IPO offer price, corresponding to $20 per share, for the total cash consideration of 4,869. As a result of the completion of the transaction, the interest of MICL was reduced to 7.57%.

The following table summarises the number of options under the CEO long-term incentive plan:

Outstanding as of 1 January 2013	23,250,000
Exercised	(7,750,000)
Outstanding as of 30 September 2013	**15,500,000**
Exercisable as of 30 September 2013	—

The weighted-average share price at the date of exercise of the option in May 2013 was $31.05 (975 Rubles) per share.

The table below summarises the grant date fair value of the options:

Nonvested as of 1 January 2013	1,755
Vested (recognised compensation expense)	(992)
Nonvested as of 30 September 2013	**763**

None of the stock options were granted, forfeited or expired during the nine months ended 30 September 2013.

Long-Term Incentive Program 2013

In August 2013, the Company's Board of Directors approved a long-term motivation and retention program for certain key executive and senior level employees under which the parties selected to participate are awarded phantom share options. In the aggregate, the value ascribed to the full package of phantom share options for which options may be awarded is 1.1% of the share capital of OJSC MegaFon (equal to 7,000,000 phantom shares) at the base price of $24.25 per share. The plan has a three-year duration and the awarded share options vest in April-May 2015 and April-May 2016 and are settled in cash upon vesting. Payments shall be made on the basis of the difference between the base price and the weighted average price of the Company's shares in the period between 15 January and 15 March of the relevant year of vesting. Vesting of the options is generally contingent upon the recipient's continuing employment with the Company.

10. Sales and marketing expenses

Sales and marketing expenses for the three and nine months ended 30 September are as follows:

	Three months ended 30 September		Nine months ended 30 September	
	2013	**2012**	**2013**	**2012**
Advertising	1,731	2,145	4,264	6,165
Dealer commissions	1,607	1,888	3,980	6,069
Cash collection commissions	1,287	1,273	3,402	3,493
Total sales and marketing expenses	**4,625**	**5,306**	**11,646**	**15,727**

11. General and administrative expenses

General and administrative expenses for the three and nine months ended 30 September are as follows:

	Three months ended 30 September		Nine months ended 30 September	
	2013	**2012**	**2013**	**2012**
Compensation expenses and related social charges	6,664	6,494	20,177	19,461
Rent	3,195	3,107	9,448	9,076
Operating taxes	1,856	1,768	5,329	5,053
Network repairs and maintenance	1,415	1,330	3,928	3,789
Utilities	1,193	995	3,214	2,795
Change in allowance account for trade and other receivables and other non-financial assets	1,180	391	1,661	1,204
Radio frequency fees	1,045	974	3,012	3,012
Office maintenance	438	435	1,248	1,329
Professional services	173	265	626	1,114
Vehicle costs	170	155	481	480
Materials and supplies	38	49	131	167
Insurance	19	21	54	66
Social infrastructure expenses *(Note 14)*	—	—	—	330
Other expenses	479	466	1,288	1,445
Total general and administrative expenses	**17,865**	**16,450**	**50,597**	**49,321**

12. Income tax

The Group calculates the period income tax expense using the tax rate that would be applicable to the expected total annual earnings. The major components of income tax expense for the three and nine months ended 30 September in the interim condensed consolidated statement of comprehensive income are as follows:

	Three months ended 30 September		**Nine months ended 30 September**	
	2013	**2012**	**2013**	**2012**
Current income tax	5,480	3,037	13,235	7,829
Deferred income tax/(benefit)	(658)	509	(843)	(260)
Total income tax expense	**4,822**	**3,546**	**12,392**	**7,569**

13. Related parties

As of 30 September 2013 and 31 December 2012, the Group is primarily owned by USM Group, the ultimate controlling party of the Company, and TeliaSonera Group, another major shareholder with significant influence over the Group. Alfa Group held an equity interest in the Company until 24 April 2012.

The following tables provide the total amount of transactions that have been entered into with related parties and balances of accounts with them for the relevant financial periods:

	Three months ended 30 September		**Nine months ended 30 September**	
	2013	**2012**	**2013**	**2012**
Revenues from USM Group	358	68	748	68
Revenues from TeliaSonera Group	120	58	366	140
Revenues from Euroset	108	—	170	—
	586	**126**	**1,284**	**208**
Services from USM Group	274	236	771	1,114
Services from TeliaSonera Group	401	171	846	557
Services from Euroset	228	—	558	—
Services from Alfa Group	—	—	—	263
	903	**407**	**2,175**	**1,934**

	30 September 2013	**31 December 2012**
Due from USM Group	1,477	850
Due from TeliaSonera Group	125	154
Due from Euroset	190	82
	1,792	**1,086**
Due to USM Group	20,476	17,558
Due to TeliaSonera Group	260	53
Due to Euroset	107	57
	20,843	**17,668**

13. Related parties (continued)

Terms and conditions of transactions with related parties

Outstanding balances as of 30 September 2013 and 31 December 2012 are unsecured. There have been no guarantees provided or received for any related party receivables or payables. As of 30 September 2013 and 31 December 2012, the Group has not recorded any impairment of receivables relating to amounts owed by related parties.

USM Group

The outstanding balances and transactions with USM Group relate to operations with Garsdale, USM Holdings Limited, an indirect owner of Garsdale, and their consolidated subsidiaries.

As of 30 September 2013 and 31 December 2012, amounts due to USM Group include 20,116 and 16,812, respectively, related to the Group's obligation to acquire Garsdale's 50% interest in Lefbord, which owns 50% of Euroset.

TeliaSonera Group

The outstanding balances and transactions with TeliaSonera Group relate to operations with various companies in that Group. Revenues and cost of services principally related to roaming agreements between MegaFon and members of the TeliaSonera Group located outside Russia and a wireline interconnection agreement with TeliaSonera International Carrier Russia.

Alfa Group

The transactions with Alfa Group relate to operations with Altimo, AlfaStrakhovanie and Alfa Bank, members of Alfa Group. Alfa Group held a 25.1% interest in the Group through its wholly-owned subsidiary Allaction Limited until 24 April 2012, when Allaction Limited ceased to hold any shareholding in the Group and ceased to be a related party.

Euroset

Euroset is the Group's joint venture with OJSC VimpelCom, formed in December 2012. Also in December 2012, the Group entered into a dealership agreement with Euroset which qualifies as a related party transaction.

14. Commitments, contingencies and uncertainties

Operating environment

Russia continues economic reforms and development of its legal, tax and regulatory frameworks as required by a market economy. The future stability of the Russian economy is largely dependent upon these reforms and developments and the effectiveness of economic, financial and monetary measures undertaken by the government.

The Russian economy is vulnerable to market downturns and economic slowdowns elsewhere in the world. The global financial crisis has resulted in uncertainty regarding further economic growth, availability of financing and cost of capital, which could negatively affect the Group's

14. Commitments, contingencies and uncertainties (continued)

future financial position, financial performance and business prospects. Management believes it is taking appropriate measures to support the sustainability of the Group's business in the current circumstances.

3G licence capital commitments

In May 2007, MegaFon was awarded a licence that expires on 21 May 2017 for the provision of 3G wireless communications services for the entire territory of the Russian Federation. The 3G licence was granted subject to certain capital and other commitments.

The three major conditions were that the Group builds a specified number of base stations that support 3G standards, starts commercial exploitation of the 3G technology in each region of the Russian Federation over the period from May 2008 through May 2010, and also builds a certain number of base stations by the end of the third, fourth and fifth years from the date of granting of the licence. The Group has complied with all of the 3G licence conditions.

4G/LTE licence capital commitments

In July 2012, the Federal Service for Supervision in Communications, Information Technologies and Mass Media granted the Group a licence and allocated frequencies to provide services under the 4G/LTE standard in Russia.

Under the terms and conditions of this licence, the Group is obligated to provide 4G/LTE services in each population center with over 50,000 inhabitants in Russia by 2019. The Group is also obligated to make capital expenditures of at least 15,000 annually toward the 4G/LTE roll-out until the network is fully deployed, to clear frequencies currently allocated to the military at its own cost and to compensate other operators for surrendering frequencies in an aggregate amount of 401. In 2012, the Group fully paid the compensation due to the other operators. It is currently not able to reasonably estimate the amount of the cost of clearing military frequencies.

Social infrastructure expenses

From time to time, the Group may decide to maintain certain social infrastructure assets which are not owned by the Group and not recorded in the consolidated financial statements as well as to incur education, science and other social costs. Such activities are conducted in collaboration with non-governmental charity organisations. These expenses are presented as part of the other general and administrative expenses in the interim condensed consolidated statement of comprehensive income.

Taxation

Russian tax, currency and customs legislation are subject to varying interpretations and changes, which can occur frequently. Management's interpretation of such legislation as applied to transactions and activities of the Group may be challenged by the relevant regional and federal authorities. Recent events within Russia suggest that the tax authorities are taking a more assertive position in their interpretation and enforcement of the legislation and assessments and as a result, it is possible that transactions and activities that have not been challenged in the past may now be challenged. Therefore, significant additional taxes, penalties and interest may be

14. Commitments, contingencies and uncertainties (continued)

assessed. Fiscal periods remain open to review by the authorities in respect of taxes for the three calendar years preceding the current year. Under certain circumstances reviews may cover longer periods.

The Group's management believes that its interpretation of the relevant legislation is appropriate and is in accordance with the current industry practice and that the Group's tax, currency and customs positions will be sustained. However, the interpretations of the relevant authorities could differ.

As of 11 November 2013, the Group's management estimated the possible effect of additional taxes, before fines and interest, if any, on these interim condensed consolidated financial statements, if the authorities were successful in enforcing different interpretations, in the amount of up to approximately 217.

Litigation

The Group is not a party to any material litigation, although in the ordinary course of business, some of the Group’s subsidiaries may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which they operate. In the opinion of management, the Company’s and its subsidiaries’ liabilities, if any, in all pending litigation, other legal proceedings or other matters, will not have a material effect on the financial condition, financial performance or liquidity of the Group.

15. Events after the reporting date

Acquisition of Scartel

On 1 October 2013, MegaFon acquired 100% of the shares of Maxiten Co Limited, which holds a 100% interest in a group of subsidiaries (together “Scartel”) that provide 4G/LTE telecommunication services under brand “Yota”, from the Group’s controlling shareholder Garsdale, for $1,180 million deferred consideration (38,167 at the exchange rate as of 30 September 2013), of which 50% is payable in one year from the date of acquisition and the other 50% in two years after the acquisition. Further, on the date of acquisition the Group repaid Scartel’s indebtedness to Telecominvest Holdings Limited, an indirect subsidiary of Garsdale, in the amount of $477 million (15,429 at the exchange rate as of 30 September 2013). The Group also had a pre-existing cash advance of 1,069 due from Scartel for future services as of 30 September 2013.

The primary reason for the acquisition was to strengthen the Group’s leadership position in the 4G/LTE services market.

The initial accounting for the business combination is incomplete at the time these financial statements are authorised for issue as the Group is still finalising the valuation of the assets acquired and liabilities assumed and the allocation of the purchase price, therefore no further disclosures have been made.

15. Events after the reporting date (continued)

Financing

On 17 October 2013, the Company drew $43.7 million (1,413 at the exchange rate as of 30 September 2013) out of $110 million (3,558 at the exchange rate as of 30 September 2013) available under the credit facility agreement with Société Générale and Crédit Agricole Corporate and Investment Bank Helsinki Branch (“Finnvera VII credit facility”).