# OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

**Consolidated Financial Statements**

At December 31, 2004 and
2003 and for the Years Ended
December 31, 2004, 2003 and 2002

# OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

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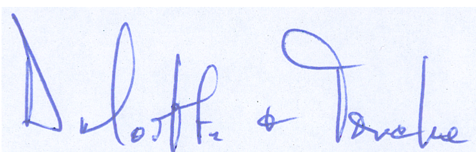
## REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Shareholders of OJSC Mobile TeleSystems:

We have audited the accompanying consolidated balance sheets of Mobile TeleSystems, a Russian Open Joint-Stock Company, and subsidiaries (the “Group”) as of December 31, 2004 and 2003, and the related consolidated statements of operations, changes in shareholders’ equity and cash flows for each of the three years in the period ended December 31, 2004. These financial statements are the responsibility of the Group’s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Group as of December 31, 2004 and 2003, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.



March 22, 2005, except for Note 23,
as to which the date is May 24, 2005

## OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEETS
### AT DECEMBER 31, 2004 AND 2003
*(Amounts in thousands of U.S. dollars, except share and per share amounts)*

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| **CURRENT ASSETS:** | | |
| Cash and cash equivalents (Note 4) | $ 274,150 | $ 90,376 |
| Short-term investments, including related party amounts of $73,100 and $245,000 as of December 31, 2004 and 2003, respectively (Note 5) | 73,360 | 245,000 |
| Trade receivables, net (Note 6) | 162,525 | 99,951 |
| Accounts receivable, related parties (Note 17) | 17,768 | 3,356 |
| Inventory (Note 7) | 89,518 | 67,291 |
| Prepaid expenses | 79,971 | 46,679 |
| Deferred tax asset, current portion (Note 14) | 49,850 | 44,423 |
| VAT receivable | 272,578 | 209,629 |
| Other current assets | 21,235 | 33,774 |
| **Total current assets** | 1,040,955 | 840,479 |
| **PROPERTY, PLANT AND EQUIPMENT**, net of accumulated depreciation of $901,416 and $532,268, respectively (Note 8) | 3,234,318 | 2,256,076 |
| **LICENSES,** net of accumulated amortization of $417,158 and $257,024, respectively (Notes 3 and 20) | 771,271 | 703,103 |
| **GOODWILL** (Notes 3 and 22) | 108,329 | 8,533 |
| **OTHER INTANGIBLE ASSETS,** net of accumulated amortization of $277,905 and $148,052, respectively (Notes 3 and 9) | 328,533 | 304,144 |
| **DEBT ISSUANCE COSTS,** net of accumulated amortization of $9,345 and $4,586, respectively (Note 11) | 16,546 | 9,431 |
| **INVESTMENTS IN AND ADVANCES TO ASSOCIATES** (Note 19) | 81,235 | 103,585 |
| **Total assets** | $ 5,581,187 | $ 4,225,351 |

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

## OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

### CONSOLIDATED BALANCE SHEETS (CONTINUED)
### AT DECEMBER 31, 2004 AND 2003
***(Amounts in thousands of U.S. dollars, except share and per share amounts)***

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| **CURRENT LIABILITIES:** | | |
| Accounts payable, related parties (Note 17) | $ 17,009 | $ 31,904 |
| Trade accounts payable | 242,495 | 168,039 |
| Deferred connection fees, current portion (Note 10) | 45,083 | 21,467 |
| Subscriber prepayments and deposits | 308,859 | 191,768 |
| Debt, current portion (Note 11) | 370,845 | 103,312 |
| Notes payable, current portion (Note 11) | - | 597,836 |
| Capital lease obligations, current portion (Notes 12 and 17) | 8,561 | 9,122 |
| Income tax payable | 22,567 | 11,128 |
| Accrued liabilities (Note 13) | 180,677 | 143,789 |
| Other payables | 33,872 | 19,604 |
| **Total current liabilities** | 1,229,968 | 1,297,969 |
| **LONG-TERM LIABILITIES:** | | |
| Notes payable, net of current portion (Note 11) | 800,000 | 800,000 |
| Debt, net of current portion (Note 11) | 753,795 | 142,418 |
| Capital lease obligations, net of current portion (Notes 12 and 17) | 3,947 | 7,646 |
| Deferred connection fees, net of current portion (Note 10) | 47,665 | 25,177 |
| Deferred taxes (Note 14) | 160,390 | 180,628 |
| **Total long-term liabilities** | 1,765,797 | 1,155,869 |
| **Total liabilities** | 2,995,765 | 2,453,838 |
| **COMMITMENTS AND CONTINGENCIES** (Note 21) | - | - |
| **MINORITY INTEREST** | 62,099 | 47,603 |
| **SHAREHOLDERS' EQUITY:** | | |
| Common stock: (2,096,975,792 shares with a par value of 0.1 rubles authorized and 1,993,326,138 shares issued as of December 31, 2004 and 2003, 432,414,940 of which are in the form of ADS (Note 1)) | 50,558 | 50,558 |
| Treasury stock (7,202,108 and 9,929,074 common shares at cost as of December 31, 2004 and 2003, respectively) (Note 16) | (7,396) | (10,197) |
| Additional paid-in capital | 564,160 | 559,911 |
| Unearned compensation (Note 16) | (1,780) | (869) |
| Shareholder receivable (Note 11) | (18,237) | (27,610) |
| Accumulated other comprehensive income (Note 2) | 22,444 | 7,595 |
| Retained earnings | 1,913,574 | 1,144,522 |
| **Total shareholders' equity** | 2,523,323 | 1,723,910 |
| **Total liabilities and shareholders' equity** | $ 5,581,187 | $ 4,225,351 |

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

## OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF OPERATIONS
### FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
***(Amounts in thousands of U.S. dollars, except share and per share amounts)***

| | Years ended December 31, | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| **NET OPERATING REVENUE** | | | |
| Services revenue and connection fees | $ 3,800,271 | $ 2,465,089 | $ 1,299,141 |
| Sales of handsets and accessories | 86,723 | 81,109 | 62,615 |
| | 3,886,994 | 2,546,198 | 1,361,756 |
| Cost of services, excluding of depreciation and amortization shown separately below (including related party amounts of $56,722, $37,680 and $31,607, respectively) | 481,097 | 301,108 | 196,445 |
| Cost of handsets and accessories | 218,590 | 173,071 | 90,227 |
| General and administrative expenses (including related party amounts of $14,557, $11,002 and 9,602, respectively) (Note 18) | 575,296 | 355,230 | 215,942 |
| Provision for doubtful accounts (Note 6) | 26,459 | 32,633 | 7,047 |
| Other operating expenses | 29,777 | 18,859 | 6,067 |
| Sales and Marketing expenses (including related party amounts of $59,113, $23,668 and $12,140, respectively) | 460,983 | 326,783 | 171,977 |
| Depreciation and Amortization expenses | 675,729 | 415,916 | 209,680 |
| Net operating income | 1,419,063 | 922,598 | 464,371 |
| CURRENCY EXCHANGE AND TRANSACTION GAINS | (6,529) | (693) | 3,474 |
| OTHER EXPENSES/(INCOME) (including related party amounts of $5,303, $6,161 and $5,141, respectively): | | | |
| Interest income | (21,792) | (18,076) | (8,289) |
| Interest expense | 107,956 | 106,551 | 44,389 |
| Other income, net | (33,456) | 3,420 | (2,454) |
| Total other expenses (income), net | 52,708 | 91,895 | 33,646 |
| Income before provision for income taxes and minority interest | 1,372,884 | 831,396 | 427,251 |
| PROVISION FOR INCOME TAXES (Note 14) | 354,664 | 242,480 | 110,417 |
| MINORITY INTEREST | 30,342 | 71,677 | 39,711 |
| NET INCOME | $ 987,878 | $ 517,239 | $ 277,123 |
| Weighted average number of common shares outstanding | 1,984,497,348 | 1,983,374,949 | 1,983,359,507 |
| Earnings per share, basic and diluted: | | | |
| Net income | $ 0.50 | $ 0.26 | $ 0.14 |

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

## OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY
### FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
***(Amounts in thousands of U.S. dollars, except share amounts)***

| | Common Stock | | Treasury Stock | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Shares | Amount | Shares | Amount | Other com-prehensive income | Additional Paid-in Capital | Unearned Compen-sation | Share-holder Receivable | Retained Earnings | Total |
| **BALANCES, December 31, 2001** | 1,993,326,138 | $ 50,558 | (9,966,631) | $ (10,206) | $ - | $ 555,794 | $ - | $ (38,958) | $ 461,091 | $ 1,018,279 |
| Receivable from Sistema (Note 11): | - | - | - | - | - | - | - | - | - | - |
| Increases for interest | - | - | - | - | - | 2,073 | - | (2,073) | - | - |
| Payments from Sistema | - | - | - | - | - | - | - | 6,619 | - | 6,619 |
| Issuance of stock options (Note 16) | - | - | - | - | - | 235 | (235) | - | - | - |
| Amortization of deferred compensation (Note 16) | - | - | - | - | - | - | 23 | - | - | 23 |
| Dividends declared | - | - | - | - | - | - | - | - | - | - |
| Translation adjustment | - | - | - | - | - | - | - | - | - | - |
| Net income | - | - | - | - | - | - | - | - | 277,123 | 277,123 |
| **BALANCES, December 31, 2002** | 1,993,326,138 | $ 50,558 | (9,966,631) | $ (10,206) | - | $ 558,102 | $ (212) | $ (34,412) | $ 738,214 | $ 1,302,044 |
| Receivable from Sistema (Note 11): | | | | | | | | | | |
| Increases for interest | - | - | - | - | - | 807 | - | (807) | - | - |
| Payments from Sistema | - | - | - | - | - | - | - | 7,609 | - | 7,609 |
| Issuance of stock options (Note 16) | - | - | - | - | - | 1,002 | (1,002) | - | - | - |
| Stock options exercised (Note 16) | - | - | 37,557 | 9 | - | - | - | - | - | 9 |
| Amortization of deferred compensation (Note 16) | - | - | - | - | - | - | 345 | - | - | 345 |
| Dividends declared (Note 1) | - | - | - | - | - | - | - | - | (110,931) | (110,931) |
| Translation adjustment | - | - | - | - | 7,595 | - | - | - | - | 7,595 |
| Net income | - | - | - | - | - | - | - | - | 517,239 | 517,239 |
| **BALANCES, December 31, 2003** | 1,993,326,138 | $ 50,558 | (9,929,074) | $ (10,197) | $ 7,595 | $ 559,911 | $ (869) | $ (27,610) | $ 1,144,522 | $ 1,723,910 |
| Receivable from Sistema (Note 11): | | | | | | | | | | |
| Increases for interest | - | - | - | - | - | 1,190 | - | (1,190) | - | - |
| Payments from Sistema | - | - | - | - | - | - | - | 10,563 | - | 10,563 |
| Issuance of stock options (Note 16) | - | - | - | - | - | 1,811 | (1,811) | - | - | - |
| Stock options exercised (Note 16) | - | - | 2,726,966 | 2,801 | - | 1,248 | - | - | - | 4,049 |
| Amortization of deferred compensation (Note 16) | - | - | - | - | - | - | 900 | - | - | 900 |
| Dividends declared (Note 1) | - | - | - | - | - | - | - | - | (218,826) | (218,826) |
| Translation adjustment | - | - | - | - | 15,361 | - | - | - | - | 15,361 |
| Change in fair value of interest rate swaps, net of taxes | - | - | - | - | (512) | - | - | - | - | (512) |
| Net income | - | - | - | - | - | - | - | - | 987,878 | 987,878 |
| **BALANCES, December 31, 2004** | 1,993,326,138 | $ 50,558 | (7,202,108) | $ (7,396) | $ 22,444 | $ 564,160 | $ (1,780) | $ (18,237) | $ 1,913,574 | $ 2,523,323 |

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

## OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CASH FLOWS
### FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
***(Amounts in thousands of U.S. dollars)***

| | Years ended December 31, | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| **CASH FLOWS FROM OPERATING ACTIVITIES:** | | | |
| Net income | $ 987,878 | $ 517,239 | $ 277,123 |
| **Adjustments to reconcile net income to net cash provided by operating activities:** | | | |
| Minority interest | 30,342 | 71,677 | 39,475 |
| Depreciation and amortization | 675,729 | 415,916 | 209,680 |
| Amortization of deferred connection fees | (46,978) | (29,372) | (24,854) |
| Equity in net income of associates | (24,146) | (2,670) | - |
| Inventory obsolescence expense | 4,610 | 3,307 | 5,614 |
| Provision for doubtful accounts | 26,459 | 32,633 | 7,047 |
| Deferred taxes | (76,023) | (43,001) | (18,989) |
| Non-cash expenses associated with stock bonus and stock options | 900 | 213 | 23 |
| **Changes in operating assets and liabilities:** | | | |
| Increase in accounts receivable | (101,223) | (64,384) | (20,305) |
| Increase in inventory | (24,179) | (14,737) | (18,186) |
| Increase in prepaid expenses and other current assets | (18,571) | (19,151) | (10,056) |
| Increase in VAT receivable | (55,044) | (50,230) | (64,154) |
| Increase in trade accounts payable, accrued liabilities and other current liabilities | 331,835 | 148,544 | 30,354 |
| **Net cash provided by operating activities** | 1,711,589 | 965,984 | 412,772 |
| **CASH FLOWS FROM INVESTING ACTIVITIES:** | | | |
| Acquisitions of subsidiaries, net of cash acquired | (355,744) | (667,206) | (143,396) |
| Purchases of property, plant and equipment | (1,204,400) | (839,165) | (502,054) |
| Purchases of intangible assets | (154,544) | (119,606) | (72,218) |
| Purchases of short-term investments | (114,440) | (215,000) | - |
| Proceeds from sale of short-term investments | 286,340 | - | 55,304 |
| Investments in and advances to associates | (413) | (69,110) | (35,557) |
| **Net cash used in investing activities** | (1,543,201) | (1,910,087) | (697,921) |

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

## OJSC MOBILE TELESYSTEMS AND SUBSIDIARIES

### CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
### FOR THE YEARS ENDED DECEMBER 31, 2004, 2003 AND 2002
***(Amounts in thousands of U.S. dollars)***

| | Years ended December 31, | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| **CASH FLOWS FROM FINANCING ACTIVITIES:** | | | |
| Proceeds from stock options exercise | 4,049 | - | - |
| Proceeds from issuance of notes | - | 1,097,000 | 50,808 |
| Repayment of notes | (600,000) | - | - |
| Notes and debt issuance cost | (12,039) | (9,556) | (649) |
| Capital lease obligation principal paid | (15,274) | (22,646) | (1,804) |
| Dividends paid including taxes | (232,662) | (110,864) | - |
| Proceeds from loans | 1,177,556 | 712,716 | 52,851 |
| Loan principal paid | (320,511) | (677,374) | (7,008) |
| Payments from Sistema | 9,654 | 8,269 | 6,619 |
| **Net cash provided by financing activities** | 10,773 | 997,545 | 100,817 |
| Effect of exchange rate changes on cash and cash equivalents | 4,613 | 2,273 | (636) |
| **NET INCREASE IN CASH AND CASH EQUIVALENTS:** | 183,774 | 55,715 | (184,968) |
| **CASH AND CASH EQUIVALENTS, beginning of year** | 90,376 | 34,661 | 219,629 |
| **CASH AND CASH EQUIVALENTS, end of year** | $ 274,150 | $ 90,376 | $ 34,661 |
| **SUPPLEMENTAL INFORMATION:** | | | |
| Income taxes paid | $ 430,109 | $ 286,016 | $ 147,346 |
| Interest paid | $ 142,899 | $ 79,824 | $ 43,438 |
| **Non-cash investing activities:** | | | |
| Additions to network equipment and software under capital lease | $ 2,861 | $ 10,928 | $ 18,917 |
| Payable related to business acquisition (Note 3) | $ - | $ 27,500 | $ - |
| Additions to network through Hermes financing | $ 8,800 | $ - | $ - |

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

## 1. DESCRIPTION OF BUSINESS

***Business of the Group*** – OJSC Mobile TeleSystems and its subsidiaries ("MTS" or the "Group") is the leading provider of wireless telecommunication services in the Russian Federation ("RF"), Ukraine and Uzbekistan in terms of the number of subscribers and revenues. The Group has operated primarily in the GSM standard since 1994.

Open Joint-Stock Company Mobile TeleSystems ("MTS OJSC" or the "Company") was created on March 1, 2000, through the merger of Closed Joint-Stock Company Mobile TeleSystems ("MTS CJSC") and RTC CJSC, a wholly-owned subsidiary. MTS CJSC was formed in 1993 to design, construct and operate a cellular telecommunications network in Moscow and the Moscow region. The development of the network was achieved through green-field build-out in the regions for which the company was granted 900 or 1800 MHz ("GSM-900" and "GSM-1800") cellular licenses or through the acquisition of majority stakes in local GSM operators (see Note 20 Operating Licenses and Note 3 Businesses Acquired).

The Company's shares are traded in the form of American Depositary Shares ("ADS"). Each ADS represents 20 shares of common stock of the Company. The Company issued a total of 17,262,204 ADS, representing 345,244,080 common shares.

***Ownership*** – As of December 31, 2004 and December 31, 2003, MTS' shareholders of record and their respective percentage direct interests were as follows:

| | December 31, | |
|---|---|---|
| | 2004 | 2003 |
| Joint-Stock Financial Corporation "Sistema" ("Sistema") | 41.0% | 41.0% |
| T-Mobile Worldwide Holding GmbH ("T-Mobile") | 10.1% | 25.4% |
| VAST, Limited Liability Company ("VAST") | 3.1% | 3.1% |
| Invest-Svyaz-Holding, Closed Joint-Stock Company | 8.0% | 8.0% |
| ADS Holders | 21.7% | 17.4% |
| GDR Holders and Others | 16.1% | 5.1% |
| | 100.0% | 100.0% |

In March 2003, Sistema and T-Mobile (together, "the Shareholders") entered into a call option agreement, pursuant to which T-Mobile granted Sistema the option to acquire from it 199,332,614 shares of MTS, representing 10.0% of outstanding common stock of MTS. On April 26, 2003, Sistema exercised its option with T-Mobile to purchase an additional 6.0% of the outstanding common stock of MTS and purchased T-Mobile's 49.0% interest in Invest-Svyaz-Holding, bringing its interest in Invest-Svyaz-Holding to 100.0%. Concurrently with this transaction, T-Mobile sold its holding of 5.0% in MTS on the open market in the form of Global Depositary Receipts ("GDRs") listed on the London Stock Exchange.

In December 2004 T-Mobile sold 15.09% stake in MTS on the open market in form of the GDR's.

Sistema owns 51.0% equity interest in VAST, a limited liability company incorporated under the laws of the Russian Federation; the remaining 49.0% interest is held by ASVT, a Russian open joint-stock company. Sistema's effective ownership in MTS is 50.6% at December 31, 2004 and December 31, 2003.

In April 2003, Sistema issued $350.0 million 10.25% notes, due in 2008. These notes are collateralized by 193,473,900 shares of common stock of MTS OJSC.

On June 30, 2003, the Group approved cash dividends of $1.12 per ADS ($0.056 per share) for a total of $111.0 million. As of December 31, 2004 dividends were fully paid.

On November 28, 2003, common shares of MTS OJSC were included by the Board of Moscow Interbank Currency Exchange ("MICEX") into the MICEX "B" Quotation List.

On June 24, 2004, MTS' shareholders approved cash dividends totaling $220.0 million ($2.2 per ADS), including 1.1 million related to treasury stock, which were fully paid by December 31, 2004.

## 2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND NEW ACCOUNTING PRONOUNCEMENTS

***Accounting Principles*** – MTS maintains its accounting books and records in Russian rubles for its subsidiaries located in the Russian Federation ("RF"), in Ukrainian hryvnias for Ukrainian Mobile Communications ("UMC"), and Uzbek som for Uzdunrobita based on respective local accounting and tax legislations. The accompanying consolidated financial statements have been prepared in order to present MTS' financial position and its results of operations and cash flows in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") and expressed in terms of U.S. dollars.

The accompanying consolidated financial statements differ from the financial statements used for statutory purposes in that they reflect various adjustments, not recorded on the entities' books, which are appropriate to present the financial position, results of operations and cash flows in accordance with U.S. GAAP. The principal adjustments are related to revenue recognition, foreign currency translation, deferred taxation, consolidation, acquisition accounting and depreciation and valuation of property and equipment and intangible assets.

***Basis of Consolidation*** – Wholly-owned subsidiaries and majority-owned subsidiaries where the Company has operating and financial control are consolidated. Those ventures where the Company exercises significant influence, but does not have operating and financial control are accounted for using the equity method. All significant intercompany accounts and transactions are eliminated upon consolidation. The Company's share in net income of unconsolidated affiliates is included in other income in the accompanying consolidated statements of operations and disclosed in Note 19. Results of operations of subsidiaries acquired are included in the consolidated statements of operations from the date of their acquisition.

As of December 31, 2004 and 2003, MTS has investments in the following significant legal entities:

| | Accounting Method | December 31, 2004 | December 31, 2003 |
|---|---|---|---|
| ACC | Consolidated | 100.0% | 100.0% |
| Telecom XXI | Consolidated | 100.0% | 100.0% |
| Telecom-900 | Consolidated | 100.0% | 100.0% |
| SCS-900 | Consolidated | 100.0% | 88.5% |
| FECS-900 | Consolidated | 100.0% | 60.0% |
| Uraltel | Consolidated | 99.8% | 99.8% |
| MTS Finance (1) | Consolidated | 100.0% | 100.0% |
| BM Telecom | Consolidated | 100.0% | 100.0% |
| Kuban-GSM | Consolidated | 100.0% | 100.0% |
| Dontelecom | Consolidated | 100.0% | 100.0% |
| MTS-Barnaul | Consolidated | 100.0% | 100.0% |
| BIT | Consolidated | 100.0% | 100.0% |
| MTS-Capital | Consolidated | 100.0% | 100.0% |
| UMC | Consolidated | 100.0% | 100.0% |
| Sibchallenge | Consolidated | 100.0% | 100.0% |
| TSS | Consolidated | 100.0% | 100.0% |
| Volgograd Mobile | Consolidated/ Equity | 100.0% | 50.0% |
| Astrakhan Mobile | Consolidated/ Equity | 100.0% | 50.0% |
| Mar Mobile GSM | Consolidated | 100.0% | 100.0% |
| Primtelefon | Consolidated/ Equity | 100.0% | 50.0% |
| MSS | Consolidated | 91.0% | 83.5% |
| ReCom | Consolidated | 53.9% | 53.9% |
| TAIF Telcom | Consolidated | 100.0% | 52.7% |
| UDN-900 | Consolidated | 100.0% | 51.0% |
| Novitel | Consolidated | 100.0% | 51.0% |
| MTS-Kostroma | Consolidated | 100.0% | 100.0% |
| MTS-NN | Consolidated | 100.0% | 65.0% |
| Uzdunrobita | Consolidated | 74.0% | - |
| Sibintertelecom | Consolidated | 93.5% | - |
| Gorizont-RT | Consolidated | 76.0% | - |
| Telesot Alania | Consolidated | 52.5% | - |
| MTS-Komi Republic | Equity | 26.0% | 26.0% |
| MTS Belarus | Equity | 49.0% | 49.0% |
| MTS Tver | Equity | 26.0% | 26.0% |

(1) Represents beneficial ownership;

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

Translation (re-measurement) of financial statements denominated in local currencies into U.S. dollars has been performed in accordance with the provisions of Statement of Financial Accounting Standard ("SFAS") No. 52 "Foreign currency translation":

- For subsidiaries of the Group where functional currency is the U.S. dollar, monetary assets and liabilities have been translated at the period end exchange rates. Non-monetary assets and liabilities have been translated at historical rates. Revenues, expenses and cash flows have been translated at historical rates. Translation differences resulting from the use of these rates have been accounted for as foreign currency gains and losses in the accompanying consolidated condensed statements of operations.
- For UMC and Kuban-GSM where functional currency is the local currency, Ukrainian hryvnia and Russian ruble, respectively, all year end balance sheet items have been translated into U.S. dollars at the period end exchange rate. Revenues and expenses have been translated at period average exchange rate. In addition, a "new cost basis" for all non-monetary assets of Kuban-GSM has been established as of January 1, 2003, when the Russian economy ceased to be considered hyperinflationary. Cumulative translation adjustment, related to the translation of UMC and Kuban-GSM, in the amount of $22.4 million, net of income taxes, was reported as accumulated other comprehensive income in the accompanying consolidated condensed balance sheet at December 31, 2004.

***Management Estimates*** – The preparation of consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Examples of significant estimates include the allowance for doubtful accounts, the recoverability of intangible assets and other long-lived assets, and valuation allowances on deferred tax assets.

***Cash and Cash Equivalents*** – Cash represents cash on hand and in MTS' bank accounts and short-term investments having original maturities of less than three months.

***Short-term Investments*** – Short-term investments represent investments in term deposits, which have original maturities in excess of three months but less than twelve months. These investments are being accounted for at cost.

***Allowance for Doubtful Accounts*** – MTS provides an allowance for doubtful accounts based on management's periodic review for recoverability of accounts receivable from customers and other receivables.

***Prepaid Expenses*** – Prepaid expenses are primarily comprised of advance payments made for inventory and services to vendors.

***Inventory*** – Inventory, accounted for at cost, determined by the first-in, first-out, or FIFO method, consists of telephones and accessories, held for sale and spare parts, to be used for equipment maintenance within next twelve months and other inventory items.

Telephones and accessories, held for sale, are written down to their market values based on specific periodic reviews and are expensed as cost of equipment sold.

***Value-added Tax ("VAT")*** – Value-added tax related to sales is payable to the tax authorities on an accrual basis based upon invoices issued to the customer. VAT incurred for purchases may be reclaimed from the state, subject to certain restrictions, against VAT related to sales.

***Property, Plant and Equipment*** – Property, plant and equipment, including improvements that extend useful lives, are stated at cost. Property, plant and equipment with a useful life of more than one year is capitalized at historical cost and depreciated on a straight-line basis over its expected useful life as follows:

| | |
|---|---|
| Network and base station equipment | 5 – 12 years |
| Leasehold improvements | shorter of 8 - 10 years or lease term |
| Office equipment and computers | 5 years |
| Buildings | 50 years |
| Vehicles | 4 years |

Construction in progress and equipment held for installation is not depreciated until the constructed or installed asset is ready for its intended use.

Maintenance and repair costs are expensed as incurred, while upgrades and improvements are capitalized.

As a result of recent financial statement restatements by numerous U.S. public companies and publication of a letter by the Chief Accountant of the SEC regarding the interpretation of longstanding lease accounting principles, MTS has corrected its accounting practices for the leasehold improvements in the fourth quarter of 2004. The primary effect of this accounting correction was to accelerate to earlier periods depreciation expenses with respect to certain components of previously capitalized leasehold improvements.

These corrections resulted in a cumulative, net charge to net income of $34.9 million in the fourth quarter of 2004, of which $21.5 million relates to the years 1998 through 2003. The net cumulative charge is comprised of a $44.5 million increase in depreciation expense related primarily to depreciation of capitalized leasehold improvements expenses for base stations; a decrease of $1.4 million in the equity net income from the MTS-Belarus also related to depreciation of capitalized leasehold improvements expenses for base stations positions; and increase of $11.0 million related to additional deferred tax benefit due to the change in accounting base for property, plant and equipment.

All components of the net charge are non-cash and do not impact historical or future cash flows or the timing of payments under the related leases.

***Asset Retirement Obligations -*** In accordance with Statement of Financial Accounting Standards, or SFAS, No. 143, "Accounting for Asset Retirement Obligations, the Group calculates an asset retirement obligation and an associated asset retirement cost when the Group have a legal obligation in connection with the retirement of tangible long-lived assets. The Group's obligations under SFAS

No. 143 arise from certain of its leases and relate primarily to the cost of removing equipment from such lease sites. As of December 31, 2004 the estimated assets retirement obligations were not significant to the Group's consolidated financial position and results of operations.

***License Costs*** – License costs are capitalized as a result of (a) purchase price allocated to licenses acquired in business combinations and (b) licenses purchased directly from government organizations, which require license payments.

Current operating licenses of the Group do not provide for automatic renewal upon expiration. As the Group and the industry do not have sufficient experience with the renewal of licenses, license costs are being amortized during the initial license period without consideration of possible future renewals, subject to periodic review for impairment, on a straight-line basis over three to ten years starting from the date such license becomes commercially operational.

***Other Intangible Assets and Goodwill*** – Intangible assets represent various purchased software costs, telephone numbering capacity, acquired customer base and rights to use premises. A part of the rights to use premises was contributed by shareholders to the Group's charter capital. Telephone numbering capacity costs with finite contractual life are being amortized over five to ten years and the rights to use premises are being amortized over ten years. Amortization of numbering capacity costs starts immediately upon the purchase of numbering capacity. Telephone numbering capacity with unlimited contractual life is not amortized, but is reviewed, at least annually, for impairment in accordance with the provisions of SFAS No. 142, "Goodwill and Other Intangible Assets. (SFAS No. 142")

Software costs are amortized over four years. Acquired customer bases are amortized over their estimated average subscriber life from 20 to 76 months. Other intangible assets are being amortized over three to four years. All finite-life intangible assets are being amortized using the straight-line method.

Goodwill represents an excess of the cost of business acquired over the fair market value of identifiable net assets at the date of acquisition.

Goodwill is reviewed for impairment at least annually or whenever it is determined that one or more impairment indicators exist. The Group determines whether an impairment has occurred by assigning goodwill to the reporting unit identified in accordance with SFAS No. 142, and comparing the carrying amount of the reporting unit to the fair value of the reporting unit. If a goodwill impairment has occurred, the Group recognizes a loss for the difference between the carrying amount and the implied fair value of goodwill. To date, no impairment of goodwill has occurred.

***Leasing Arrangements*** – The Group accounts for leases based on the requirements of SFAS No. 13, "Accounting for Leases." Certain subsidiaries of the Group lease operating facilities, which include switches, base stations and other cellular network equipment as well as billing systems. For capital leases, the present value of future minimum lease payments at the inception of the lease is reflected as an asset and a liability in the balance sheet. Amounts due within one year are classified as short-term liabilities and the remaining balance as long-term liabilities.

***Subscriber Acquisition Costs*** – Subscriber acquisition costs represent the direct costs paid for each new subscriber enrolled through MTS' independent dealers. MTS expenses these costs as incurred.

***Investments Impairment*** – Management periodically assesses the realizability of the carrying values of the investments and if necessary records impairment losses to write the investment down to fair value. For the three years in the period ended December 31, 2004, no such impairment has occurred.

***Debt Issuance Costs*** – Debt issuance costs are amortized using the effective interest method over the terms of the related debt.

***Impairment of Long-Lived Assets*** – MTS periodically evaluates the recoverability of the carrying amount of its long-lived assets in accordance with SFAS No. 144, "Accounting for the Impairment or Disposal of Long-Lived Assets." Whenever events or changes in circumstances indicate that the carrying amounts of those assets may not be recoverable, MTS compares undiscounted net cash flows estimated to be generated by those assets to the carrying amount of those assets. When these undiscounted cash flows are less than the carrying amounts of the assets, MTS records impairment losses to write the asset down to fair value, measured by the estimated discounted net future cash flows expected to be generated from the use of the assets. No impairment of long-lived assets has occurred during the three years in the period ended December 31, 2004.

***Subscriber Prepayments*** – MTS requires the majority of its customers to pay in advance for telecommunication services. All amounts received in advance of service provided are recorded as a subscriber prepayment liability and are not recorded as revenues until the related services have been provided to the subscriber.

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

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

- Service revenue and connection fees: (a) subscription fees, (b) usage charge, (c) value added service fees, (d) roaming fees charged to other operators for guest roamers utilizing MTS' network, (e) connection fees and (f) prepaid phone cards;
- Sales of handsets and accessories.

***Subscription Fees*** – MTS recognizes revenues related to the monthly network fees in the month that the wireless service is provided to the subscriber.

***Usage Charges and Value Added Services Fees*** – Usage charges consist of fees based on airtime used by subscriber, the destination of the call and the service utilized.

Value added service fees are based on usage of airtime or volume of data transmitted for value added services, such as short message services, internet usage and data services. MTS recognizes revenues related to usage charges and value added services in the period when services are rendered.

***Roaming Fees*** – MTS charges roaming per-minutes fees to other wireless operators for non-MTS subscribers utilizing MTS' network. MTS recognizes such revenues when the services are provided.

***Connection Fees*** – MTS defers initial connection fees on its prepaid and postpaid tariff plans from the moment of initial signing of the contract with subscribers over the estimated average subscriber life. Prior to December 31, 2003 the Group estimated that the average expected term of the subscriber relationship ranging from 39 to 47 months.

Based on management analysis of the subscriber base in the regions the Group operates, churn periods effective January 1, 2004, have been changed accordingly. Commencing January 1, 2004 the Group calculates an average expected term of the subscriber relationship for each region and amortizes regional connection fees accordingly. Average expected subscribe life is ranging from 20 to 76 months. The effect of change in estimate in 2004 was approximately $8.5 million, net of income tax or $0.004 per share.

***Prepaid Phone Cards*** – MTS sells prepaid phone cards to subscribers, separately from the handset. These cards allow subscribers to make a predetermined allotment of wireless phone calls and/or take advantage of other services offered by the Group, such as short messages and sending or receiving faxes.

At the time that the prepaid phone card is purchased by a subscriber, MTS records the receipt of cash as a subscriber prepayment. The Group recognizes revenues from the sale of phone cards in the period when the subscriber uses airtime under the phone card. Unused airtime on sold phone cards is not recognized as revenues until the related services have been provided to the subscriber or the prepaid phone card expired.

Recently MTS introduced a new line of prepaid service tariff plans, whereby a customer may purchase a package that allows a connection to the MTS network and a predetermined allotment of wireless phone calls and/or other services offered by the Group. Revenues under these plans are allocated between connection fees and service fees based on their relative fair values.

***Sales of Handsets and Accessories*** – MTS sells handsets and accessories to customers who are entering into contracts for service and also as separate distinct transactions. The Group recognizes revenues from the sale of handsets and accessories when a title for product passes to the customer. MTS records estimated returns as a direct reduction of sales at the time the related sales are recorded. The costs of handsets and accessories, whether sold to subscribers through the distribution channel or as part of the service contract, are expensed when title passes to the customer.

In Ukraine, MTS also from time to time sells handsets at prices below cost. MTS recognizes these subsidies in cost of equipment when sale is recorded.

***Expense Recognition*** – Expenses incurred by MTS in relation to the provision of wireless communication services mainly relate to interconnection and line rental costs, roaming expenses, costs of handsets and other accessories sold, depreciation and amortization and maintenance of the network.

Calls made by subscribers from areas outside of territories covered by the Group licenses are subject to roaming fees charged by the wireless provider in those territories. These fees are recorded as roaming expenses, as MTS acts as the principal in the transaction with subscriber and bears the risk of non-collection from the subscriber. Roaming fees are charged to MTS subscribers based on Group's existing tariffs and are recorded as service revenues.

Any fees paid to dealers as commissions are recorded as a component of sales and marketing expenses.

***Taxation*** – Deferred tax assets and liabilities are recognized for the expected future tax consequences of existing differences between financial reporting and tax reporting bases of assets and liabilities, and for the loss or tax credit carry-forwards using enacted tax rates expected to be in effect at the time these differences are realized. Valuation allowances are recorded for deferred tax assets for which it is more likely that these assets will not be realized.

***Advertising Costs*** – Advertising costs are expensed as incurred. Advertising costs for the years ended December 31, 2004, 2003 and 2002 were $159,035, $102,018 and $48,624, respectively, and are reflected as a component of sales and marketing expenses in the accompanying consolidated statements of operations.

***Government Pension Fund*** – Subsidiaries of the Group contribute to the local state pension fund and social fund, on behalf of all its employees.

In Russia, starting from January 1, 2001 all social contributions, including contributions to the pension fund, were substituted with a unified social tax ("UST") calculated by the application of a regressive rate from 35.6% to 2% of the annual gross remuneration of each employee. UST is allocated to three social funds, including the pension fund, where the rate of contributions to the pension fund vary from 28% to 2%, respectively, depending on the annual gross salary of each employee. The contributions are expensed as incurred.

In Ukraine, the subsidiary of the Group is required to contribute a specified percentage of each employee payroll up to a fixed limit to the Ukrainian pension fund, unemployment fund and social security fund.

The Company does not participate in any pension funds other then described above.

***Earnings per Share*** – Basic earnings per share ("EPS") have been determined using the weighted average number of shares outstanding during the year. Diluted EPS reflect the potential dilution of stock options, granted to employees. There are 3,530,970 stock options outstanding as at December 31, 2004.

The following is the reconciliation of the share component for basic and diluted EPS with respect to the Group's net income:

| | December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| Weighted average number of common share outstanding | 1,984,497,348 | 1,983,374,949 | 1,983,359,507 |
| Dilutive effect of stock options, as if exercised | 1,168,573 | 1,727,131 | 405,946 |
| Weighted average number of common shares and potential shares outstanding | 1,985,665,921 | 1,985,102,080 | 1,983,765,453 |

***Fair Value of Financial Instruments*** – The fair market value of financial instruments, consisting of cash and cash equivalents, accounts receivable and accounts payable, which are included in current assets and liabilities, approximates the carrying value of these items due to the short term nature of these amounts. As of December 31, 2004 the $400 million Notes due in 2008 have fair value of 105.5% or $422 million and the $400 million Notes due in 2010 have fair value of 102.4% or $410 million. As of December 31, 2004, fair value of other fixed rate debt including capital lease obligation approximated its carrying value. The fair value of variable rate debt approximates carrying value.

***Derivative Financial Instruments and Hedging Activities*** – From time to time, in its acquisitions the Group uses derivative instruments, consisting of put and call options on all or part of the minority stakes of acquired companies, to defer payment of the purchase price and provide optimal acquisition structuring. In addition, in December 2004, the Group entered into two variable-to-fixed interest rate swap agreements to manage its exposure to changes in fair value of future cash flows of its variable-rate long term debt, which is caused by interest rate fluctuations. The Group does not use derivatives for trading purposes.

The Group accounts for its derivative financial instruments following the provisions of SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities" and SFAS No. 149 "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." All derivatives are recorded as either assets or liabilities in the consolidated balance sheets and measured at their respective fair values. The Group's interest rate swap agreements are designated as a cash flow hedge and the hedging relationship qualifies for hedge accounting. The effective portion of the change in fair value of interest rate swap agreements is, accordingly, recorded in other comprehensive income and reclassified to interest expense when the hedged debt affects the interest expense. Changes in fair value of other derivative instruments are recognized in net income as those instruments were not designated as hedges.

At the inception of the hedge and on a quarterly basis, the Group performs an analysis to assess whether changes in cash flows of its interest rate swap agreements are deemed highly effective in offsetting changes in cash flows of the hedged debt. If at any time the correlation assessment will indicate that the interest rate swap agreements are no longer effective as a hedge, the Group will discontinue hedge accounting and all subsequent changes in fair value will be recorded in net income.

***Comprehensive income*** – Comprehensive income is defined as net income plus all other changes in net assets from non-owner sources. The following is the reconciliation of other comprehensive income, net of tax for the years ended December 31, 2004, 2003 and 2002:

| | Year ended December 31, | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| Net Income | $ 987,878 | $ 517,239 | $ 277,123 |
| Translation Adjustment | 15,361 | 7,595 | - |
| Change in fair value of interest rate swaps, net of tax of $123 | (512) | - | - |
| Total Comprehensive Income | $ 1,002,727 | $ 524,834 | $ 277,123 |

***Comparative Information*** – Certain prior year amounts have been reclassified to conform to the current period presentation.

***Stock-based Compensation*** – MTS accounts for stock options issued to employees, non-employee directors and consultants following the requirements of SFAS No. 123, *"Accounting for Stock-Based Compensation"* and SFAS No. 148 *"Accounting for Stock Based Compensation – Transition and Disclosure, an amendment to FASB Statement No. 123."* Under the requirements of these statements, the Company elected to use intrinsic value of options on the measurement date as a method for accounting for compensation to employees and non-employee directors. Compensation to consultants is measured based on the fair value of options on the measurement date as determined using a binomial option-pricing model.

If the Group had elected to recognize compensation costs based on the fair values of options at the date of the grant, net income and earning per share amounts would have been as follows:

| | December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| Net income as reported | $ 987,878 | $ 517,239 | $ 277,123 |
| Pro-forma effect of the application of fair value method of accounting | (1,078) | (727) | (460) |
| Pro-forma net income | $ 986,800 | $ 516,512 | $ 276,663 |
| Earnings per share – basic and diluted | | | |
| As reported | $ 0.50 | $ 0.26 | $ 0.14 |
| Pro-forma | $ 0.50 | $ 0.26 | $ 0.14 |

***New and Recently Adopted Accounting Pronouncements*** – In January 2003, the Financial Accounting Standards Board, or FASB, issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities – an interpretation of ARB No. 51" ("FIN46"), to address perceived weaknesses in accounting for entities commonly known as special-purpose or off-balance-sheet. In addition to numerous FASB Staff Positions written to clarify and improve the application of FIN . 46, the FASB announced a deferral for certain entities, and an amendment to FIN. 46 entitled FASB Interpretation No. 46R, "Consolidation of Variable Interest Entities" (FIN 46R"). FIN. 46 establishes consolidation criteria for entities for which "control" is not easily discernable under Accounting Research Bulletin No. 51, "Consolidated Financial Statements," which is based on the premise that holders of the equity of an entity control the entity by virtue of voting rights.

FIN. 46 provides guidance for identifying the party with a controlling financial interest resulting from arrangements or financial interests rather than from voting interests. FIN 46 defines the term variable interest entity, or VIE, and is based on the premise that if a business enterprise absorbs a majority of the VIE's expected losses and/or receives a majority of its expected residual returns (measures of risk and reward), that enterprise (the primary beneficiary) has a controlling financial interest in the VIE. Under FIN 46, the assets, liabilities, and results of the activities of the VIE should be included in the consolidated financial statements of the primary beneficiary. The Group was required to apply the provisions of FIN. 46R in the first quarter 2004. As the Group did not have any VIEs during the year ended December 31, 2004, the adoption of this new method of accounting for VIEs did not affect its financial condition or results of operations as of December 31, 2004.

In September 2004, 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. The Group does not anticipate that the adoption of EITF Issue No. 04-1 will have a material impact on its financial position or results of operations.

At the September 2004 meeting of the Emerging Issues Task Force, the SEC staff issued an announcement D-108 "Use of the residual method to value acquired assets other then goodwill" stating that companies must use the direct value method to determine the fair value of their intangible assets acquired in business combinations completed after September 29, 2004.
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, the Group performed the annual impairment test to measure the fair value of our 900 and 1800 megahertz or MHz, licenses in its national footprint using the residual value approach. Under this new accounting guidance, the Group performed an impairment test to measure the fair value of our 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 December 2004, Financial Accounting Standards Board ("FASB") issued SFAS No. 123R (revised 2004), "Share-Based Payment." The statement is a revision of FASB Statement No. 123, "Accounting for Stock Based Compensation" and supersedes Accounting Principles Board, or APB, Opinion No. 25, "Accounting for Stock Issued to Employees." The statement focuses primarily on accounting for transactions in which the Group obtains employee services in share-based payment transactions. This statement requires a public company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This standard is scheduled to become effective in the first interim reporting period beginning after June 15, 2005. Assuming that the effective date is not delayed, the Group will apply this new standard to its interim reporting period beginning July 1, 2005. The Group has not yet determined the amount of impact on the consolidated statements of operations following adoption and subsequent to 2005 or the transition method the Group will use. The Group does not believe that results of the adoption of SFAS No. 123R will be significant to the consolidated financial position or results of operations.

In March 2005, the U.S. Securities and Exchange Commission, or SEC, released Staff Accounting Bulletin 107, "Share-Based Payments", or SAB 107. The interpretations in SAB 107 express views of the SEC staff, or staff, regarding the interaction between SFAS No. 123R and certain SEC rules and regulations, and provide the 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 SFAS 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 SFAS No. 123R, the modification of employee share options prior to adoption of SFAS No. 123R.

In March 2005, 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. The Group is currently in the process of assessing effects of Interpretation 47 on its consolidated financial position and result of operations.

## 3. BUSINESSES ACQUIRED

***Gorizont - RT Acquisition*** – In December 2004, MTS completed transaction to acquire a 76.0% stake in Gorizont-RT, a GSM mobile phone operator in the Republic of Sakha (Yakutia) in the Far East of Russia, for cash consideration of $53.2 million. Gorizont-RT holds licenses to provide GSM-900/1800 services in the Republic of Sakha (Yakutia). Commencing from the date of acquisition, MTS consolidates financial results of Gorizont-RT. The Gorizont-RT's customer base as at the date of acquisition was approximately 100,000 subscribers.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

| | | |
|---|---|---|
| Current assets | $ | 3,820 |
| Non-current asset | | 17,501 |
| License costs | | 26,362 |
| Customer base cost | | 1,050 |
| Trade mark | | 153 |
| Goodwill | | 20,214 |
| Current liabilities | | (4,949) |
| Non-current liabilities | | (529) |
| Deferred taxes | | (6,814) |
| Minority interest | | (3,604) |
| Purchase price | $ | 53,204 |

Goodwill is mainly attributable to economic potential of the market assuming low regional penetration level as of the date of acquisition. License costs are amortized over the remaining contractual terms of the licenses of approximately 0.5 year and customer base is amortized over the average subscriber's life of approximately 60 months.

***Sibintertelecom Acquisition*** – In November 2004, MTS acquired a 93.53% stake in Sibintertelecom, mobile phone operator in Chita region and Aginsk-Buryatsk District in the Far-East of Russia, for cash consideration of $37.4 million. Sibintertelecom holds license to provide 900 MHz services in Chita region and Aginsk-Buryatsk District in the Far-East of Russia. Sibintertelecom is the sole mobile service provider in two regions with a total population of 1.23 million. Commencing from the date of acquisition, MTS consolidates financial results of Sibintertelecom. The company's customer base as at the date of acquisition was approximately 100,000 subscribers.

The acquisition was accounted for using the purchase method of accounting. The purchase price allocation was as follows:

| | | |
|---|---|---|
| Current assets | $ | 5,939 |
| Non-current asset | | 6,966 |
| License costs | | 29,555 |
| Customer base cost | | 1,488 |
| Trademark | | 465 |
| Goodwill | | 10,376 |
| Current liabilities | | (9,523) |
| Deferred taxes | | (7,668) |
| Minority interest | | (190) |
| Purchase price | $ | 37,408 |

Goodwill is mainly attributable to economic potential of the market assuming low regional penetration level as of the date of acquisition. License costs are amortized over the remaining contractual terms of the licenses of approximately 9 years for Chita region and one year for Aginsk-Buryatsk District and customer base is amortized over the average subscriber's life of approximately 44 months.

***Telesot Alania Acquisition*** – In December 2004, MTS purchased a 52.5% stake in Telesot Alania, a GSM mobile phone operator in the Republic of North Ossetia in the Southern part of Russia, for cash consideration of $6.2 million. Telesot Alania holds license to provide 1800/900 MHz services in the Republic of North Ossetia in the Southern part of Russia. Commencing from the date of acquisition, MTS consolidates financial results of Telesot Alania. Telesot Alania's customer base as at the date of acquisition was approximately 54,000 subscribers.

The acquisition was accounted for using the purchase method of accounting. The purchase price allocation was as follows:

| | | |
|---|---|---|
| Current assets | $ | 2,229 |
| Non-current asset | | 5,085 |
| License costs | | 3,606 |
| Customer base cost | | 90 |
| Current liabilities | | (767) |
| Deferred taxes | | (887) |
| Minority interest | | (3,110) |
| Purchase price | $ | 6,246 |

License costs are amortized over the remaining contractual terms of the licenses of approximately 2 years and customer base is amortized over the average subscriber's life of approximately 60 months.

***Uzdunrobita Acquisition*** – In July 2004, MTS entered into an agreement to acquire 74.0% of Uzbekistan mobile operator JV Uzdunrobita ("Uzdunrobita") for a cash consideration of $126.4 million, including transaction costs of $5.4 million. Acquisition was completed on August 1, 2004 and starting from this date Uzdunrobita's financial results are consolidated. Uzdunrobita holds licenses to provide GSM-1800 mobile communication services in the whole territory of Uzbekistan, which has a population of approximately 25.2 million. Uzdunrobita's customer base as of the date of acquisition was approximately 230,000 subscribers.

The acquisition was accounted for using the purchase method. The purchase price allocation for the acquisition was as follows:

| | | |
|---|---|---|
| Current assets | $ | 5,950 |
| Non-current assets | | 67,293 |
| License costs | | 40,861 |
| Customer base cost | | 958 |
| Trademark | | 3,622 |
| Goodwill | | 46,470 |
| Current liabilities | | (14,705) |
| Non-current liabilities | | (1,356) |
| Deferred taxes | | (6,384) |
| Minority interest | | (16,308) |
| Purchase price | $ | 126,401 |

Goodwill is mainly attributable to economic potential of the market assuming low penetration level as of the date of acquisition. License costs are amortized over the remaining contractual terms of the licenses of approximately 12 years and customer base is amortized over the average remaining subscriber's life of approximately 39 months.

MTS also entered into call and put option agreements with the existing shareholders of Uzdunrobita to acquire the remaining 26.0% of common shares of the company. The exercise period for the call and put option is 36 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. Fair value of the option was $4.0 million at December 31, 2004 and included in other current assets on the consolidated balance sheet.

***Primtelefon Acquisition*** – In June 2004, MTS purchased 50.0% of Far-Eastern operator CJSC Primtelefon ("Primtelefon") for cash consideration of $31.0 million, increasing its effective ownership to 100%, as 50% of Primtelefon's shares were controlled through Vostok Mobile, a wholly-owned subsidiary of MTS. Commencing from the date of acquisition of the second stake, MTS consolidates financial results of Primtelefon. Primtelefon holds licenses to provide GSM 900/1800 mobile cellular communications in the Far-East region of Russia. The company's subscriber base as of the date of acquisition of the controlling stake was approximately 216,000 people.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

| | | |
|---|---|---|
| Current assets | $ | 11,041 |
| Non-current assets | | 16,809 |
| License costs | | 21,891 |
| Current liabilities | | (7,488) |
| Non-current liabilities | | (5,671) |
| Deferred taxes | | (5,582) |
| Purchase price | $ | 31,000 |

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 7 years and customer base is amortized over the average remaining subscriber's life of approximately 41 months.

***Telecom-900 Acquisition*** – In August 2001, MTS acquired 81% of the outstanding common stock of Telecom-900, a Russian closed joint-stock company, for a cash consideration of $26.8 million from Sistema. Telecom-900 is the holding company for three regional mobile phone operators, Siberia Cellular System 900 CJSC ("SCS-900"), Uraltel CJSC ("Uraltel"), and Far East Cellular Systems 900 CJSC ("FECS-900").

At the date of acquisition these companies had approximately 96,000 subscribers and licenses to provide GSM 900/1800 mobile services in the Novosibirsk region, Altai Republic, Sverdlovsk region and Khabarovsk region.

Telecom-900 acquisition was accounted for using the purchase method of accounting. The purchase price was allocated as follows:

| | |
|---|---|
| Current assets | $ 12,136 |
| Non-current assets | 29,297 |
| License costs | 31,542 |
| Current liabilities | (21,883) |
| Non-current liabilities | (10,626) |
| Deferred taxes | (7,754) |
| Minority interest | (5,900) |
| Purchase price | $ 26,812 |

In November 2002, MTS acquired the remaining 19% of Telecom-900 from Invest-Svyaz-Holding, a shareholder of the Group and a wholly-owned subsidiary of Sistema, for a cash consideration of $6.9 million. The acquisition was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by $2.7 million.

On August 13, 2003, Telecom-900, completed the purchase of the 43.7% and 2.95% stakes in Uraltel for a cash consideration of $35.7 million. The transaction increased Telecom-900's ownership in Uraltel to 99.85%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by $24.5 million.

In November 2003, the Group completed the purchase of the 30% stake in SCS-900 from Sibirtelecom for cash consideration of $28.6 million. The Group's acquisition of this stake increased its ownership in SCS-900 to 81.0%. On December 29, 2003, the Group acquired for cash consideration of $9.3 million a 100% stake in ILIT LLC, a company which owns a 7.5% stake in SCS-900, increasing its ownership in SCS-900 to 88.5%. The acquisition was accounted using purchase method of accounting. The allocation of purchase price increased recorded license cost by $25.7 million.

In March 2004, the Group acquired 11% stake in SCS-900 from CJSC Sibirskie Zvezdy for cash consideration of $8.5 million, increasing its ownership in SCS-900 to 99.5%. The acquisition was accounted for using a purchase method of accounting. The allocation of purchase price increased recorded license cost by $2.6 million.

In April 2004, the Group acquired 40% stake in FECS-900 from OJSC Dalnevostochnaya Kompaniya Electrosvyazi for cash consideration of $8.3 million, increasing its ownership in FECS-900 to 100.0%. The acquisition was accounted for using a purchase method of accounting. The allocation of purchase price increased recorded license cost by $4.1 million.

License costs are amortized over the remaining contractual terms of the respective license, ranging from 6 to 10 years at the date of the first acquisition. Customer base is amortized over the average remaining subscribers life ranging from 32 to 40 months.

***Tomsk Cellular Communications Acquisition*** – In September 2003, MTS purchased 100.0% of Siberian operator Tomsk Cellular Communications ("TSS") for cash consideration of $47.0 million. TSS holds licenses to provide GSM 900/1800 mobile cellular communications in the Tomsk region. The company's customer base as of the date of acquisition was approximately 183,000 subscribers.

The acquisition was accounted for using the purchase method. The purchase price allocation was as follows:

| | | |
|---|---|---|
| Current assets | $ | 3,299 |
| Non-current assets | | 11,412 |
| License costs | | 49,282 |
| Current liabilities | | (4,543) |
| Non-current liabilities | | (105) |
| Deferred taxes | | (12,345) |
| Purchase price | $ | 47,000 |

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 8 years and customer base is amortized over the average remaining subscribers life of approximately 76 months.

***Sibchallenge Acquisition*** – On August 22, 2003, MTS completed the purchase of 100.0% of Sibchallenge, a cellular operator in the Krasnoyarsk region, for cash consideration of $45.5 million, paid a finder's fee of $2.0 million and assumed net debt of approximately $6.6 million. Sibchallenge holds licenses to provide GSM 900/1800 and DAMPS mobile services in the Krasnoyarsk region of Siberia, the Republic of Khakasiya, and in the Taimyr Autonomous region, all of which are located in the Siberian part of Russia. At the date of acquisition, Sibchallenge had approximately 132,000 subscribers.

The purchase price allocation was as follows:

| | | |
|---|---|---|
| Current assets | $ | 4,078 |
| Non-current assets | | 16,678 |
| License costs | | 52,625 |
| Current liabilities | | (6,405) |
| Non-current liabilities | | (6,628) |
| Deferred taxes | | (12,894) |
| Purchase price | $ | 47,454 |

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 8 years and customer base is amortized over the average remaining subscribers life of approximately 36 months.

***Kuban-GSM Acquisition*** – In March 2002, MTS acquired 51% of Kuban-GSM, a Russian closed joint-stock company, for cash consideration of $71.4 million. At the date of acquisition, Kuban-GSM had approximately 500,000 subscribers and it operates in thirteen major cities throughout the south of the European part of the Russian Federation, including Sochi, Krasnodar and Novorossiisk. The Kuban-GSM acquisition was accounted for using the purchase method of accounting.

The purchase price was allocated as follows:

| | | |
|---|---|---|
| Current assets | $ | 11,751 |
| Non-current assets | | 80,848 |
| License costs | | 62,549 |
| Customer base cost | | 3,561 |
| Current liabilities | | (31,289) |
| Non-current liabilities | | (19,827) |
| Deferred taxes | | (15,866) |
| Minority interest | | (20,327) |
| Purchase price | $ | 71,400 |

In October 2002, MTS exercised its option to acquire additional 353 shares for $5.0 million payable in cash, increasing its ownership in Kuban-GSM to 52.7%. The acquisition of the additional interest was accounted for using the purchase method of accounting. The allocation of the purchase price increased recorded license costs by $4.4 million, increased customer base cost by $0.2 million, and decreased minority interest by $0.5 million.

In September 2003, the Group acquired 100.0% of Kubtelesot for cash consideration of $107.0 million. Kubtelesot owned 47.3% of Kuban-GSM, and the Group's purchase of this stake increased its ownership in Kuban-GSM to 100.0%. Kubtelesot was a holding company with no operational activities. The acquisition was accounted for using the purchase method of accounting.
The allocation of purchase price increased recorded license cost by $57.5 million, increased customer base cost by $8.4 million, and decreased minority interest by $59.0 million.

In May 2004, Kubtelesot was liquidated and all its shares in Kuban-GSM, were transferred to OJSC MTS as the only shareholder.

License costs are amortized over the remaining contractual term of the license of approximately 5 years at the date of the acquisition. Acquired customer base is amortized over the average remaining subscribers life of approximately 48 months.

***UMC Acquisition*** – On March 4, 2003, MTS acquired 57.7% of the outstanding voting interest of UMC, a provider of mobile services in Ukraine, for cash consideration of $199.0 million, including the acquisition of 16.3% of the outstanding voting interest from Deutsche Telekom AG, a related party, for $55.0 million. Acquisition costs relating to the transaction of $1.4 million were capitalized. In connection with the acquisition, MTS also assumed debt of UMC with face value of approximately $65.0 million, with the fair value of approximately $62.0 million. At the date of acquisition, UMC had approximately 1.8 million subscribers and was one of the two leading mobile operators in Ukraine, operating under nationwide GSM 900/1800 and NMT 450 licenses.

The acquisition was accounted for using the purchase method. For convenience, MTS consolidated UMC from March 1, 2003. Purchase price allocation is as follows:

| | |
|---|---|
| Current assets | $ 82,293 |
| Non-current assets | 272,721 |
| License costs | 82,200 |
| Customer base cost | 30,927 |
| Current liabilities | (63,551) |
| Non-current liabilities | (78,580) |
| Deferred taxes | (27,425) |
| Minority interest | (99,581) |
| Purchase price | $ 199,004 |

MTS paid $171.5 million of the purchase price in cash and agreed to pay the balance of the purchase price of $27.5 million to Cetel B.V., a wholly-owned subsidiary of Deutsche Telekom AG, within one year. The amount payable accrued interest of 9% per annum. In March 2004, MTS cash settled the balance payable to Cetel B.V.

MTS also had an option agreement with Ukrtelecom to purchase its remaining 26.0% stake in UMC, exercisable from February 5, 2003 to November 5, 2005, with an exercise price of $87.6 million. On June 4, 2003, MTS exercised its call option. As a result of the transaction, MTS' ownership in UMC increased from 57.7% to 83.7%. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by $10.2 million, increased customer base cost by $13.9 million, and decreased minority interest by $66.4 million.

In addition, MTS entered into a put and call option agreement with TDC Mobile International A/S ("TDC") for the purchase of its 16.3% stake in UMC. The exercise period of the call option was from May 5, 2003 to November 5, 2004, and the put option was exercisable from August 5, 2003 to November 5, 2004. The call option price was $85.0 million plus interest accrued from November 5, 2002 to the date of the exercise at 11% per annum; the price of the put option was calculated based on reported earnings of UMC prior to the exercise and was subject to a minimum amount of $55.0 million. On June 25, 2003, MTS notified TDC of its intent to exercise its rights under the put and call option agreement. The purchase was completed during July 2003. MTS paid cash consideration of approximately $91.7 million to purchase the remaining 16.3% stake in UMC. The acquisition was accounted for using purchase method of accounting. The allocation of purchase price increased recorded license cost by $52.7 million, increased customer base cost by $8.7 million, and decreased minority interest by $43.8 million.

The UMC license costs are amortized over the remaining contractual terms of the licenses of approximately 9 to 13 years at the date of the acquisition, acquired customer base is amortized over the average remaining subscriber's life of approximately 32 months. Other acquired intangible assets, represented mostly by software, are amortized over their respective useful lives of 3 to 10 years.

In accordance with SFAS No. 141 "Business Combinations," the Group recognized $8.0 million of goodwill relating to workforce-in-place.

***TAIF Telcom Acquisition*** – In April 2003, MTS acquired 51.0% of the common shares of TAIF Telcom, a Russian open joint-stock company, for cash consideration of $51.0 million and 50.0% of the preferred shares of TAIF Telcom for cash consideration of $10.0 million. In May 2003, MTS acquired an additional 1.7% of the common shares of TAIF Telcom for cash consideration of $2.3 million. In connection with the acquisitions, MTS also assumed indebtedness of approximately $16.6 million that was collateralized by telecom equipment.

MTS also entered into call and put option agreements with the existing shareholders of TAIF Telcom to acquire the remaining 47.3% of common shares and 50.0% of preferred shares of TAIF Telcom.

The exercise period for the call option on common shares is 48 months from the acquisition date and for the put option on common shares is 36 months following an 18 months period after the acquisition date. The call and put option agreements for the common shares stipulate a minimum purchase price of $49.0 million plus 8% per annum commencing from the acquisition date. The exercise period for the call option on preferred shares is 48 months following a 24 months period after the acquisition date and for the put option on preferred shares it is a 24 months period after the acquisition date. The call and put option agreements for the preferred shares stipulate a minimum purchase price of $10.0 million plus 8% per annum commencing from the acquisition date. Fair value of the option was $3.5 million at December 31, 2003.

The purchase price allocation for initial stake acquired was as follows:

| | | |
|---|---|---|
| Current assets | $ | 3,870 |
| Non-current assets | | 48,391 |
| License costs | | 68,407 |
| Current liabilities | | (26,099) |
| Non-current liabilities | | (5,550) |
| Deferred taxes | | (16,814) |
| Minority interest | | (8,965) |
| Purchase price | $ | 63,240 |

License costs acquired are amortized over the remaining contractual terms of the licenses of approximately 4 years and customer base is amortized over the average remaining subscribers' life of approximately 38 months.

TAIF Telcom provides mobile services in the GSM-900/1800 standard in the Republic of Tatarstan and in the Volga region of Russia. At the date of acquisition, TAIF Telcom had approximately 240,000 subscribers.

In September 2004, MTS exercised its option to acquire the remaining 47.3% of common shares and 50% of preferred shares in TAIF Telcom for cash consideration of $63.0 million, increasing its ownership to 100.0%. The Group received title to the acquired shares in October 2004. The purchase price allocation increased recorded license cost by $35,8 million, increased acquired customer base by $4.2 million; goodwill was recorded in the amount of $21.2 million. Goodwill is mainly attributable to economic potential of the market.

***Dontelecom Acquisition*** – On September 26, 2002, MTS completed its acquisition of 66.7% of the outstanding common stock of Dontelecom, a closed joint-stock company, for cash consideration of $15.0 million (including 33.3% acquired from Sistema for $7.5 million). At the date of acquisition, Dontelecom had approximately 39,000 subscribers. Dontelecom holds a GSM-900/1800 license to operate in the Rostov region. This acquisition was accounted for using the purchase method.

The purchase price was allocated as follows:

| | | |
|---|---|---|
| Current assets | $ | 3,422 |
| Non-current assets | | 8,401 |
| License costs | | 14,739 |
| Current liabilities | | (5,849) |
| Non-current liabilities | | (357) |
| Deferred taxes | | (3,675) |
| Minority interest | | (1,681) |
| Purchase price | $ | 15,000 |

In October 2002, the Group completed the acquisition of the remaining 33.3% of the outstanding common stock of Dontelecom for $7.5 million. The acquisition was accounted for using the purchase method of accounting. The purchase increased the recorded license costs by $7.3 million.

License costs are amortized over the remaining contractual term of the license of approximately 3 years at the date of the acquisition. Customer base is amortized over the average remaining subscribers life of approximately 20 months.

***BM Telecom Acquisition*** – In May 2002, MTS completed its acquisition of 100% of the outstanding common stock of Ufa-based BM Telecom, a closed joint-stock company, for $41.0 million in cash. At the date of acquisition, BM Telecom had approximately 100,000 subscribers and it holds a GSM-900/1800 license to operate in Bashkortostan Republic of Russia. This acquisition was accounted for by the purchase method. The purchase price was allocated as follows:

| | | |
|---|---|---|
| Current assets | $ | 3,312 |
| Non-current assets | | 14,736 |
| License costs | | 48,932 |
| Current liabilities | | (3,603) |
| Non-current liabilities | | (10,227) |
| Deferred taxes | | (12,150) |
| Purchase price | $ | 41,000 |

License costs associated with the acquisition of BM Telecom are amortized over the remaining term of the license of approximately 5 years. Customer base is amortized over the average remaining subscribers life of approximately 30 months.

***Acquisitions of Various Regional Companies*** – In August 2003, the Group reached an agreement to acquire, in a series of related transactions, equity interests in five Russian regional mobile phone operators from MCT Corporation for a total of $71.0 million. The Group agreed to purchase a 43.7% stake in Uraltel (described above) and 100.0% of Vostok Mobile BV, which holds a 50.0% stake in Primtelefon.

The Group also agreed to purchase Vostok Mobile South, which holds 50.0% stakes in Astrakhan Mobile and Volgograd Mobile, as well as an 80.0% stake in Mar Mobile GSM. The Group also entered into agreements to acquire the remaining 20.0% of Mar Mobile GSM and another 2.95% stake in Uraltel from existing shareholders unrelated to MCT Corporation for approximately $1.0 million.

On August 26, 2003, the Group completed the acquisition of Vostok Mobile and recorded a 50.0% stake investment in Primtelefon using equity method of accounting.

On October 14, 2003, the Group completed the purchase of Vostok Mobile South and thus acquired a 50.0% stake in Volgograd Mobile and Astrakhan Mobile and an 80.0% stake in Mar Mobile GSM. Also, in a separate transaction the Group completed the acquisition of the remaining 20.0% stake in Mar Mobile GSM from existing shareholders unrelated to MCT Corporation, thus consolidating a 100.0% ownership in the company.

In August 2004, MTS acquired from UTK the remaining 50% stakes in Astrakhan Mobile and Volgograd Mobile, increasing its ownership to 100%. An acquisition price was paid in cash and amounted to $1.1 million and $2.9 million, respectively. Commencing from the date of acquisition financial results of both companies are consolidated into MTS financial statements. Astrakhan Mobile holds a 800/1800 MHz licenses covering Astrakhan region (population of approximately 1 million) and Volgograd Mobile holds a 800/1800 MHz licenses covering Volgograd region (population of approximately 2.7 million). As of July 31, 2004, two companies provided AMPS/DAMPS services to around 10 thousand subscribers. The acquisition was accounted for using a purchase method of accounting. The allocation of purchase price for the first and second stakes in both companies resulted in increase in license cost by $16.5 million.

In April 2004, MTS acquired from OJSC Sibitelecom additional 7.5% stake in MSS, a company, which operates in the Omsk region, for $2.2 million in cash. This acquisition increased MTS's ownership in MSS to 91%. The acquisition was accounted for using a purchase method of accounting. The allocation of purchase price increased recorded license cost by $1.1 million.

In April and May of 2004, MTS acquired the remaining stakes in the following subsidiaries:

- 35% of MTS-NN (a service provider in Nizhny Novgorod) for $0.5 million, and
- 49% of Novitel (handsets dealer in Moscow) for $1.3 million.

Both acquisitions increased MTS's share in the respective companies to 100%. The acquisitions were accounted for using a purchase method of accounting. The allocation of purchase price increased recorded goodwill by $1.8 million.

In August 2004, MTS acquired from OJSC Volgatelecom remaining 49% stake in UDN-900 for $6.4 million in cash. This acquisition increased MTS's ownership in UDN to 100%. The allocation of purchase price increased recorded license cost by $0.3 million. UDN-900 provides GSM 900 services under the MTS brand in Udmurtia Republic (population 1.6 million). UDN's subscriber base as of July 31, 2004 was 219,760.

***Pro Forma Results of Operations (unaudited)*** – The following unaudited pro forma financial data for the years ended December 31, 2004 and 2003, give effect to the acquisitions of Uzdunrobita, Primtelefon and other various regional companies as if they had occurred at January 1, 2003.

| | December 31, | |
|---|---|---|
| | 2004 | 2003 |
| Pro forma: | | |
| Net revenues | $ 3,986,932 | $ 2,636,072 |
| Net operating income | 1,440,480 | 936,174 |
| Net income | 972,362 | 495,411 |
| Earnings per share, basic and diluted | $ 0.49 | $ 0.25 |

The pro forma information is based on various assumptions and estimates. The pro forma information is not necessarily indicative of the operating results that would have occurred if the Group acquisitions had been consummated as of January 1, 2003, nor is it necessarily indicative of future operating results. The pro forma information does not give effect to any potential revenue enhancements or cost synergies or other operating efficiencies that could result from the acquisitions. The actual results of operations of these companies are included in the consolidated financial statements of the Group only from the respective dates of acquisition.

## 4. CASH AND CASH EQUIVALENTS

Cash and cash equivalents as of December 31, 2004 and 2003 comprised of the following:

| | December 31, | |
|---|---|---|
| | **2004** | **2003** |
| U.S. dollar current accounts | $ 107,172 | $ 20,130 |
| U.S. dollar term deposits | 45,295 | 886 |
| Ruble current accounts | 90,527 | 40,597 |
| Ruble deposits | 2,596 | 20,201 |
| Hryvnia current accounts | 10,190 | 1,371 |
| Uzbek som deposit accounts | 15,106 | - |
| Uzbek som current accounts | 715 | - |
| Other | 2,549 | 7,191 |
| Total cash and cash equivalents | $ 274,150 | $ 90,376 |

## 5. SHORT-TERM INVESTMENTS

Short-term investments, denominated in U.S. dollars, as of December 31, 2004 comprised of the following:

| | Annual interest rate | Maturity date | December 31, 2004 |
|---|---|---|---|
| OJSC Moscow Bank of Reconstruction and Development | 8.4% | December 9, 2005 | $ 30,000 |
| East-West United Bank S.A. | 2.0% | April 04, 2005 | 23,100 |
| OJSC Moscow Bank of Reconstruction and Development | 8.4% | October 10, 2005 | 10,000 |
| OJSC Moscow Bank of Reconstruction and Development | 8.4% | December 14, 2005 | 10,000 |
| Other | | | 260 |
| Total short-term investments | | | $ 73,360 |

Short-term investments, denominated in U.S. dollars, as of December 31, 2003 comprised of the following:

| | Annual interest rate | Maturity date | December 31, 2003 |
|---|---|---|---|
| OJSC Moscow Bank of Reconstruction and Development | 4.8% | February 2, 2004 | $ 200,000 |
| OJSC Moscow Bank of Reconstruction and Development | 8.4% | October 21, 2004 | 19,100 |
| OJSC Moscow Bank of Reconstruction and Development | 8.0% | October 4, 2004 | 10,000 |
| OJSC Moscow Bank of Reconstruction and Development | 8.4% | November 23, 2004 | 5,000 |
| OJSC Moscow Bank of Reconstruction and Development | 8.4% | December 5, 2004 | 5,900 |
| OJSC Moscow Bank of Reconstruction and Development | 8.4% | December 20, 2004 | 5,000 |
| Total short-term investments | | | $ 245,000 |

OJSC Moscow Bank of Reconstruction and Development is a related party (see also Note 17).

## 6. TRADE RECEIVABLES

Trade receivables as of December 31, 2004 and 2003 were as follows:

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| Accounts receivable, subscribers | $ 154,453 | $ 87,149 |
| Accounts receivable, roaming | 24,731 | 26,500 |
| Allowance for doubtful accounts | (16,659) | (13,698) |
| Trade receivables, net | $ 162,525 | $ 99,951 |

The following table summarizes the changes in the allowance for doubtful accounts for the year ended December 31, 2004, 2003 and 2002:

| | December 31, 2004 | December 31, 2003 | December 31, 2002 |
|---|---|---|---|
| Balance, beginning of the year | $ 13,698 | $ 6,270 | $ 5,187 |
| Provision for doubtful accounts | 26,459 | 32,633 | 7,047 |
| Accounts receivable written off | (23,498) | (25,205) | (5,964) |
| Balance, end of the year | $ 16,659 | $ 13,698 | $ 6,270 |

## 7. INVENTORY

Inventory as of December 31, 2004 and 2003 comprised of the following:

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| Spare parts for base stations | $ 14,775 | $ 26,635 |
| Handsets and accessories | 30,574 | 23,499 |
| Other inventory | 44,169 | 17,157 |
| Total Inventory | $ 89,518 | $ 67,291 |

Obsolescence expense for the years ended December 31, 2004, 2003 and 2002 amounted to $4,610, $3,307 and $5,614, respectively, and was included in General and administrative expenses in the accompanying consolidated statements of operations. Spare parts for base stations included in inventory are expected to be utilized within 12 months period.

## 8. PROPERTY, PLANT AND EQUIPMENT

The net book value of property, plant and equipment as of December 31, 2004 and 2003 was as follows:

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| Network ,base station equipment (including leased network and base station equipment of $67,905 and $66,311, respectively) and related leasehold improvements | $ 2,538,240 | $ 1,775,180 |
| Office equipment, computers, software and other (including leased office equipment, computers and software of $1,613 and $1,923, respectively) | 249,458 | 147,395 |
| Buildings related and leasehold improvements | 202,095 | 151,262 |
| Vehicles | 15,658 | 11,611 |
| Property, plant and equipment, at cost | 3,005,451 | 2,085,448 |
| Accumulated depreciation (including accumulated depreciation on leased equipment of $30,304 and $23,343) | (901,416) | (532,268) |
| Equipment for installation | 275,010 | 334,264 |
| Construction in-progress | 855,273 | 368,632 |
| Property, plant and equipment, net | $ 3,234,318 | $ 2,256,076 |

Depreciation expenses during the years ended December 31, 2004, 2003 and 2002 amounted to $385.7, $233.1 and $116.0 million, respectively, including depreciation expenses for leased property, plant and equipment in the amount of $5.4, $7.6 and $3.4 million, respectively.

## 9. OTHER INTANGIBLE ASSETS

Intangible assets at December 31, 2004 and 2003 comprised of the following:

| | | December 31, 2004 | | | December 31, 2003 | | |
|---|---|---|---|---|---|---|---|
| | Useful lives | Gross carrying value | Accumu-lated amorti-zation | Net carrying value | Gross carrying value | Accumu-lated amorti-zation | Net carrying value |
| **Amortized intangible assets** | | | | | | | |
| Acquired customer base | 20 to 76 months | $ 94,632 | $ (50,276) | $ 44,356 | $ 81,289 | $ (18,307) | $ 62,982 |
| Rights to use premises | 10 years | 19,638 | (12,393) | 7,245 | 19,638 | (10,476) | 9,162 |
| Numbering capacity with finite contractual life, software and other | 3 to 10 years | 474,921 | (215,236) | 259,685 | 338,222 | (119,269) | 218,953 |
| | | 589,191 | (277,905) | 311,286 | 439,149 | (148,052) | 291,097 |
| **Unamortized intangible assets:** | | | | | | | |
| Numbering capacity with indefinite contractual life | | 17,247 | - | 17,247 | 13,047 | - | 13,047 |
| Total other intangible assets | | $ 606,438 | $(277,905) | $ 328,533 | $ 452,196 | $(148,052) | $ 304,144 |

As a result of a limited availability of local telephone numbering capacity in Moscow and the Moscow region, MTS has been required to enter into agreements for the use of telephone numbering capacity with several telecommunication operators in Moscow. Costs of acquiring numbering capacity with finite contractual life are amortized over period of five to ten years in accordance with the terms of the contract entered into to acquire such capacity. Numbering capacity with indefinite contractual life is not amortized.

The significant component of MTS' right to use premises was obtained in the form of contributions to its charter capital in 1993. These premises included MTS' administrative offices and facilities utilized for mobile switching centers. In addition and simultaneously with acquisition of UMC in 2003 the Group obtained some additional property rights.

Amortization expense for the years ended December 31, 2004, 2003 and 2002 amounted to $129.9, $69.2 and $30.0 million, respectively. Based on the amortizable intangible assets existing at December 31, 2004, the estimated amortization expense is $130.5 million during 2005, $82.6 million during 2006, $54.3 million during 2007, $37.6 million during 2008, $2.8 million during 2009 and $3.5 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

## 10. DEFERRED CONNECTION FEES

Deferred connection fees for the years ended December 31, 2004 and 2003 were as follows:

| | December 31, | |
|---|---|---|
| | 2004 | 2003 |
| Balance at beginning of the year | $ 46,644 | $ 41,904 |
| Payments received and deferred during the year | 93,082 | 34,112 |
| Amounts amortized and recognized as revenue during the year | (46,978) | (29,372) |
| Balance at end of the year | 92,748 | 46,644 |
| Less current portion | 45,083 | 21,467 |
| Non-current portion | $ 47,665 | $ 25,177 |

MTS defers 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 (see Note 2).

## 11. DEBT

At December 31, 2004 and 2003 debt comprised of the following:

| | Currency | Annual interest rate (Actual rate at December 31, 2004) | December 31, 2004 | December 31, 2003 |
|---|---|---|---|---|
| 9.75% Notes due 2008 | USD | 9.75% | $ 400,000 | $ 400,000 |
| 8.38% Notes due 2010 | USD | 8.38% | 400,000 | 400,000 |
| 10.95% Notes due 2004 | USD | 10.95% | - | 299,640 |
| Floating Rate Notes due 2004 | USD | - | - | 298,196 |
| **Total notes** | | | **$ 800,000** | **$ 1,397,836** |
| **Less current portion** | | | **-** | **597,836** |
| **Total long-term notes** | | | **$ 800,000** | **$ 800,000** |
| Syndicated loan | USD | LIBOR+2.50% (5.28%) | $ 600,000 | $ - |
| EBRD | USD | LIBOR+3.10% (5.88%) | 150,000 | - |
| CSFB | USD | LIBOR+2.20% (4.76%) | 140,000 | - |
| HSBC Bank plc & ING-BHF-Bank | USD | LIBOR+0.44% (3.21%) | 77,003 | |
| Hermes Credit Facility | EUR | EURIBOR+0.65% (2.86%) | 63,851 | 55,550 |
| ING Bank (Eurasia) | USD | LIBOR+2.25%-4.15% (4.81%-6.71%) | 46,667 | 60,000 |
| HSBC | USD | LIBOR+2.75% (5.24%) | 17,500 | 25,000 |
| Ericsson | USD | LIBOR+4.00% (6.56%) | 14,850 | 23,400 |
| Deutsche Telekom AG and TDC Mobile International A/S | USD | - | - | 14,819 |
| Nordea Bank Sweden | USD | LIBOR+0.40% (3.18%) | 6,499 | - |
| West LB | EUR | EURIBOR+2.00% (4.22%) | 4,000 | 5,092 |
| KFW | EUR | EURIBOR+0.95% (3.16%) | 1,478 | 4,313 |
| Citibank | USD | LIBOR+1.15% (3.71%) | 868 | 10,000 |
| Dresdner | USD | - | - | 15,400 |
| AVAL bank | UAH | - | - | 10,890 |
| International Moscow Bank | RUR | - | - | 10,864 |
| MBRD | RUR | - | - | 1,220 |
| Ruble denominated debt | RUR | 4.30%-16.50% | 1,924 | 5,860 |
| Other debt | USD | - | - | 3,322 |
| **Total debt** | | | **$ 1,124,640** | **$ 245,730** |
| **Less current portion** | | | **370,845** | **103,312** |
| **Total long-term debt** | | | **$ 753,795** | **$ 142,418** |

***The Notes*** – On December 21, 2001, MTS Finance S.A. ("MTS Finance"), a 100% beneficially owned subsidiary of MTS, registered under the laws of Luxembourg, issued $250.0 million 10.95% (effective interest rate of 11.25%) notes at the price of 99.254%. Proceeds received from the notes, net of underwriting discount, were $248.1 million. Related debt issuance costs in the amount of $3.9 million were capitalized. On March 20, 2002, MTS Finance issued additional $50.0 million 10.95% (effective interest rate of 10.25%) notes at a price of 101.616%. Proceeds received from these notes, including the offering premium, were $50.8 million. Related debt issuance costs in the amount of $0.6 million were capitalized. All the notes are fully and unconditionally guaranteed by MTS OJSC. MTS Finance made interest payments on the notes semi-annually in arrears on June 21 and December 21 of each year, commencing on June 21, 2002. The notes were listed on the Luxemburg Stock Exchange. In May 2002, these notes were registered with the SEC under the Securities Act of 1933. In December 2004, the Group redeemed all outstanding notes, mentioned above, in the principal amount plus accrued interest thereon to the date of redemption.

On January 30, 2003, MTS Finance issued $400.0 million 9.75% notes at par. These notes are fully and unconditionally guaranteed by MTS OJSC and mature on January 30, 2008. MTS Finance is required to make interest payments on the notes semi-annually in arrears on January 30 and July 30, commencing on July 30, 2003. The notes are listed on the Luxembourg Stock Exchange. Proceeds received from the notes were $400.0 million and related debt issuance costs of $3.9 million were capitalized.

On August 5, 2003, MTS Finance issued $300.0 million notes bearing interest at floating rate 3 months LIBOR + 4.00% at the price of 99%. These notes were fully and unconditionally guaranteed by MTS OJSC and matured on August 7, 2004. MTS Finance was required to make interest payments on the notes quarterly, commencing on November 5, 2003. The notes were listed on the Luxembourg Stock Exchange. Proceeds received from the notes, net of underwriting discount, were $297.0 million and related debt issuance costs of $1.8 million were capitalized. On May 5, 2004, the Group redeemed all outstanding floating rate notes, mentioned above, in the principal amount plus accrued interest thereon to the date of redemption.

On October 14, 2003, MTS Finance issued $400.0 million notes bearing interest at 8.38% at par. The cash proceeds, net of issuance costs of approximately $4.6 million, amounted to $395.4 million. These notes are fully and unconditionally guaranteed by MTS OJSC and will mature on October 14, 2010. MTS Finance is required to make interest payments on the notes semi-annually in arrears on April 14 and October 14 of each year, commencing on April 14, 2004. The notes are listed on the Luxembourg Stock Exchange.

Subject to certain exceptions and qualifications, the indentures governing the notes contain covenants limiting the Group's ability to:

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

In addition, if the Group experiences certain types of mergers, consolidations or other changes in control, noteholders will have the right to require the Group to redeem the notes at 101% of their principal amount, plus accrued interest. The Group is also required to take all commercially reasonable steps necessary to maintain a rating of the notes from Moody's or Standard & Poor's. The notes also have cross default provisions with publicly traded debt issued by Sistema, the shareholder of the Group.

If the Group fails to meet these covenants, after certain notice and cure periods, the noteholders can accelerate the debt to be immediately due and payable.

Management believes that the Group is in compliance with all restrictive debt covenants provisions during the three year period ended as of December 31, 2004.

***Syndicated Loan*** – In July 2004, MTS OJSC entered into a $500.0 million syndicated loan agreement ("Syndicated Loan") with international financial institutions: ING Bank N.V., ABN AMRO Bank N.V., HSBC Bank PLC, Raiffeisen Zentralbank Oesterreich AG ZAO, Bank Austria Creditanstalt AG, Commerzbank Aktiengesellschaft and other. The credit facility bears interest of LIBOR +2.50% per annum and matures in 3 years. The proceeds were used by OJSC MTS for corporate purposes, including refinancing of its existing indebtedness. In September 2004, MTS extended total amount available under the Syndicated Loan for an additional $100.0 million to total amount of $600.0 million. Commitment fee for the Syndicated Loan amounted to $0.5 million. The debt issuance costs in the amount of $10.2 million has been capitalized. At December 31, 2004, $600.0 million were outstanding under this credit facility. The Syndicated Loan is subject to certain restrictive covenants including, but not limited to, certain financial ratios. As of December 31, 2004, the Group is in compliance with all existing covenants.

***EBRD Loan*** – In December 2004, MTS OJSC entered into a credit facility with European Bank for Reconstruction and Development ("EBRD") for the total amount of $150.0 million. The facility bears interest at LIBOR +3.10%. Commitment fee of 0.50% per annum should be paid in accordance with the credit agreement. The final maturity of this agreement is December 15, 2011. As of December 31, 2004, the balance outstanding under the loan was $150.0 million. The loan is subject to certain restrictive covenants including, but not limited to, certain financial ratios. As of December 31, 2004 the Group is in compliance with all existing covenants.

***CSFB Loans*** – In April 2004, MTS OJSC entered into a short-term bridge loan facility with Credit Swiss First Boston for the total amount of $200.0 million. The proceeds were used to repay the floating rate notes originally due in August 2004. Amounts outstanding under the loan agreement bear interest at LIBOR+2.25%. The MTS OJSC repaid $110.0 million and $90.0 million due under the loan in June 2004 and July 2004, respectively.

In October 2004, MTS Finance entered into a short-term loan facility with CSFB for the total amount of $140.0 million. Amounts outstanding under the loan agreement bear interest at LIBOR+2.20%. The final maturity of this short-term loan facility was April 29, 2005. As of December 31, 2004 the balance outstanding under the loan was $140.0 million. The loan is subject to certain restrictive covenants including, but not limited to, certain financial ratios. As of December 31, 2004, the Group is in compliance with all existing covenants.

***HSBC Bank plc and ING BHF-BANK AG*** – In October 2004, MTS OJSC entered into two credit facility agreements with HSBC Bank plc and ING BHF-BANK AG for the total amount $122.3 million. The funds were used to purchase telecommunication equipment and software from Siemens AG and Alcatel SEL AG for the technical upgrade and expansion of network. Euler Hermes Kreditversicherungs-AG, the German credit export agency, is providing export credit cover in respect to both facilities. The facility bears interest at LIBOR + 0.44%. A commitment fee of 0.20% per annum and an agreement fee of 0.25% should be paid in accordance with the loan agreement. The principal and interest amounts are to be repaid in seventeen equal half year installments, starting July 2005 for the first agreement and September 2005 for the second one. As of December 31, 2004, the outstanding balance under these agreements was $77.0 million. The final maturity of these agreements is in July and September 2013. The loan facility is subject to certain restrictive covenants. As of December 31, 2004, the Group is in compliance with all existing covenants.

***Hermes Credit Facility ("HECF")*** – On December 30, 2003, UMC entered into Hermes Credit Facility with ING BHF Bank and Commerzbank Aktiengesellschaft to finance the acquisition of GSM equipment from Siemens AG. The aggregate amount available under this credit facility is EUR 47.4 million ($64.5 million at December 31, 2004). In 2004, the agreement was amended to increase the amount available under the facility by EUR 9.2 million ($12.5 million as of

December 31, 2004). The loan is guaranteed by MTS OJSC and bears interest at EURIBOR+0.65%. The amount outstanding is redeemable in 10 equal semi-annual installments starting on July 31, 2004. As of December 31, 2004 and 2003, the amounts outstanding under the loan were $63.9 million and $55.6 million, respectively. The available credit facility as at December 31, 2004 and 2003 was $0.6 million and $3.7 million, respectively.

***ING Bank ("Eurasia")*** – In September 2003, UMC entered into a $60.0 million syndicated credit facility with ING Bank ("Eurasia") ZAO, ZAO Standard Bank and Commerzbank Aktiengesellschaft with an interest rate of LIBOR + 2.25% – 4.15%. The loan is guaranteed by MTS OJSC. The proceeds were used by UMC to refinance its existing indebtedness. The loan is payable in 8 equal quarterly installments starting from September 2004. As of December 31, 2004 and 2003, $46.7 million and $60.0 million were outstanding, respectively, under this credit facility.

***HSBC Bank LLC*** – In October 2003, TAIF Telcom entered into a $25.0 million credit facility with HSBC Bank LLC, which is guaranteed by MTS OJSC. The facility bears interest at LIBOR + 2.75% and is redeemable in ten equal quarterly installments commencing on June 2004. The funds were used to purchase telecommunication equipment and general corporate purposes. The loan is subject to certain restrictive covenants including, but not limited to, restriction on the amount of dividends paid by TAIF Telcom until MTS owns 100% of TAIF Telcom's outstanding common stock. As of December 31, 2004 and 2003 the outstanding balances under the credit facility were $17.5 million and $25.0 million, respectively.

***Ericsson Debt Restructuring*** – In December 1996, Rosico, a wholly-owned subsidiary merged into MTS OJSC in June 2003, entered into a credit agreement with Ericsson Project Finance AB ("Ericsson") that provided for a credit facility with an aggregate principal amount of $60.0 million and had a maximum term of five years (the "Ericsson Loan"). The loan was repayable in ten equal consecutive quarterly payments of $6.0 million commencing in 1999. On July 24, 2001, MTS, Rosico and Ericsson signed an amendment to the credit agreement rescheduling Rosico principal payments in nineteen consecutive quarterly installments. The amounts advanced under the agreement bear interest of LIBOR + 4.00%. If Rosico fails to pay any amount under this facility, the overdue interest would bear interest at a rate of additional 6.00% per annum. The credit agreement contains covenants restricting Rosico's ability to encumber its present and future assets and revenues without lender's express consent.

Concurrent with the Group's acquisition of Rosico, Sistema agreed to fund the full and timely repayment of the Ericsson Loan and to indemnify Rosico and MTS for any costs incurred by either Rosico or MTS in connection with the repayment of the Ericsson Loan. During 2000, Sistema and MTS agreed on a method that would allow Sistema to fund its obligation in a manner that minimizes the total costs of meeting this obligation (including related tax costs). Under this method, MTS enters into a long-term, ruble-denominated promissory notes with 0% interest and maturities from 2049 to 2052 to repay a portion of the funding from Sistema. The carrying value of these notes is insignificant at December 31, 2004, December 31, 2003 and 2002. The Group records interest expense on these notes over the term such that the full amount of the obligation will be reflected as a liability at the date of repayment. Through December 31, 2004, Sistema has made payments under this obligation in the amount of $60.0 million, $45.1 million of which are repayable in the form of long-term, ruble denominated promissory notes with 0% interest. Amounts receivable from Sistema under this indemnification are recorded as shareholder receivable in the accompanying consolidated balance sheets.

On February 25, 2003, Ericsson assigned all of its rights and obligations under the Ericsson Loan to Salomon Brothers Holding Company, Inc.

At December 31, 2004 and 2003, $14.9 million and $23.4 million were outstanding, respectively, under the Ericsson Loan.

***Deutsche Telekom AG and TDC Mobile International A/C*** – The credit facilities with Deutsche Telekom AG and TDC Mobile International A/C bear interest at LIBOR + 5.00%-7.00% and were redeemable in five equal quarterly installments commencing April 2003. At December 31, 2003 the unpaid balance under these loans was $14.8 million. The debt was fully repaid in April 2004.

***Nordea Bank Sweden loan*** – In September 2003, Primtelefon entered into a long-term loan facility with Nordea Bank Sweden for the total amount of $9.8 million. Amounts outstanding under the loan agreement bear interest at LIBOR+0.40% and mature in October 2006. The loan is guaranteed by MTS OJSC. As of December 31, 2004 and 2003, the amounts outstanding under the loan were $6.5 million and nil, respectively.

***WestLB International loan*** – In July 2002, MTS-P entered into a credit facility agreement with WestLB International S.A. Amounts outstanding under this agreement bear interest of EURIBOR + 2.00% per annum for the first two years for each advance and 4.00% per annum for the remaining interest periods for each advance until maturity. The final maturity of this agreement is December 28, 2006. The loan is guaranteed by MTS OJSC. As of December 31, 2004 and 2003, the balances outstanding under the loan were $4.0 million and $5.1 million, respectively.

***KFW*** – On December 21, 1998, UMC entered into two loan agreements with KWF, a German bank, for EUR 1.9 million and EUR 10.9 million. These loans bear interest at EURIBOR + 0.95% per annum and mature on March 31, 2004 and February 28, 2005, respectively. As of December 31, 2004 and 2003 the outstanding balances under these loans were $1.5 million and $4.3 million, respectively.

***Citibank credit facility*** – In November 2002, Telecom XXI entered into a credit facility with Citibank. Amounts borrowed under the credit facility bear interest of LIBOR + 3.50% per annum. Overdue amounts bear an additional 3.00% per annum. The $10.0 million outstanding under this facility as of December 31, 2003 was fully repaid in July 2004.

The balance outstanding as at December 31, 2004 in the amount of $0.9 million is comprised of the amounts borrowed by Primtelefon and Astrakhan Mobile, which bear interest at LIBOR + 1.15% and are payable in 2006.

***Dresdner Bank Credit Facilities*** – In December 2001 and April 2002, UDN-900 entered into credit agreements with Dresdner Bank (“Dresdner”), expiring on April 2004. As of December 31, 2003 the amount outstanding under these agreements was $5.4 million. These borrowings bear interest at LIBOR + 3.20% per annum and are guaranteed by MTS OJSC. In April 2004, the loans were fully repaid.

In October 2002, MSS entered into a credit agreement with Dresdner to borrow up to $10.0 million. As of December 31, 2004 and 2003, $nil and $10.0 million, respectively were outstanding under this agreement. Borrowings under this agreement bear interest of LIBOR + 3.20%-3.35% per annum. The loan was guaranteed by MTS OJSC.

***AVAL Bank*** – On December 31, 2003 UMC had the balance of $10.9 million of overdraft with AVAL bank. The short-term overdraft facility was limited to 110.0 million hryvnias ($20.6 million at December 31, 2003), bore interest at 10.00-16.00% per annum and matured on June 30, 2004. The balance of overdraft was fully repaid in January 2004.

***International Moscow Bank*** – On June 9, 2003, Kuban-GSM entered into a 350.0 million ruble ($12.6 million at December 31, 2004) credit facility with International Moscow Bank. Amounts borrowed under this facility mature in June 2005, have an interest rate of 13.4% per annum and are collateralized by equipment with a book value of 458.1 million rubles (approximately $16.5 million at December 31, 2004). As of December 31, 2003, approximately $10.9 million was outstanding under this facility. The loan was fully repaid in March 2004. As of December 31, 2004, the available credit facility was $12.6 million.

***ABN AMRO loan -*** In November 2004 MTS signed a loan agreement with ABN AMRO Bank N.V. (Stockholm branch) for $ 56.6 million and EUR 8.4 million. These funds will be used to purchase telecommunication equipment from Ericsson AB for expansion of the network. The loan is repayable on a biannual basis in equal installments over 9 years and has an interest rate of USD LIBOR/EURIBOR+0.35% per annum. As of December 31, 2004, $nil was outstanding under the facility.

***MBRD –*** In August 2004, Novitel entered into ruble-denominated credit facility with Moscow Bank for Reconstruction and Development (“MBRD”), a related party. The facility allows borrowings of up to 60.0 million ruble ($2.2 million at December 31, 2004). The loan bears interest at 15.00% per annum and is collateralized by equipment with a book value of 63.0 million rubles (approximately $2.3 million at December 31, 2004). The facility was fully repaid by of December 2004.

In 2003, Dontelecom entered into a ruble-denominated loan agreement with MBRD. The amounts borrowed bear interest at 18.5% and are payable in June 2004. As of December 31, 2003, $1.2 million were outstanding under the facility. The loan was fully repaid in June 2004.

During the year 2003, MTS OJSC signed several short-term loan agreements with MBRD. Amounts borrowed were payable during the period of one to two months. During 2003, interest expense on these loans was approximately $0.3 million.

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

| Payments due in the year ended December 31, | |
|---|---|
| 2005 | $ 370,845 |
| 2006 | 365,749 |
| 2007 | 227,195 |
| 2008 | 447,240 |
| 2009 | 40,100 |
| Thereafter | 473,511 |
| | $ 1,924,640 |

In December 2004, the Group entered into two variable-to-fixed interest rate swap agreements with ABN AMRO Bank N.V and with HSBC Bank PLC to hedge MTS’ exposure to variability of future cash flows caused by the change in LIBOR related to the syndicated loan. MTS agreed with ABN

AMRO to pay a fixed rate of 3.27% and receive a variable interest of LIBOR on $100.0 million for the period from October 7, 2004 up to July 27, 2007. MTS agreed with HSBC Bank PLC to pay a fixed rate of 3.25% and receive a variable interest of LIBOR on $150.0 million for the period from October 7, 2004 up to July 27, 2007.These instruments qualify as cash flow hedges under the requirements of SFAS No. 133 as amended by SFAS No. 149. As of December 31, 2004, the Group recorded a liability of $0.6 million in relation to these contracts in the accompanying consolidated balance sheet and a loss of $0.5 million net of tax of $0.1 million as other comprehensive income in the accompanying consolidated statement of changes in shareholders equity in relation to the change in fair value of these agreements. In 2004 there were no amounts reclassified from other comprehensive income to income due to hedge ineffectiveness.

## 12. CAPITAL LEASE OBLIGATIONS

The following table presents future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of December 31, 2004:

| | | |
|---|---|---|
| Payments due in the year ended December 31, | | |
| 2005 | $ | 10,547 |
| 2006 | | 3,233 |
| 2007 | | 826 |
| 2008 | | 171 |
| 2009 | | 169 |
| Thereafter | | 451 |
| Total minimum lease payments (undiscounted) | | 15,397 |
| Less amount representing interest | | (2,889) |
| Present value of net minimum lease payments | | 12,508 |
| Less current portion of lease payable | | (8,561) |
| Non-current portion of lease payable | $ | 3,947 |

For a schedule by years of future minimum lease payments under capital leases to Invest-Svyaz-Holding, a related party, together with the present value of the net minimum lease payments as of December 31, 2004, see Note 17.

## 13. ACCRUED LIABILITIES

Accrued liabilities at December 31, 2004 and 2003 were comprised of the following:

| | December 31, | | | |
|---|---|---|---|---|
| | 2004 | | 2003 | |
| Accrued payroll and vacation | $ | 44,673 | $ | 6,595 |
| VAT | | 32,174 | | 33,545 |
| Interest payable | | 31,177 | | 32,911 |
| Taxes other than income | | 23,706 | | 31,139 |
| Other accruals | | 48,947 | | 39,599 |
| Total accrued liabilities | $ | 180,677 | $ | 143,789 |

## 14. INCOME TAX

MTS' provision for income taxes was as follows for the years ended December 31, 2004, 2003 and 2002:

| | December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| Current provision for income taxes | $ 430,687 | $ 285,481 | $ 129,406 |
| Deferred income tax benefit | (76,023) | (43,001) | (18,989) |
| Total provision for income taxes | $ 354,664 | $ 242,480 | $ 110,417 |

Effective January 1, 2002, the statutory income tax rate in Russia was set at 24%.
From January 1, 2004, UMC statutory income tax rate changes from 30% to 25% as a result of changes in Ukranian tax legislation.

The statutory income tax rate reconciled to MTS' effective income tax rate is as follows for the years ended December 31, 2004, 2003 and 2002:

| | December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| Statutory income tax rate for year | 24.0% | 24.0% | 24.0% |
| Adjustments: | | | |
| Expenses not deductible for tax purposes | 1.0 | 2.3 | 2.1 |
| Effect of higher tax rate of UMC | 0.2 | 0.9 | - |
| Currency exchange and transaction gains | 1.2 | 1.6 | - |
| Other | (0.6) | 0.4 | (0.3) |
| Effective income tax rate | 25.8% | 29.2% | 25.8% |

Temporary differences between the tax and accounting bases of assets and liabilities give rise to the following deferred tax assets and liabilities at December 31, 2004 and December 31, 2003:

| | December 31, | |
|---|---|---|
| | **2004** | **2004** |
| Assets (liabilities) arising from tax effect of: | | |
| **Deferred tax assets** | | |
| Depreciation of property, plant and equipment | $ 48,829 | $ 19,171 |
| Deferred connection fees | 22,598 | 8,805 |
| Subscriber prepayments | 18,151 | 12,030 |
| Accrued expenses | 18,934 | 7,316 |
| Allowance for doubtful accounts | 5,220 | 14,157 |
| Inventory obsolescence | 2,759 | 3,906 |
| Amortization of intangible assets | 9,148 | 5,444 |
| Loss carryforward (Rosico and MSS) | 7,171 | 7,113 |
| Other | 4,328 | 5,683 |
| | 137,138 | 83,625 |
| Valuation allowance | (7,171) | (7,113) |
| Total deferred tax assets | 129,967 | 76,512 |
| **Deferred tax liabilities** | | |
| Licenses acquired | $ (179,935) | $ (168,889) |
| Depreciation of property, plant and equipment | (31,429) | (14,084) |
| Customer base | (10,746) | (15,506) |
| Other intangible assets | (9,797) | (11,980) |
| Other | (8,600) | (2,258) |
| Total deferred tax liabilities | (240,507) | (212,717) |
| Net deferred tax liability | (110,540) | (136,205) |
| Net deferred tax assets, current | $ 49,850 | $ 44,423 |
| Net deferred tax liability, long term | $ (160,390) | $ (180,628) |

As of December 31, 2004, the Group had a tax loss carryforward in the amount of $29,879 related to operations of Rosico. As of December 31, 2003, the Group had taxable losses carryforwards in the amount of $29,638 related to operations of Rosico and MSS. These loss carryforwards resulted in deferred tax assets at December 31, 2004 and December 31, 2003 in the amounts of $7,171 and $7,113, respectively. As Russian companies are required to file tax declarations on a standalone basis, MTS is not able to utilize these losses to offset its taxable income. While Rosico was merged into MTS OJSC in June 2003, the Group has still recorded a valuation allowance for the entire amount of the available tax loss carryforward related to Rosico as MTS has not yet performed all procedures necessary to determine what amounts will be available for deductions in the future.

The Group does not record a deferred tax liability related to undistributed earnings of UMC, as it intends to permanently reinvest these earnings. The undistributed earnings of UMC amounted to $559.5 and $327.8 million as of December 31, 2004 and 2003, respectively.

## 15. SHAREHOLDERS' EQUITY

In accordance with Russian laws, earnings available for dividends are limited to profits determined in accordance with Russian statutory accounting regulations, denominated in rubles, after certain deductions. Net income of MTS OJSC for the years ended December 31, 2004, 2003 and 2002 that is distributable under Russian legislation totaled 15,209 million rubles ($527.9 million), 13,423.0 million rubles ($437.4 million) and 10,759 million rubles ($343.3 million), respectively.

In December 2004, the shareholder of the Group T-Mobile Worldwide Holding GMBH, sold 15.09% stake in MTS on the open market in the form of GDRs.

## 16. STOCK BONUS AND STOCK OPTION PLANS

In 2000 MTS established a stock bonus plan and stock option plan (the "Option Plan") for selected officers, key employees and key advisors. During its initial public offering in 2000 (see Note 1) MTS allotted 9,966,631 shares of it common stock to fund the Option Plan.

During 2004, 2003 and 2002, MTS made several grants pursuant to its stock option plan to employees and directors of the Group. These options generally vest over a two year period from the date of the grant, contingent on continued employment of the grantee with the Company.

A summary of the status of the Group's Option Plan is presented below:

| | Shares | Weighted average exercise price, U.S. dollar |
|---|---|---|
| Outstanding at January 1, 2002 | 1,829,221 | 1.31 |
| Granted | 2,846,681 | 1.49 |
| Forfeited | (27,481) | 1.31 |
| Outstanding at December 31, 2002 | 4,648,421 | 1.42 |
| Granted | 1,952,632 | 2.43 |
| Exercised | (37,557) | 1.31 |
| Exchanged for cash award | (1,746,310) | 1.31 |
| Forfeited | (19,776) | 1.31 |
| Outstanding at December 31, 2003 | 4,797,410 | 1.87 |
| Granted | 1,665,256 | 5.95 |
| Exercised | (2,726,966) | 1.49 |
| Forfeited | (204,730) | 1.92 |
| Outstanding at December 31, 2004 | 3,530,970 | 4.09 |

As of December 31, 2004, the Group had the following stock options outstanding:

| Exercise prices | Number of shares | Remaining weighted average life (years) |
|---|---|---|
| 2.43 | 1,868,214 | 0.54 |
| 5.95 | 1,662,756 | 1.54 |
| | 3,530,970 | |

None of the options outstanding at December 31, 2004 and 2003 were exercisable.

According to the terms of the Option Plan, the exercise price of the options equals the average market share price during the hundred day period preceding the grant date. The difference in the exercise price of the option and the market price at the date of grant is shown as unearned compensation in the consolidated statements of changes in shareholders' equity and is amortized to expense over the vesting period of 2 years. This amount historically had been insignificant to the consolidated financial statements.

The Group's Option Plan does not routinely allow a grantee to receive cash in lieu of shares, however due to the lack of liquidity for the Group's stock in the Russian market, 1,746,310 options were cancelled by MTS in 2003 and exchanged for a cash award of $2.9 million.

The fair value of options granted during the three years in the period ended December 31, 2004 were estimated using the binomial option pricing model using the following assumptions:

| | 2004 | 2003 | 2002 |
|---|---|---|---|
| Risk free rate | 4.5% | 5.2% | 6.1% |
| Expected dividend yield | 3% | 3% | 3% |
| Expected volatility | 48.8% | 40.0% | 50.0% |
| Expected life (years) | 2 | 2 | 2 |
| Fair value of options (per share) | $2.36 | $1.02 | $0.50 |

In accordance with the Russian legislation, MTS Board members and key employees may be considered insiders with respect to the Group and thus may be restricted from selling their shares.

## 17. RELATED PARTIES

Related party balances as of December 31, 2004 and, 2003 comprised of the following:

| | December 31, | |
|---|---|---|
| Accounts receivable: | 2004 | 2003 |
| Rosno for insurance | $ 9,065 | $ - |
| Kvazar-MicroRu for information systems consulting | 2,161 | - |
| MTT for interconnection | 1,497 | 822 |
| T-Mobile for roaming | 1,198 | 853 |
| Maxima, for advertising | 884 | 83 |
| STROM telecom for software | - | 1,074 |
| Receivables from investee companies | 2,963 | 524 |
| Total accounts receivable, related parties | $ 17,768 | $ 3,356 |
| Accounts payable: | | |
| Strom Telecom for software | $ 7,070 | $ - |
| MTT for interconnection | 2,964 | - |
| T-Mobile for roaming | 1,580 | - |
| MTU-Inform for interconnection | 2,398 | 2,398 |
| MGTS for interconnection | 607 | 704 |
| Cetel B.V. for UMC shares | - | 27,500 |
| Other | 2,390 | 1,302 |
| Total accounts payable, related parties | $ 17,009 | $ 31,904 |

Transactions with major related parties are described below.

***Moscow Bank of Reconstruction and Development ("MBRD")*** – Starting August 2000, MTS has been keeping certain bank and deposit accounts with MBRD, whose major shareholder is Sistema. As of December 31, 2004, MTS' cash position at MBRD amounted to $72.0 million in current accounts. As of December 31, 2003, MTS' cash position at MBRD amounted to $279.7 million including $265.2 million in time deposits and $14.5 million in current accounts. The related interest accrued and collected on the deposits for the years ended December 31, 2004 and 2003 amounted to $6.8 million and $9.9 million, respectively, and was included as a component of interest income in the accompanying consolidated statements of operations.

Borrowing transactions with MBRD are described in Note 11.

***Rosno OJSC*** – MTS arranged medical insurance for its employees and property with Rosno OJSC, whose significant shareholder is Sistema. Insurance premium paid to Rosno OJSC for the years ended December 31, 2004, 2003 and 2002 amounted to $7.6 million, $16.9 million and $4.9 million, respectively. Management believes that all of the insurance contracts with Rosno OJSC have been entered at market terms.

***Kvazar-Micro Corporation ("Kvazar")*** – Kvazar, a Ukrainian based company providing solutions, services, and business consulting in the field of information and communication technologies. Since July 2004, Sistema is a controlling shareholder in Kvazar. In 2004, MTS signed agreements for software implementation services with Kvazar. Related fees for the year 2004 amounted to approximately $0.1 million and $9.7 million, respectively. Management believes that these agreements are at market terms.

***Maxima Advertising Agency ("Maxima")*** – In 2004, 2003 and 2002, MTS had agreements for advertising services with Maxima, a subsidiary of Sistema. Advertising costs related to Maxima for the years ended December 31, 2004, 2003 and 2002 amounted to $48.9 million, $23.7 million and $12.1 million, respectively. Management believes that these agreements are at market terms.

***Telmos*** – In 2004, 2003 and 2002, MTS had interconnection arrangements with, and received domestic and international long-distance services from Telmos, a subsidiary of Sistema. Interconnection and line rental expenses for the years 2004, 2003 and 2002 comprise $1.6 million, $1.6 million and $1.8 million, respectively. Management believes that these arrangements are at market terms.

***Moscow City Telephone Network ("MGTS")*** – In 2004, 2003 and 2002, MTS had line rental agreements with MGTS and rented cable plant from MGTS for installation of optic-fiber cable. MTS also rented buildings for administrative office, sales and marketing offices as well as premises for switching and base station equipment. Rental expenses for the years 2004, 2003 and 2002 amounted to $5.9 million, $4.5 million and $3.4 million, respectively. Management believes that all these transactions were made at market terms.  Sistema is the majority shareholder of MGTS.

***MTU-Inform*** – In 2004, 2003 and 2002, MTS had interconnection and line rental agreements with MTU-Inform, a subsidiary at Sistema. Interconnection and rental expenses for the years 2004, 2003 and 2002, were $25.7 million, $23.3 million and $24.3 million, respectively. In 2003 and 2002, MTS also purchased telephone numbering capacity from MTU-Inform and $2.0 million and $2.6 million, respectively. Management believes that these agreements are at market terms.

***Comstar*** – In 2004, 2003 and 2002, MTS had interconnection and line rental agreements with Comstar, a subsidiary of Sistema. Cost of interconnecton and line rental services rendered by Comstar for the years 2004, 2003 and 2002 amounted to $3.1 million, $3.6 million and $3.5 million, respectively. In 2004 MTS also purchased telephone numbering capacity from Comstar for $ 4.2 million. Management believes that these agreements are at market terms.

***T-Mobile*** – In 2004, 2003 and 2002, the Group had non-exclusive roaming agreements with T-Mobile, a shareholder of the Group. Roaming expenses for the years ended December 31, 2004, 2003 and 2002 amounted to $ 6.1 million, $1,7 million and $1.1 million, respectively. Management believes that these agreements are at market terms.

***Invest-Svyaz-Holding*** – In 2004 and 2003, MTS entered into agreements with Invest-Svyaz-Holding, a shareholder of MTS and a wholly-owned subsidiary of Sistema, for leasing of network equipment and billing system. These leases were recorded as capital leases in compliance with requirements of SFAS No. 13, "Accounting for Leases." The present value of future lease payments due within one year are classified as current liabilities, and the remaining balance as long-term liabilities. The interest rate implicit in these leases varies from 14% to 44%, which management believes are market terms.

The following table summarizes the future minimum lease payments under capital leases to Invest-Svyaz-Holding together with the present value of the net minimum lease payments as of December 31, 2004:

| Payments due in the year ended December 31, | |
|---|---|
| 2005 | $ 8,174 |
| 2006 | 3,058 |
| 2007 | 653 |
| Total minimum lease payments (undiscounted) | 11,885 |
| Less amount representing interest | (2,436) |
| Present value of net minimum lease payments | 9,449 |
| Less current portion of lease obligations | (6,103) |
| Non-current portion of lease obligations | $ 3,346 |

In addition to the above lease transactions, the Group guarantees debt of Invest-Svyaz-Holding in the amount of $21.6 million to a third party, which is used by Invest-Svyaz-Holding primarily to finance its leases to the Group.

For the year ended December 31, 2004 principal and interest paid to Invest-Svyaz-Holding were $6.4 and $4.1, respectively. Principal and interest paid to Invest-Svyaz-Holding for the year ended December 31, 2003 were $5.4 million and $3.3 million, respectively. Principal and interest paid for the year ended December 31, 2002 were $2.9 million and $1.4 million, respectively. Management believes that these agreements are at market terms.

***STROM telecom*** – During 2004 and 2003, the Group entered into a number of agreements with STROM telecom, an associate of Sistema for a total amount up to $116.5 and $32.3 million, respectively. Pursuant to these contracts, the Group purchased in 2004 and 2003 billing systems and communication software support systems for approximately $9.1 and $23.7 million, respectively. Advances paid under these agreements and outstanding as of December 31, 2004 and 2003 amount to $51.0 million and $1.1 million, respectively.

***MTT*** – In 2004, MTS had interconnection and line rental agreements with MTT, a subsidiary at Sistema. Interconnection expenses for the year 2004 amounted to $16.1 million. Management believes that these agreements are at market terms.

See Note 3 for other related parties transactions.

## 18. GENERAL AND ADMINISTRATIVE EXPENSES

General and administrative expenses for the years ended December 31, 2004, 2003 and 2002 consisted of the following:

| | December 31, | | |
|---|---|---|---|
| | 2004 | 2003 | 2002 |
| Salaries and social contributions | $ 256,989 | $ 156,808 | $ 84,706 |
| Repair and maintenance | 81,538 | 39,406 | 20,361 |
| General and administrative | 72,586 | 42,530 | 26,549 |
| Rent | 54,054 | 31,968 | 15,578 |
| Billing and data processing | 28,238 | 22,067 | 9,549 |
| Taxes other than income | 50,033 | 40,432 | 39,119 |
| Consulting expenses | 19,694 | 11,361 | 7,692 |
| Insurance | 7,554 | 7,351 | 6,774 |
| Inventory obsolescence expense | 4,610 | 3,307 | 5,614 |
| General and administrative expenses | $ 575,296 | $ 355,230 | $ 215,942 |

## 19. INVESTMENTS IN AND ADVANCES TO ASSOCIATES

At December 31, 2004 and 2003, the Group's investments in and advances to associates included, respectively, the following:

| | December 31, | |
|---|---|---|
| | 2004 | 2003 |
| MTS Belarus – loans receivable | $ 51,894 | $ 51,481 |
| MTS Belarus – equity investment | 27,699 | 5,884 |
| Primtelefon – equity investment | - | 31,174 |
| Astrakhan Mobile and Volgograd Mobile – equity investment | - | 5,806 |
| Astrakhan Mobile and Volgograd Mobile – loans receivable | - | 6,850 |
| Volgograd Mobile – loans receivable | - | 204 |
| MSS – note receivable | - | 827 |
| Receivables from other investee companies | 1,642 | 1,359 |
| Total investments in and advances to associates | $ 81,235 | $ 103,585 |

***MTS Belarus*** – As of December 31, 2004 and 2003, the Group provided MTS Belarus with a total of $51.9 million and $51.5 million in loans, respectively. These loans bear interest at 3.00% to 11.00% per annum. In addition, the Group guarantees the debt of MTS Belarus in the amount of $25.0 million to several banks.

***Primtelefon, Astrakhan Mobile and Volgograd Mobile*** – As described in Note 3, in August 2003 the Group purchased equity interests in various Russian regional mobile operators, including stakes in Primtelefon, Astrakhan Mobile and Volgograd Mobile, as a part of its strategic business plans.

Following the acquisition, in 2004 of the additional stakes in Primtelefon, Astrakhan Mobile and Volgograd Mobile, those companies have been consolidated starting June 30, 2004 for Primtelefon and September 1, 2004 for both Astrakhan Mobile and Volgograd Mobile.

The Company's share in net income of unconsolidated affiliates is included in other income in the accompanying consolidated statements of operations. For the years ended December 31, 2004, 2003 and 2002, this share amounted $24.2 million, $2.7 million and nil net income, respectively.

## 20. OPERATING LICENSES

In connection with providing telecommunication services, the Group has been issued various operating licenses by the Russian Ministry of Information Technologies and Communications.
In addition to the licenses received directly from the Russian Ministry of Information Technologies and Communications, the Group was granted access to various telecommunication licenses through acquisitions. At December 31, 2004 and 2003, recorded values of the Group's telecommunication licenses were as follows:

| | December 31, | |
|---|---|---|
| | 2004 | 2003 |
| Moscow license area (MTS OJSC) | $ 255,812 | $ 255,812 |
| Ukraine (UMC) | 171,815 | 151,857 |
| Krasnodar and Adigeya regions (Kuban-GSM) | 124,396 | 124,396 |
| Five regions of Asian Russia (Telecom-900)) | 91,202 | 84,395 |
| North-Western region (Telecom XXI) | 74,639 | 74,639 |
| Tatarstan Republic (TAIF Telcom) | 104,159 | 68,407 |
| Krasnoyarsk region, Taimyr region and Khakassia Republic (Sibchallenge) | 52,625 | 52,625 |
| Tomsk region (TSS) | 49,282 | 49,282 |
| Bashkortostan Republic (BM Telecom) | 48,932 | 48,932 |
| Far East (Primtelefone) | 48,107 | - |
| Uzbekistan (Uzdunrobita) | 40,861 | - |
| Rostov region (Dontelecom) | 22,067 | 22,067 |
| Seven regions of European Russia | 19,503 | 19,503 |
| Other | 85,029 | 8,212 |
| Licenses, at cost | 1,188,429 | 960,127 |
| Accumulated amortization | (417,158) | (257,024) |
| Licenses, net | $ 771,271 | $ 703,103 |

Amortization expense for the years ended December 31, 2004, 2003 and 2002 amounted to $160.1 million, $113.6 million and $63.7 million, respectively.

Based on the amortizable intangible assets existing at December 31, 2004, the estimated amortization expenses is $222.9 million during 2005, $168.5 million during 2006, $125.6 million during 2007, $75.8 million during 2008, $37.3 million during 2009 and $140.8 million thereafter. Actual amortization expense to be reported in future periods could differ from these estimates as a result of new intangible assets acquisitions, changes in useful lives and other relevant factors.

Each of the Group's licenses, except the licenses covering the Moscow license area and Uzbekistan, contains a requirement for service to be commenced and for subscriber number and territorial coverage targets to be achieved by a specified date. The Group has met these targets or received extensions to these dates in those regional license areas in which the Group has not commenced operations. The management believes that the Group is in compliance with all material terms of its licenses.

The Group's operating licenses do not provide for automatic renewal. The Group has limited experience with the renewal of its existing licenses. However, management believes that licenses required for the Group's operations will be renewed upon expiration.

## 21. COMMITMENTS AND CONTINGENCIES

***Capital Commitments*** – As of December 31, 2004, the Group had executed non-binding purchase agreements in the amount of approximately $164.7 million to subsequently acquire property, plant and equipment.

***Operating Lease*** – The Group has entered into lease agreements of space for telecommunication equipment and offices, which expire in various years up to 2053. Rental expenses under these operating leases of $54.0 million, $32.0 million and $15.6 million for the years ended December 31, 2004, 2003 and 2002, respectively, are included in operating expenses in the accompanying statements of operations. Future minimum lease payments due under non-cancelable leases at December 31, 2004 are as follows:

| Payments due in the years ended December 31, | |
|---|---|
| 2005 | $ 33,459 |
| 2006 | 17,787 |
| 2007 | 14,021 |
| 2008 | 10,670 |
| 2009 | 7,261 |
| Thereafter | 35,475 |
| Total | $ 118,673 |

***Operating Licenses –*** Since the commencement of MTS' operations in 1994, a number of telecommunication licenses for the Russian Federation were issued to MTS and its now consolidated subsidiaries. These license agreements stipulate that certain fixed "contributions" be made to a fund for the development of telecommunication networks in the Russian Federation. Most of MTS' current licenses provide for the payment of such fees, which in the aggregate could total approximately $103.0 million, as at December 31, 2004. According to the terms of licenses, such contributions are to be made during the license period upon the decision and as defined by the Board of Directors of the Association of GSM-900 Operators (the "Association"). The Association is a nongovernmental, not-for-profit association, and their Board of Directors comprises representatives of the major cellular communications companies, including MTS.

The Association has not adopted any procedures enforcing such payments and no such procedures have been established by Russian legislation. To date, MTS has not made any such payments pursuant to any of the current operating licenses issued to MTS and its consolidated subsidiaries. Further, the management of MTS believes that MTS will not be required to make any such payments in the future. In relation to these uncertainties, MTS has not recorded a contingent liability in the accompanying consolidated financial statements.

***Provision for Doubtful Accounts*** – In 2003, MTS incurred a loss of $16.7 million due to dealers and subscriber fraud. In 2003, the Group's management took measures to prevent further fraud of that nature. No significant losses from the dealers' fraud were incurred during year ended December 31, 2004.

***Issued Guarantees*** – As of December 31, 2004, the Group has issued guarantees to third party banks for the loans taken by Invest-Svyaz-Holding, a shareholder of the Group for a total amount of $21.6 millions (see also Note 17). The guarantees expire by May 2006.The Group issued additional guarantees on behalf of MTS-Belarus, an equity investee, for the total amount of $25.0 million. Under these guarantees, the Group could be potentially liable for a maximum amount of $46.6 in case of the borrower's default under the obligations. The guarantees expire by April 2007.

As of December 31, 2004, no event of default has occurred under any of the guarantees issued by the Group.

***Contingencies*** – The Russian economy, while deemed to be of market status beginning in 2002, continues to display certain traits consistent with that of an emerging market. These characteristics have in the past included higher than normal inflation, insufficient liquidity of the capital markets, and the existence of currency controls which cause the national currency to be illiquid outside of Russia. The continued success and stability of the Russian economy will be subject to the government's continued actions with regard to supervisory, legal, and economic reforms.

On January 1, 2004, a new Law on telecommunications came into effect in Russia. The law sets the legal basis for the telecommunications business in Russia and defines the status that state bodies have in the telecommunications sector. The Group cannot predict with any certainty how the new law will affect MTS. The new law creates a new interconnect pricing regime in 2004 that should be more transparent and unified and it creates a universal service charge calculated as a percentage of revenue which will be introduced from 2005. The new law may increase the regulation of the MTS operations and until the time when appropriate regulations consistent with the new law are promulgated, there will be a period of confusion and ambiguity as regulators interpret the legislation.

Russia currently has a number of laws related to various taxes imposed by both federal and regional governmental authorities. Applicable taxes include value added tax ("VAT"), corporate income tax (profits tax), a number of turnover-based taxes, and payroll (social) taxes, together with others. Laws related to these taxes have not been in force for significant periods, in contrast to more developed market economies; therefore, the government's implementation of these regulations is often inconsistent or nonexistent. Accordingly, few precedents with regard to tax rulings have been established. Tax declarations, together with other legal compliance areas (for example, customs and currency control matters), are subject to review and investigation by a number of authorities, which are enabled by law to impose extremely severe fines, penalties and interest charges. These facts create tax risks in Russia that is more significant than typically found in countries with more developed tax systems.

In recent years, the Russian government has initiated revisions of the Russian tax system. Effective January 1, 1999, the first part of the Tax Code was enacted. Effective January 1, 2001, the second part of the Tax Code was enacted and effective January 1, 2002 new regulations, relating to federal income tax were enacted. The new tax system is generally intended to reduce the number of taxes, the overall tax burden on businesses, and to simplify the tax laws.

Generally, tax declarations remain open and subject to inspection for a period of three years following the tax year. As of December 31, 2004, tax declarations of the Group for the preceding three fiscal years were open to further review.

In the ordinary course of business, MTS may be party to various legal and tax proceedings, and subject to claims, certain of which relate to the developing markets and evolving fiscal and regulatory environments in which MTS operates. In the opinion of management, the MTS's liability, if any, in all pending litigation, other legal proceeding or other matters will not have a material effect upon the financial condition, results of operations or liquidity of MTS.

Management believes that it has adequately provided for tax liabilities in the accompanying consolidated financial statements; however, the risk remains that relevant authorities could take differing positions with regard to interpretive issues and the effect could be significant.

***UMC*** – On June 7, 2004, the General Prosecutor of Ukraine filed a claim against MTS and others in the Kiev Commercial Court seeking to unwind the sale by Ukrtelecom of its 51% stake in UMC to MTS. The complaint also seeks an order that would prohibit MTS from alienating 51% of its stake in UMC until the claim is resolved.

On August 12, 2004, the Kiev Commercial Court rejected a claim of General Prosecutor of Ukraine against MTS. No appellation was filed to the Court by the office of General Prosecutor of Ukraine within an established period. As of the date of these statements an office of General Prosecutor of Ukraine filed a request to the Constitutional Court of Ukraine to clear out terms of the State Privatization Plan for 2000-2002 and respond whether Ukrtelecom had a right to sell 51% stake in UMC.

MTS believes that it acquired a stake in UMC in full compliance with Ukrainian law and, if required, intends to vigorously defend its acquisition of UMC.

## 22. SEGMENT INFORMATION

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information", established standards for reporting information about operating segments in financial statements. Operating segments are defined as components of an enterprise engaging in business activities about which separate financial information is available that is evaluated regularly by the chief operating decision maker or group in deciding how to allocate resources and in assessing performance. The Group's business is organized based on geographical operations. Management of the Group regularly reviews certain operational and statistical information by license area, however currently no discrete financial information is available on this basis, therefore the performance is measured and decisions about resource allocation are made by management based on operating income by legal entities as an aggregate of the license area information.

Intercompany eliminations presented below consist primarily of the following items: intercompany sales transactions, elimination of gross margin in inventory and other intercompany transactions conducted under the normal course of operations.

At December 31, 2004, the Group has several operating segments, of which four are reportable segments – MTS OJSC, UMC, Telecom XXI and Kuban-GSM.

| | Year ended December 31, | | |
|---|---|---|---|
| | **2004** | **2003** | **2002** |
| Revenue: | | | |
| MTS OJSC | $ 2,129,544 | $ 1,471,198 | $ 1,044,877 |
| UMC(1) | 832,313 | 394,038 | - |
| Telecom XXI | 297,194 | 210,460 | 79,166 |
| Kuban-GSM | 225,350 | 168,401 | 79,317 |
| Other | 796,256 | 432,770 | 211,826 |
| Intercompany eliminations | (393,663) | (130,669) | (53,430) |
| Total revenue | $ 3,886,994 | $ 2,546,198 | $ 1,361,756 |
| Depreciation and amortization: | | | |
| MTS OJSC | $ 253,485 | $ 199,946 | $ 144,004 |
| UMC | 124,935 | 66,392 | - |
| Telecom XXI | 57,265 | 36,782 | 17,343 |
| Kuban-GSM | 68,140 | 32,299 | 21,224 |
| Other | 175,221 | 82,185 | 27,109 |
| Intercompany eliminations | (3,317) | (1,688) | - |
| Total depreciation and amortization | $ 675,729 | $ 415,916 | $ 209,680 |
| Operating income: | | | |
| MTS OJSC | $ 728,101 | $ 527,837 | $ 365,698 |
| UMC | 317,860 | 131,704 | - |
| Telecom XXI | 104,936 | 80,632 | 2,331 |
| Kuban-GSM | 74,622 | 74,599 | 27,725 |
| Other | 198,390 | 123,577 | 72,806 |
| Intercompany eliminations | (4,846) | (15,751) | (4,189) |
| Total operating income | $ 1,419,063 | $ 922,598 | $ 464,371 |
| Total operating income | $ 1,419,063 | $ 922,598 | $ 464,371 |
| Currency exchange and transaction losses (gains) | (6,529) | (693) | 3,474 |
| Interest income | (21,792) | (18,076) | (8,289) |
| Interest expense | 107,956 | 106,551 | 44,389 |
| Other (income)/expenses | (33,456) | 3,420 | (2,454) |
| Income before provision for income taxes and minority interest | $ 1,372,884 | $ 831,396 | $ 427,251 |
| Additions to long-lived assets: | | | |
| MTS OJSC | $ 679,023 | $ 389,446 | $ 360,598 |
| UMC (1) | 303,761 | 900,465 | - |
| Telecom XXI | 62,333 | 174,128 | 175,361 |
| Kuban-GSM | 69,689 | 172,949 | 199,225 |
| Other | 714,344 | 393,526 | 169,378 |
| Total additions to long-lived assets | $ 1,829,150 | $ 2,030,514 | $ 904,562 |

(1) Acquired in March 2003.

| | December 31, 2004 | December 31, 2003 |
|---|---|---|
| Long-lived assets: | | |
| MTS OJSC | $ 1,891,869 | $ 1,454,570 |
| UMC, including goodwill in the amount of $8,000 as of December 31, 2004 and 2003 | 838,020 | 648,812 |
| Telecom XXI | 295,505 | 288,256 |
| Kuban-GSM | 279,883 | 276,883 |
| Other, including goodwill in amounts of $100,329 and $533 as of December 31, 2004 and 2003, respectively | 1,174,582 | 623,037 |
| Intercompany eliminations. | (37,408) | (19,702) |
| Total long-lived assets | $ 4,442,451 | $ 3,271,856 |
| | | |
| Total assets: | | |
| MTS OJSC | $ 2,717,814 | $ 2,328,426 |
| UMC | 993,997 | 772,792 |
| Telecom XXI | 363,888 | 345,784 |
| Kuban-GSM | 393,656 | 319,546 |
| Other | 1,573,239 | 727,600 |
| Intercompany eliminations | (461,407) | (268,797) |
| Total assets | $ 5,581,187 | $ 4,225,351 |

## 23. SUBSEQUENT EVENTS

***The Notes*** – On January 27, 2005, MTS Finance issued $400.0 million 8.00% unsecured notes at 99.736%. These notes are fully and unconditionally guaranteed by MTS OJSC 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.

***ADS Ratio Change*** – In December 2004, the Group announced that it will be changing its current ADS ratio effective January 3, 2005, the first trading day in 2005. The ratio has change from 1 ADS per 20 ordinary shares to 1 ADS per 5 ordinary shares.

***Acquisition of Subsidiary*** – In February 2005, MTS 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. The Company is providing wide-range radio access services for the "last mile" based on the Radio-Ethernet technology.

The purchase price allocation for this acquisition has not been yet finalized at the date of these statements.

***Tax Audit*** – In March 2005, the Russian tax authorities audited MTS OJSC's compliance with tax legislation for the year ended December 31, 2002. Based on the results of this audit, the Russian tax authorities assessed that 372,152 thousand roubles (approximately $13.4 million as at December 31, 2004) of additional taxes, penalties and fines were payable by the Group. The Group has prepared and filed with the Arbitrary Court of Moscow a petition to recognize the tax authorities' resolution as partially invalid. The amount of disputed taxes and fines equals 281,504 thousand roubles (approximately $10.1 million).

***CSFB Loan*** – In April 2005 loan due to Credit Swiss First Boston in the amount of $140.0 million was fully repaid.